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European Scrutiny Committee

Forty-sixth Report of Session 2017–19

Documents considered by the Committee on 28 November 2018

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/.

Staff

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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:

- The extent to which existing EU arrangements with third countries would permit UK stakeholders to provide technical services to EU type approval authorities;
- The extent to which EU Member States would be able to agree bilateral road transport agreements with the UK in either a negotiated or a non-negotiated exit.

Summary

Ending seasonal changes of time

The proposed Directive would discontinue the twice-yearly clock changes in March and October and require each Member State to decide whether to observe summer time (GMT+1 in the UK) or standard time all year round. Neither the proposed Directive nor existing EU law affects the choice of time zone which remains a Member State competence. Nonetheless, the effect of the proposed change would be indistinguishable from a change in time zone and, perversely in light of the internal market legal base, could result in more rather than less variation in time across the EU than under the current arrangements. The Committee previously recommended that the House issue a Reasoned Opinion; a recommendation which the House adopted on 13 November. The Government shares the Committee's concern that there is insufficient justification for the proposed action but its latest update still does not provide a convincing analysis of EU competence under Article 114 TFEU (the legal base for EU measures concerning the operation of the internal market). The Government's strategy is to seek to block the proposal, but it is far from clear whether this will work. A recent Presidency progress report indicates that a majority of Member States support the abolition of seasonal time changes, though most consider that more time is needed to consult on the proposed change and to assess the impact. A revised Presidency text pushes back the date for applying any changes to April 2021—after the date on which the post-exit transition/implementation period envisaged in the draft EU/UK Withdrawal Agreement is expected to end (31 December 2020). Given these uncertainties, the European Scrutiny Committee considers that it would be premature to accede to the Government's request for scrutiny clearance or a waiver. It seeks further information on the EU's competence to act; progress reports on negotiations; details of the Government's consultation of the Devolved Administrations and their views on the Commission proposal, as well as on any compromise text being considered within the Council; and details of the European Parliament's position (once established).

Not cleared from scrutiny; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee and the Exiting the European Union Committee.

Consumer Digital Single Market: Proposed Directives on consumer contract rights for the supply of digital content and the sale of goods

The proposed Digital Content and Sale of Goods Directives are mainly aimed at breaking down the barriers to cross-border online trade which arise from Member States' differing contract law on matters such as quality of goods, remedies for defective goods and guarantees. Although it is unlikely that the UK will have to implement these proposals before Brexit, that is irrespective of the impact of a transitional/implementation period, particularly if extended.

One of the Government's main concerns on the proposed Digital Content Directive (Document (a)) has been the extent to which online content and services would be covered where exchanged for personal data. This contrasts with the position under UK law where only those exchanged for money are protected. However, some narrowing down of that scope was achieved during the negotiations compared with the original text. Given this, we issued a scrutiny waiver for the agreement of a General Approach in June 2017 paving the way for trilogues to commence in December 2017.

Negotiations are less advanced on the proposed Sale of Goods Directive (Document (b)). This is because it was only proposed in 2017, replacing a 2015 initiative proposed at the same time as Document (a). This covers both online and offline sales of goods whereas the 2015 initiative was limited to online or distance sales. The Government's main concern with this "maximum harmonisation" proposal (where more or less stringent national requirements cannot be maintained) is potential loss of existing consumer rights available in UK law under the Criminal Rights Act 2015: the short-term right to reject faulty goods and the right to be refunded for them.

The Government has provided an update on progress on both proposals. In short, it anticipates that in December 2018 there could be:

- final adoption of the proposed Digital Content Directive; and
- a General Approach on the proposed Sale of Goods Directive.

We have decided to clear the proposed Digital Content Directive and grant a scrutiny waiver on the proposed Sale of Goods Directive given:

- the detailed information that the Government provides on the progress of both negotiations; and
- it is the UK's interests for the Government to have flexibility to influence these texts while it still has a vote, so that they align with existing UK consumer law and facilitate a future EU-UK relationship on consumer protection.

(a) Cleared from scrutiny; further information requested; (b) Not cleared from scrutiny; scrutiny waiver granted for the General Approach expected at the JHA Council of 6–7 December; further information requested; drawn to the attention of the Business and Industrial Strategy Committee.

Improving cross-border law enforcement access to financial information

The European Commission has proposed a Directive to improve cross-border law enforcement access to financial information to support the investigation and prosecution of serious crime. It complements the EU's latest (5th) anti-money laundering legislation and would take effect at the same time, in January 2020 — post-exit but during the transition/implementation period envisaged in the draft EU/UK Withdrawal Agreement. The Government has opted into the proposed Directive, stating that it is broadly in line with UK law and practice, but has highlighted two concerns: the possible encroachment on the decision-making autonomy of Financial Intelligence Units and the time limits for intra-EU exchanges of information. The Government says that these concerns have been addressed in the latest compromise text put forward by the Presidency and invites the European Scrutiny Committee to clear the proposal from scrutiny or grant a scrutiny waiver so that the Government can vote for a General Approach at a COREPER meeting on 21 November. The Committee makes clear that it is wholly unrealistic to expect scrutiny clearance or a scrutiny waiver to be granted at such short notice; reminds the Government that the scrutiny reserve applies to decisions taken by Ministers within the EU's Council of Ministers, not to decisions taken by officials within COREPER; requests a copy of any compromise text agreed by COREPER, once the meeting has taken place, along with details of how the UK voted, as well as details of any changes proposed by the European Parliament once it has agreed its position. The Government is also asked to provide an update on the prospects for concluding a new post-exit internal security with the EU once the final text of the Political Declaration setting out the framework for the future relationship between the EU and the UK has been agreed.

Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee and the Justice Committee.

Preventing the dissemination of terrorist propaganda online

The European Commission has proposed a Regulation which seeks to ensure that online terrorist content is identified and removed as quickly as possible whilst safeguarding freedom of expression and information. It would require online platforms to take proactive measures to prevent the dissemination of terrorist content; empower national authorities to issue a legally binding removal order to take terrorist content off the web within an hour; introduce penalties for platforms which fail to remove terrorist content promptly; and strengthen cooperation amongst Member States and with Europol. The Government welcomes the proposal and expects the Presidency to seek a general approach at the Justice and Home Affairs Council on 6/7 December. As the proposed Regulation would not necessitate any changes to domestic law, the European Scrutiny Committee agrees to grant a scrutiny waiver to enable the Government to support the general approach but ask the Government to report back on the outcome of the December Council, explain whether

any decision has been made to set up a central oversight mechanism at EU level to monitor removal orders being sent to hosting service providers, and to provide a summary of any changes sought by the European Parliament once it has agreed its position.

Not cleared from scrutiny; scrutiny waiver granted; further information requested; drawn to the attention of the Home Affairs Committee, the Justice Committee, the Digital, Culture, Media and Sport Committee and the Joint Committee on Human Rights.

Commission Brexit preparedness proposal: Vehicle type approvals

The European Commission has proposed a regulation which will allow manufacturers with Vehicle Certification Agency-issued EU type approvals to transfer these approvals to EU type approval authorities before EU exit. The Government is supportive of the proposal as it will mitigate the immediate impact of EU exit for industry, including UK manufacturers. The Minister (Jesse Norman) has written to the Committee requesting that it clear the proposal in advance of its anticipated final adoption by the Council of Ministers in December. The Minister stated that he expects trilogue negotiations to conclude imminently, because the European Parliament's amendments are very similar to those of the Council, and also because the procedure must conclude quickly if the regulation is to have its intended effect and manufacturers are to be able to transfer their approvals prior to 29 March 2019 in the event of a "No Deal" exit.

The Minister also responded to a series of the Committee's questions about EU exit. He stated that the Government explored the option of requiring vehicles with EU type approvals to undergo additional testing in the UK, but that this option was discarded because of the exceptionally large cost implications this would have for the Vehicle Certification Agency (which would have to hire a very large number of staff), manufacturers, who would incurs costs in the hundreds of millions, and ultimately UK consumers, if these costs were passed on to them. The Minister stated that he expected the UK to secure an agreement with the EU post-exit which allowed UK based technical services to continue to provide the services which underpin EU type approval authorities. However, the precedents he cited (Switzerland and Australia) offer little encouragement in this regard, as the Swiss arrangement is in the context of an overall relationship that involves the acceptance of the free movement of persons, and the Australian agreement is limited to the United Nations Economic Commission for Europe approvals and would therefore not address UK concerns. The Committee chose to grant the Government a scrutiny waiver to support the proposal in Council but retained lest there should be any unexpected developments in trilogue negotiations.

Not cleared from scrutiny; waiver granted; further information requested; drawn to the attention of the Select Committees for Transport and Business, Energy & Industrial Strategy.

First mobility Package: market pillar

After the Bulgarian Presidency failed to secure a General Approach for the market pillar of the mobility package, the Austrian Presidency will seek to do so at Transport Council on 3 December. The Minister (Jesse Norman) has therefore written to the Committee to request clearance of the file or a waiver to support the proposed General Approach. The Minister reported that all of the changes secured in the previous round of negotiations, which addressed the UK's key concerns—notably regarding quotas for roadside

enforcement of working time rules—have been retained. On the most contentious element of the negotiations—the extent of the right to provide cabotage operations—the Minister indicated that the Commission's proposal to permit unlimited cabotage operations within a five-day period would be dropped and the status quo retained—an acceptable outcome to the Government.

During the negotiations Member States have introduced a provision which would require that hauliers who provided cabotage services in another Member State would have to go through a ten day "cooling off period" before they could do so again. Intended to tackle the abuse of cabotage by non-domestic operators in certain parts of Europe, this would potentially have unintended consequences for hauliers operating between Ireland and the UK (particularly Northern Ireland). As other minor local opt-outs are provided for Cyprus and Malta in the emerging Regulation, the Committee made its granting of the Government a waiver conditional on the Government seeking to negotiate an opt-out from this provision as it applied to trade between the UK (particularly Northern Ireland) and Ireland, during the remainder of the legislative procedure.

In response to the Committee's questions about EU exit, the Minister indicates that the principal benefit EU exit offers the sector is the ability "to shape a domestic road haulage regime tailored to the specifics of the domestic market, for example around developing driving tests that work for the UK", but also notes that the Government has no plans to scrap or substantially reform the drivers' hours and working time rules applicable to the haulage sector, or the Combined Transport Directive. In response to the Minister's observation that the Government was "confident of securing an agreement with Ireland to allow continued access for Northern Ireland hauliers which will replicate the current arrangements", the Committee considered the complex question of competence with respect to external trade regarding road transport. The Committee requested further information from the Minister as to how such a bilateral arrangement would be legally able to coexist with an overarching UK-EU agreement on freight transport like that proposed in the political declaration, and how far EU Member States would be constrained by EU law from entering into bilateral agreements with the UK in the event that the there is no Withdrawal Agreement.

Not cleared from scrutiny; waiver granted; further information requested; drawn to the attention of the Select Committees for Exiting the European Union, Transport, Business, Energy and Industrial Strategy, and Northern Ireland.

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: Digital Single Market: Consumer contract rights for the supply of digital content and the sale of goods [Proposed Directives (a) (C); (b) (NC, scrutiny waiver granted)]; Ending seasonal changes of time [Proposed Directive (NC)]; Commission Brexit preparedness proposal: Vehicle type approvals [Proposed Regulation (NC, scrutiny waiver granted)]; First mobility package: social pillar [Proposed (a) Regulation; (b) Directive (NC, scrutiny waiver granted)]; Multiannual financial framework 2021–27: Connecting Europe Facility [Proposed Regulation (NC)]; Parental and Carers' Leave Directive [Proposed Directive (NC, scrutiny waiver granted)]

Digital, Culture, Media and Sport Committee: Preventing the dissemination of terrorist propaganda online [Proposed Regulation (NC, scrutiny waiver granted)]; Multiannual financial framework 2021–27: Connecting Europe Facility [Proposed Regulation (NC)]

Exiting the EU Committee: Brexit: EU supervision of UK-based central counterparties [(a) Proposed Regulation; (b) Proposed Decision (NC, scrutiny waiver granted)]; Ending seasonal changes of time [Proposed Directive (NC)]; First Mobility Package: market pillar [Proposed Regulation (NC, scrutiny waiver granted)]

Health and Social Care Committee: Workplace safety: amendments to the Carcinogens and Mutagens Directive [Proposed Directive (NC, scrutiny waiver granted)]

Home Affairs Committee: Preventing the dissemination of terrorist propaganda online [Proposed Regulation (NC, scrutiny waiver granted)]; Improving cross-border law enforcement access to financial information [Proposed Directive (NC)]

International Trade Committee: The EU's schedule of services commitments — compensatory adjustments under the General Agreement on Trade in Services [Council Decision (C)]

Joint Committee on Human Rights: Preventing the dissemination of terrorist propaganda online [Proposed Regulation (NC, scrutiny waiver granted)]

Justice Committee: Preventing the dissemination of terrorist propaganda online [Proposed Regulation (NC, scrutiny waiver granted)]; Improving cross-border law enforcement access to financial information [Proposed Directive (NC)]; Recast of the Brussels IIa Regulation [Proposed Regulation (NC, scrutiny waiver granted)]

Northern Ireland Affairs Committee: First Mobility Package: market pillar [Proposed Regulation (NC, scrutiny waiver granted)]

Treasury Committee: Brexit: EU supervision of UK-based central counterparties [(a) Proposed Regulation; (b) Proposed Decision (NC, scrutiny waiver granted)]; Digital Services Tax [(a)(b) Proposed Directives; (c) Recommendation (NC)]

Transport Committee: Commission Brexit preparedness proposal: Vehicle type approvals [Proposed Regulation (NC, scrutiny waiver granted)]; First mobility package: social pillar [Proposed (a) Regulation; (b) Directive (NC, scrutiny waiver granted)]; Multiannual financial framework 2021–27: Connecting Europe Facility [Proposed Regulation (NC)]; First Mobility Package: market pillar [Proposed Regulation (NC, scrutiny waiver granted)]

Women and Equalities Committee: Parental and Carers' Leave Directive [Proposed Directive (NC, scrutiny waiver granted)]

Work and Pensions Committee: Parental and Carers' Leave Directive [Proposed Directive (NC, scrutiny waiver granted)]; Workplace safety: amendments to the Carcinogens and Mutagens Directive [Proposed Directive (NC, scrutiny waiver granted)]

1 Digital Single Market: Consumer contract rights for the supply of digital content and the sale of goods

Committee's assessment	Legally and politically important
Committee's decision	(a) Cleared from scrutiny; further information requested; (b) Not cleared from scrutiny; scrutiny waiver granted for the General Approach expected at the JHA Council of 6–7 December; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	(a) Proposed Directive on certain aspects concerning contracts for the supply of digital content; (b) Amended proposal for a Directive on certain aspects concerning contracts for the sale of goods, amending Regulation (EC) 2006/2004 and Directive 2009/22/EC and repealing Directive 1999/44/EC
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (37389), 15251/15 + ADDs 1–2, COM (15) 634; (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 envisaged a uniform set of rules on business-to-consumer contracts across the EU, which would support the EU's Digital Market Strategy.

1.2 The two proposed Directives addressed aspects of:

- contracts for the supply of digital content (the Digital Content proposal),[1] for example dRun 'Unordered ownloading a film from an online platform like Netflix (document (a)); and
- contracts for the sale of goods online or by other distance selling[2] (the Tangible Goods proposal)[3] for example the sale of a coffee machine from Amazon or clothes from the mail order catalogue or over the phone.

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.

1.3 We have been scrutinising negotiations on the Digital Content proposal. We understand that it is unlikely that the UK will have to implement this proposal before the end of the implementation/transition period.[4] A General Approach was agreed on 1 June 2017[5] for which we granted a scrutiny waiver. The General Approach met one of the Government's concerns about the scope of the original proposal being wider the UK's Consumer Rights Act 2015 (CRA). This is because content and services provided in exchange for personal data are included in the EU proposal, as well as those supplied in exchange for money. However, some narrowing down of that scope was achieved in the General Approach.

1.4 Following a consumer law REFIT,[6] the Sale of Goods proposal (document (b)) was published on 31 October 2017 to replace the Tangible Goods proposal. As a result, negotiations are not as advanced on this document. The proposal extends to offline sales of goods as well as the online and distances sales covered by the Tangible Goods proposal. The new proposal reflected the concerns of the UK and other Member States about the possibility of different contractual rules for online and offline sales. The Government has told us that the extension in scope is significant, covering over 90% more sales transactions across the EU than the Tangible Goods 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 has also highlighted points of divergence between the "maximum harmonisation" proposal (where more or less stringent national requirements cannot be maintained) and current UK law, mainly the CRA. The potential loss of the UK consumer's short term right to reject and be refunded for faulty goods[7] are key concerns of the Government.

1.5 A detailed account of both proposals, the Government's view of the proposal and progress to date in the negotiations, is set out in the previous Reports of this and previous Committees listed at the end of this chapter.

1.6 We last considered both documents in July of this year. Responding to the letter of 18 June from the Government which focused on the Sale of Goods proposal, we said in our letter of 11 July that we noted that the UK is unlikely to have to implement that proposal before the end of the proposed implementation/transition period.[8] However, we recognised the risks of a maximum harmonisation measure to current high levels of UK consumer protection should the measure feature in any way as part of a future UK-EU future economic relationship. We therefore supported the UK's efforts in trying to negotiate a favourable text, particularly in respect of the short-term right to reject faulty goods and to be refunded for them.

1.7 We also asked the then Minister to explain the relevance to proposals of the new European Electronic Communications Code (EECC), politically agreed in June. We asked for an update on both proposals to cover any relevant and emerging Brexit developments.

4 Article 21 of the original proposal provides for a transposition date of two years after the entry into force of the proposal.

5 See General Approach text (Council document 9901/17)

6 A Regulatory Fitness and Performance review of EU legislation.

7 The right to obtain a refund or discount for goods not conforming with the sales contract without having to afford the trader multiple attempts to repair or replace the item.

8 This stated that "It is too early to judge this with accuracy, but the best estimate currently is that the file will be adopted during the first quarter of 2019. This means that transposition of the Directive is likely to be required by the first quarter of 2021, which falls outside the proposed Implementation Period following the UK's EU withdrawal".

The current Minister for Small Business, Consumers and Corporate Responsibility (Kelly Tolhurst) now writes in two separate letters on the respective proposals to respond to our letter of 18 June and to update us.

1.8 In a letter of 6 November concerning the proposed Digital Content Directive, the Minister tells us that trilogue negotiations between the Council, Commission and European Parliament (EP) did not commence until December 2017. However, they are now nearly complete despite the complexity of the proposal, interinstitutional differences and linkage to the delayed negotiation of the Sale of Goods proposal. The current Austrian Presidency wants to make up progress on the Sale of Goods proposal so that the two files can progress better together and both be adopted in time for the European Parliament (EP) elections in May. It is possible that a vote on final adoption will be sought in December.

1.9 In another letter of 6 November relating to the proposed Sale of Goods Directive, the Minister tells us that since the Government's last letter of 18 June, a second draft of the proposal was published based on the outcome of the Justice and Home Affairs Council on 4 June. Technical working group meetings are continuing throughout the autumn. She says that it is likely a General Approach will be sought in December.

1.10 In both letters the Minister provides some detailed explanation of the key issues emerging in negotiations of both proposals. Given that we base our decisions concerning future scrutiny of these proposals heavily on this information, we set it out in full at paragraphs 0.15 and 0.16 below.

1.11 **We thank the Minister for her detailed and helpful letters on these two proposals. We note that neither proposal may have to be implemented by the UK during the planned implementation/transition period. However, we are keen to give the Government as much flexibility as possible to influence the negotiations on these texts whilst it still has a vote. We recognise the importance trying to facilitate a future EU-UK relationship on consumer protection but at the same time not undermine current UK legal protection for consumers.**

1.12 **Based on the Minister's detailed explanations provided on the key issues and UK objectives in the respective negotiations of these proposals, we now clear the Digital Content proposal from scrutiny and grant a scrutiny waiver for the expected General Approach on the proposed Sale of Goods Directive. We also grant the waiver on the basis that we are reassured by the Governments' commitment to marshalling support amongst Member States:**

- **for a minimum harmonisation approach to that proposed Directive to preserve established UK consumer protections, principally the short term right to reject faulty goods and to be refunded for them; and**
- **to clarify that the very specific legal concept of a liability period does not have to be introduced in national law.**

1.13 **However, we ask that the Government report fully on the outcomes of the respective meetings, supplying us with copies of the agreed texts. We would expect to be told of any significant changes to the texts affecting when the proposals might have to be implemented and or which could particularly affect future EU-UK cooperation on consumer protection.**

1.14 **We draw this chapter and these documents to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents:

(a) Proposal for a Directive of the European Parliament and the Council on certain aspects concerning contracts for the supply of digital content: (37389), 15251/15, + ADDs 1–2, COM(15) 634; (b) Amended proposal for a Directive of the European Parliament and of the Council on certain aspects concerning contracts for the sale of goods, amending Regulation (EC) 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.

Detailed summary of issues emerging in the trilogue negotiations: document (a)

1.15 The following information is provided in the Minister's letter of 6 November on the proposed Digital Content Directive:

- **The linkage between the two proposed Directives**: Despite ongoing discussions, the Minister thinks it likely that embedded digital content such as software operating a washing machine will come within the scope of the proposed Sales of Goods Directive rather than the proposed Digital Content Directive. This would be the clearest outcome for consumers who are more likely to see the good as a whole, rather than its component parts.

- **Link with the new European Electronic Communications Code (EECC)**: The EECC was adopted earlier this year. It comprises common EU rules regulating the telecoms industry, updated to reflect developments in the digital economy. The links with the proposed Digital Content Directive concern:

- **Scope:** The EECC categorised interpersonal communication services as either number-based or number-independent. Most consumer protection matters in the EECC, such as contract information and duration provisions, regulate number-based communication services (in addition to internet services), whether they are traditional (such as mobiles and landlines) or 'over-the-top', such as Skype. Number-independent interpersonal communication services (known as 'NIICs') such as "Whatsapp" are not connected to the national numbering plan and are therefore considered to be a digital service within the scope of the contractual provisions of the proposed Digital Content Directive. The Minister says that this approach aligns regulation with the service and appropriate consumer protection, thereby ensuring that companies are not burdened with unnecessary provisions.

- **Bundles**: Electronic communication services (as regulated by EECC) and digital content or services (as regulated by the proposed Digital Content Directive) can be bundled together when provided to consumers. The EECC provides that where a bundle comprises, as a minimum, an internet-access service (such as broadband) or a traditional number-based interpersonal communication service (connected

to the national numbering plan), then consumer rights as provided for by EECC apply to the whole of the bundle (for example, where a consumer has the right to terminate one element of the bundle, they would have the right to terminate the whole bundle). This helps to prevent a situation in which a consumer could be locked into a bundle in which only some of the services operate. The Minister says that this outcome is in line with UK objectives.

- **Compensating traders for the termination of long-term contracts:** The proposed Digital Content Directive allows consumers to terminate, free of charge, a contract for digital content or services any time after the first twelve months, including where an initial contract duration has been extended beyond this period. The current proposed text would entitle the trader to some proportionate compensation for any promotional advantage that may have been enjoyed by the consumer and that is of direct link to the agreed contract duration. This would also include goods, where they have been provided, although the consumer would also have the option of returning the good to the trader as part of the free of charge termination right. A recital would provide more detail on how this compensation could be calculated. This proposal is due to be discussed in the autumn, so it is unclear presently whether it will be agreed. This requirement for trader compensation, has resulted from pressure from both the EP and traders, appears to the Minister to represent a sensible balance.

- **Consumer remedies and the level of harmonisation:** It was agreed in trilogue to reserve these issues until the autumn so that they can be discussed in one context together with the parallel provisions in the proposed Sales Directive. In general, there has been convergence on consumer protection measures between the two proposed Directives, but this won't be agreed until later in the year.

1.16 The Minister then turns to questions we have raised during our past scrutiny:

- **The relationship with the Commission's regulatory fitness (REFIT) review of EU consumer law:** The Commission's REFIT review has had no direct bearing on the proposal's negotiations as it concerns an entirely new area of regulation for the EU. REFIT concerned the fitness for purpose of the existing acquis.

- **General alignment with the UK's Consumer Rights Act 2015 (CRA):** On alignment with the related aspects of the CRA, the regimes have much in common. The main area of difference concerns scope, because the proposed Digital Content Directive covers not only paid-for digital content and services but also those provided where the consumer has supplied personal data to the trader (unless that data is processed exclusively to enable the supply of the digital content or service, or to comply with legal requirements).

- **Transitional arrangements for purchases made pre-EU withdrawal:** Post-Brexit cross-border cooperation with the EU on consumer enforcement is still under negotiation. However, the European Union (Withdrawal) Act 2018 retains UK consumer protections that are based on EU law. The Minister says that after the UK leaves the EU, when buying from UK-based traders, UK consumers will

be able to rely on the same rights they have now. This will protect most purchases by UK consumers. Furthermore, UK exporters will benefit from there being a single set of contract rules in the EU.

- **The future partnership with the EU:** Section 1.6.6 of the Government's White Paper on the future relationship between the UK and EU sets out the Government's commitment to maintaining high standards of consumer protection in the future relationship and its desire for a negotiated agreement on future cooperation on cross-border consumer law enforcement. Cross-border cooperation and alignment with the EU after exit is still under negotiation. It remains unclear whether negotiations on the proposed Digital Content Directive will complete before 29 March 2019.

Detailed summary of issues emerging in the Council negotiations: document (b)

1.17 The following information is provided in the Minister's letter of 6 November on the proposed Sale of Goods Directive:

- **Consumer remedies:** The UK has proposed a regime for consumer remedies at minimum harmonisation, which would allow Member States to retain or adopt provisions on consumer remedies that go beyond existing minimum EU law. This would avoid requiring the UK to weaken certain aspects of its existing consumer remedy regime, such as abolishing the short-term right to reject a faulty good, meeting a key UK negotiating objective. At present, evidence suggests that there is enough support for the UK's proposal to represent a blocking minority. However, these are only initial positions and it will not be debated until late October.

- **Time limits:** On the period within which a fault must arise for the consumer to be entitled to a remedy (known commonly as the 'liability period'), the new draft text reflects a minimum harmonisation approach supported by most Member States. However, the current text does not entirely meet UK objectives because it assumes that Member States have a liability period in the first place. But UK laws only provide for limitation periods (six years in England and Wales and five years in Scotland), which serve a different purpose by setting a time limit for pursuing legal action. In practice, the existence of a limitation period acts in the same way as a liability period because the fault must arise before the deadline for bringing a claim, but it is a distinct legal concept. The Government wants to resist introducing a new concept of a liability period into UK consumer law through better clarity in the text.

- **Period for a reversed burden of proof:** On the period for the reversed burden of proof in favour of the consumer (during which any fault is presumed to have been present at the time the consumer acquired the goods, unless it can be proven otherwise or unless the presumption is incompatible with the nature of the goods or with the nature of the lack of conformity), Council currently supports setting this at a period of one year, aligning it with the current position

in the proposed Digital Content Directive. The existing period in most Member States, including the UK, is six months, so this would represent an increase in consumer protection in the UK.

- **Links with the new EECC:** There are no explicit links between the proposed Sales of Goods Directive, though the Minister endeavours to outline some peripheral links in her letter which we do not reproduce here. As already explained, there are stronger links between the EECC and the proposed Digital Content Directive.

- **EU withdrawal and UK-EU future relationship:** The European Union (Withdrawal) Act 2018 will retain UK consumer protections that are based on EU law. This means that after the UK leaves the EU, and when buying from UK-based traders, UK consumers will be able to rely on the same rights they have now, delivering stability and continuity for consumers and businesses. This will protect most purchases by UK consumers. The Minister makes similar points on the future relationship as for proposal (a) above.

Previous Committee Reports

(a) Second Report HC 301–ii (2017–19), chapter 2 (22 November 2017); Fortieth Report, HC 71–xxxvii (2016–17), chapter 3 (25 April 2017); Thirty-fifth Report HC 71–xxxiii (2016–17), chapter 1 (15 March 2017); Eighteenth Report HC 71–xvi, chapter 3 (16 November 2016); Sixth Report HC 71–iv (2016–17), chapter 3 (15 June 2016) and Twenty-third Report HC 342–xxii (2015–16), chapter 4 (10 February 2016); (b) Fifth Report HC 301–v (2017–19), chapter 1 (13 December 2017); 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 Parental and Carers' Leave Directive

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted for adoption at the EPSCO Council of 6 December 2018; drawn to the attention of the Business, Energy and Industrial Strategy Committee, the Women and Equalities Committee, and the Work & Pensions Committee
Document details	Proposal for a Directive of the European Parliament and of the Council on work-life balance for parents and carers and repealing Council Directive 2010/18/EU.
Legal base	Articles 1531(1) and 153(2)(b) TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38689), 8633/19 + ADDs 1 - 3, COM(17) 253

Summary and Committee's conclusions

2.1 In April 2017, as part of a push to modernise EU social law and policy under the European Pillar of Social Rights, the Commission published a proposal for a Directive on statutory entitlements to paternity, parental and carers' leave for workers. The proposed Parental and Carers' Leave Directive would establish a statutory right in Member States to paid paternity, parental and carers' leave for workers with employment contracts. The proposal provides that workers should be compensated for each form of leave by at least the same amount as national sick pay.

2.2 A full background to the proposal — including the Government's initial legal and political analysis — can be found in our first Report to the House of 27 November 2017.

2.3 In early correspondence on the proposal,[9] former Minister for Small Business (Andrew Griffiths), informed the Committee that the proposal — as introduced by the Commission — would make substantial changes to existing UK law on statutory rights for workers, for example, by creating an entirely new entitlement to paid carers' leave (which was later amended during Working Group negotiations).

2.4 The Committee last considered the proposal in its Report to the House of 13 June 2018 and granted a scrutiny waiver so that the Government could support a General Approach to be sought at the EPSCO Council of 21 June 2018.

2.5 Since this time, incoming Minister for Small Business (Kelly Tolhurst), has written to the Committee with an update on negotiations (dated 31 August 2018).[10] The Minister

9 See letter of 16 January 2018 from Minister for Small Business (Andrew Griffiths) to the Chairman of the European Scrutiny Committee.

10 See letter of 31 August 2018 from Minister for Small Business (Kelly Tolhurst) to the Chairman of the European Scrutiny Committee.

informs the Committee that during the June EPSCO Council the Government worked with other Member States to reduce the mandatory length of time for which parental leave would have to be paid — or an allowance made available — under the proposal to a period of at least 1.5 months.

2.6 On other contentious points, agreement was reached on an EU-wide standard of 10 days paternity leave around the time of child birth and a commitment for Member States to "take necessary measures to ensure that workers have the right to carers' leave…". Remuneration — for parental and paternity leave — would be determined by Member States and/or social partners taking into account the need to facilitate the up-take of paternity and/or parental leave by first time earners.

2.7 The Minister now writes — 13 November 2018 — requesting that the Committee waives or lifts scrutiny on the proposal so that the Government can vote on its adoption at the EPSCO Council of 6 December 2018.[11]

2.8 The Minister states that, throughout negotiations, the Government has:

> [Sought] to secure as much flexibility as possible for Member States to maintain or develop their own systems of leave and pay for workers with caring responsibilities, for paternity leave, and for parental leaves as we consider it more appropriate for this to remain in the remit of Member States.

2.9 The Minister is candid in explaining the dynamics of trilogue negotiations, in particular, the more expansive approach to the substance of the proposal adopted by the European Parliament. By way of example, in its draft legislative resolution of 24 August 2018, the Parliament calls for remuneration levels for paternal, parental and carers' leave to be set as a percentage of a worker's gross wages (ranging for 78 - 80%). If Member States were to determine pay or allowance levels conservatively — as would be possible under the current Presidency text — the approach of the Parliament would lead to far higher remuneration for workers.

2.10 It is also worth noting that the same European Parliament Resolution retains the right for workers to take 5 days paid carers' leave per year as included in the Commission's original proposal.

2.11 That having been said, the Minister believes that there may be the possibility for a compromise to be reached that is not too different from the General Approach agreed in June. The Minister is clear that the Government's support will depend upon the proposal retaining broadly the same form as that which was agreed between Member States at the June EPSCO Council.

2.12 **We thank the Minister for her letter and for providing the Committee with an update on the progress of trilogue negotiations.**

2.13 **We are happy to agree to the requested scrutiny waiver so that the Government can vote on the adoption of the proposal at the EPSCO Council of 6 December 2018. This**

11 See letter of 13 November 2018 from Minister for Small Business (Kelly Tolhurst) to the Chairman of the European Scrutiny Committee.

waiver is provided on the basis that the Government has made clear to the Committee that it will only support the adoption of the proposal if it is similar in form to the General Approach agreed between Member States at the June EPSCO Council.

2.14 **Due to the political sensitivity of the proposal and the possibility that it will have to be transposed into UK law during the planned implementation/transition period — as per the terms of the draft Withdrawal Agreement — we retain it under scrutiny.**

2.15 **We request a report on the outcome of the 6 December EPSCO Council detailing how the Government voted by 17 January 2019.**

2.16 **We draw this report to the attention of the attention of the Business, Energy and Industrial Strategy Committee, the Women and Equalities Committee, and the Work & Pensions Committee.**

Full details of the documents:

Proposal for a Directive of the European Parliament and of the Council on work-life balance for parents and carers and repealing Council Directive 2010/18/EU: (38689), 8633/19 + ADDs 1 - 3, COM(17) 253.

Previous Committee Reports

Thirty-first Report HC 301-xxx (2017-19) chapter 2 (19 June 2018), Eleventh Report HC 301–xii (2017–19) chapter 3 (31 January 2018), and Third Report HC 301–iii (2017–19) chapter 1 (29 November 2017).

3 MFF Single Market Programme

Committee's assessment	Politically important
Committee's decision	(a) Not cleared from scrutiny; scrutiny waiver granted; (b) (c) cleared from scrutiny
Document details	(a) Proposal for a Regulation of the European Parliament and of the Council establishing the Programme for single market, competitiveness of enterprises, including small and medium-sized enterprises, and European statistics and repealing Regulations (EU) No 99/2013, (EU) No 1287/2013, (EU) No 254/2014, (EU) No 258/2014, (EU) No 652/2014 and (EU) 2017/826; (b) Report from the Commission to the European Parliament and the Council Cosme Programme for the Competitiveness of Enterprises and SMEs 2014–2020 Monitoring Report 2015; (c) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on the Reinforcement of SOLVIT: Bringing the benefits of the Single Market to citizens and businesses
Legal base	(a) Article 114 TFEU (internal market); Article 169 (2)(b) (consumer protection) TFEU; Articles 43 and 168 (4)(b) TFEU (veterinary and phytosanitary measures); Article 197 TFEU (administrative cooperation); Article 174 TFEU (SMEs); Article 195 TFEU (tourism); Article 338 TFEU (statistics); ordinary legislative procedure; QMV (b) — (c) —
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (39877), 9890/18 + ADDs 1–3, COM(18) 441; (b) (39875), 9908/18 + ADDs 1–2, COM(18) 388 (c) (38697), 8770/17 + ADD 1, COM(17) 255

Summary and Committee's conclusions

3.1 The Parliamentary Under Secretary of State at the Department of Business, Energy and Industrial Strategy (Lord Henley) has written[12] to the Committee in advance of Competitiveness Council on 29 November 2018, requesting a waiver for a Partial General Approach (PGA) regarding the Commission's proposed regulation governing the Single Market Programme for the next Multiannual Financial Framework.

3.2 The proposal will come into force with the start of the next Multiannual Financial Framework (MFF)—the EU's multi-year budgetary framework, which will span 2021–2027, which the Committee is scrutinising as a whole.[13] The proposed budget allocation is in the region of €4bn and will be implemented through public procurement and grants.

12 Letter from the Minister to the Chair of the European Scrutiny Committee (15 November 2018).

13 Thirty-eighth Report HC 301–xxxvii (2017–19) chapter 18 (12 September 2018).

3.3 The programme's main objective is to support a well-functioning Single Market, ensure high levels of health protection and appropriate action to counter cross-border health risks. To achieve this general objective, the programme will finance activities related to:

- human, animal and plant health (emergency measures combatting threats; costs of complying with control requirements and training staff);
- standardisation (funding to financial reporting and audit standards assessments; financing of new standardisation initiatives and stakeholder involvement therein);
- consumer protection (supporting consumer associations and watchdogs, particularly financial services end-users; support to national product safety authorities; raising awareness of consumer rights and access to redress as part of New Deal);
- statistics (funding to national statistics institutes); and
- internal market governance (support to the Single Digital Gateway, Your Europe Advice, SOLVIT, the Internal Market Information system, Single Market Scoreboard).

3.4 In terms of proposed spending, €1bn is proposed for competitiveness of enterprises with special emphasis on SMEs and achieving additionality through the provision of measures that provide various forms of support to SMEs; €1.68bn is proposed for contributing to a high level of health for humans, animals and plants along the food chain, supporting the improvement of the welfare of animals and promoting sustainable food production and consumption; and €552,000 is proposed for producing and communicating high quality statistics on Europe. Other smaller items of proposed expenditure include €188,000 for empowering, assisting and educating consumers, businesses and civil society.

3.5 In the Government's Explanatory Memorandum,[14] the Minister stated that the proposal would not have any direct policy or financial implications for the UK, on the basis that the UK will no longer be a Member State at the time this legislation comes into force—although, if the implementation period in the draft Withdrawal Agreement were to enter into force, and to be extended, the proposal would be relevant.

3.6 The Minister did not initially clarify whether the Government wanted to take part in any parts of the Single Market Programme when it ceased to be a Member State, other than to observe in general that it would consider continued participation policies and programmes which are to the UK's and EU's joint advantage. The proposal allows for third countries to become associated to the Programme subject to the negotiation of a specific agreement, which would have to comply with a set of conditions which are consistent with those contained in most other MFF proposals, including there being a balance between the associated country's financial contributions and benefits, and not granting the country "decisional power" with regards to the Programme. The Minister said that if the UK chose to participate in future EU programmes, it would make contributions to cover its fair share of the costs involved.

14 Explanatory Memorandum from the Government (3 July 2018).

3.7 The Minister has separately written to the Lords EU Committee with information in relation to the Competitiveness of SMEs (COSME) programme, which forms part of the wider Single Market Programme, and which is specifically addressed in document (b).[15] The Minister reported that, of the four components which make up COSME (access to finance; access to markets; better regulations; and actions to support entrepreneurship) the UK had principally engaged in the access to markets component: the Enterprise Europe Network (EEN) and, to a lesser extent, the COSME financial instruments (FIs).

3.8 The Minister told the Lords that the EEN was an EU-funded business support network focused on supporting SMEs to grow, innovate and expand into other markets within the EU and beyond, which provided advice on laws and promoting innovation, as well as access to a business database portal for facilitating and brokering collaborative partnerships. The Minister reported that UK Research and Innovation (UKRI) and Scottish Enterprise (SE) were responsible for delivering EEN objectives in the UK and between January 2015 to December 2018 they had supported 10,590 UK SMEs' engagement in the EEN. The total value of the grants received from the EU during the same period is €26,909,136.

3.9 In relation to the COSME access to finance component, the Minister stated that this comprised two financial instruments—the Loan Guarantee Facility (LGF) and the Equity Facility for Growth (EFG)—both of which target Member State financial intermediaries (FIs). Member State financial intermediaries then provide loans (backed by a COSME-funded guarantee) to SMEs and can draw down funds from the guarantee to cover an agreed portion of losses resulting from loan defaults. To date, approximately 3,000 UK SMEs have benefitted from a COSME-backed loan, with a loan portfolio of around €66m and €3.2m provided in guarantees. However, the Minister states that there are difficulties assessing the overall impact of COSME due to the disparate nature of the programme, and the UK's relatively short engagement in it.

3.10 The Minister added that, in the event of a "no deal" scenario, the financial guarantee announced by the Chancellor in August and October 2016, covering EU funding agreed before we leave the EU, which was extended in July 2018 to cover successful bids to participate in EU projects made before the end of 2020, would cover the Enterprise Europe Network (EEN) under the "access to markets" component of COSME, but not the financial instruments (the Loan Guarantee and the Equity Facility for Growth) as they do not form part of the competitive bidding elements of COSME.

3.11 In his subsequent update to the Committee,[16] the Minister indicates that progress in working parties has been swift, and that there will be a vote on a Partial General Approach (PGA) at Competitiveness Council in Brussels on 29 November. The Minister states that, in general, Member States, including the United Kingdom, are content with the most recent drafting of the regulation, and that voting in favour of the regulation would send a signal of goodwill to the EU and other Member States, and keep the United Kingdom's options open in relation to any future engagement with the programme. No decision on participation has yet been taken in relation to this programme. The Minister requests a waiver to enable HM Government to vote in favour of the proposed Regulation.

15 Letter to the House of Lords European Union Committee (31 October 2018).

16 Letter from the Minister to the Chair of the European Scrutiny Committee (15 November 2018).

3.12 The Minister adds that a vote in favour at this Competitiveness Council "would not commit the United Kingdom to participating in the Single Market Programme, nor to any financial matters, as the vote is entirely concerned with the regulatory framework of the programme".

3.13 The Minister has also previously replied to the Committee's previous report[17] in relation to a Commission Communication on improving the functioning of the SOLVIT network—a service which forms part of the Single Market Programme and helps EU/EEA citizens and businesses when they are experiencing difficulties with having their EU rights recognized by public authorities on a cross-border basis within the EU. The Minister indicates that, in the event of a negotiated exit, SOLVIT will continue to operate on current terms during the implementation period, but that, thereafter, UK involvement with SOLVIT will depend on the nature of the future relationship with the EU.

3.14 **We thank the Minister for his update regarding the proposed Regulation establishing Single Market Programme, which represents a small proportion of proposed EU spending relating to the Single Market.**

3.15 **We have taken note of the information provided about the participation of UK stakeholders in the COSME Programme, particularly the Enterprise Europe Network (EEN)—which has supported 10,590 UK SMEs with grants of €26,909,136 between January 2015 and December 2018—and the COSME access to finance component, which have provided approximately 3000 UK SMEs with loans worth around €66m. While the Minister indicates that there are difficulties assessing the overall impact of COSME due to the disparate nature of the programme and the UK's relatively recent involvement in it, we note that a significant number of businesses have derived benefits from this participation.**

3.16 **The Government has not yet decided whether to apply to become associated to any parts of the Single Market Programme when the UK ceases to automatically participate in it as an EU Member State / during the implementation period envisaged in the draft Withdrawal Agreement.**

3.17 **As the proposal does not contain any points of significant contention, would "keep the United Kingdom's options open in relation to any future engagement with the programme", and would not commit the United Kingdom to participating in the Single Market Programme, we are willing to grant the Government a waiver to support the proposal at Council, as requested.**

3.18 **In the Minister's next update, we ask that he provide greater clarity regarding any significant changes to the Commission's original proposal effected by the Partial General Approach. We also ask that the Minister consult with UK Research and Innovation (UKRI) and Scottish Enterprise (SE) regarding the value of participation in the Enterprise Europe Network (EEN) and provide us with a summary of their views on this point.**

3.19 **In the meantime, we retain the proposal under scrutiny. We clear non-legislative documents (b) and (c) from scrutiny.**

17 Letter from the Minister to the Chair of the European Scrutiny Committee (27 February 2018).

Full details of the documents:

(a) Proposal for a Regulation of the European Parliament and of the Council establishing the Programme for single market, competitiveness of enterprises, including small and medium-sized enterprises, and European statistics and repealing Regulations (EU) No 99/2013, (EU) No 1287/2013, (EU) No 254/2014, (EU) No 258/2014, (EU) No 652/2014 and (EU) 2017/826: (39877), 9890/18 + ADDs 1–3, COM(18) 441; (b) Report from the Commission to the European Parliament and the Council Cosme Programme for the Competitiveness of Enterprises and SMEs 2014–2020 Monitoring Report 2015: (39875), 9908/18 + ADDs 1–2, COM(18) 388; (c) Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on the Reinforcement of SOLVIT: Bringing the benefits of the Single Market to citizens and businesses (38697), 8770/17 + ADD 1, COM(17) 255.

Previous Committee Reports

(a) (b) None; (c) Tenth Report HC 301–x (2017—2019), chapter 1 (17 January 2018).

4 Ending seasonal changes of time

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee and the Exiting the European Union Committee
Document details	Proposal for a Directive discontinuing seasonal changes of time and repealing Directive 2000/84/EC
Legal base	Article 114 TFEU, ordinary legislative procedure, QMV
Department	Business, Energy and Industrial Strategy
Document Number	(40063), 12118/18 + ADD 1, COM(18) 639

Summary and Committee's conclusions

4.1 Following a commitment made by the European Commission President Jean-Claude Juncker in his State of the Union speech in September 2018, the Commission put forward a proposed Directive which would end seasonal clock changes. Under existing EU law, all Member States move their clocks forward by an hour on the last Sunday in March and move them back by an hour on the last Sunday in October.[18] This practice would end in 2019 under the Commission's proposal. Each Member State would have to decide whether to opt for permanent summer or winter time arrangements, without the possibility of introducing any seasonal variation in subsequent years. The proposed Directive cites an internal market legal base—Article 114 of the Treaty on the Functioning of the European Union (TFEU)—reflecting the Commission's view that harmonised EU rules are necessary for the effective functioning of the EU's internal market and that uncoordinated time changes would be detrimental, resulting in "higher costs to cross-border trade, inconveniences and possible disruption in transport, communications and travel, and lower productivity in the internal market for goods and services".[19]

4.2 The Commission is keen to secure the formal adoption of the proposed Directive no later than March 2019 so that its provisions take effect in national law by 1 April 2019 (ahead of the next European Parliament elections in May 2019). If this ambitious timescale is met, the UK would be required under the terms of the draft EU/UK Withdrawal Agreement to implement the Directive during a post-exit transition/implementation period (ending, at the earliest, on 31 December 2020) and to decide by 27 April 2019 whether to switch permanently to British Summer Time (GMT+1) or to remain on standard (GMT) time all year round.

4.3 In her Explanatory Memorandum of 11 October 2018, the Parliamentary Under-Secretary of State at the Department for Business, Energy and Industrial Strategy (Kelly Tolhurst) accepted that Article 114 TFEU was an appropriate legal base for the proposed

18 The current rules on summertime arrangements are set out in Council Directive 2000/84/EC.

19 See p.3 of the Commission's explanatory memorandum accompanying the proposed Directive.

Directive but said that existing EU law "already ensures harmonisation of time across the Union" and that the Commission had failed to demonstrate why the changes it had proposed were necessary or would be beneficial for the EU.

4.4 We shared the Government's concern that there was an insufficient justification for the action proposed by the Commission and the House of Commons, acting on our recommendation, issued a Reasoned Opinion on 13 November 2018 following a debate in European Committee. The Reasoned Opinion is not concerned with the merits of seasonal time changes but with the application of the principle of subsidiarity. This principle means that the EU should act only where there is clear added value and similar benefits cannot be achieved by Member States acting at a national, regional or local level. Our earlier Report agreed on 31 October 2018 provides a detailed overview of the proposed Directive and the reasons why the House determined that the proposal fails the subsidiarity test.

4.5 Since much of the impetus for the proposed Directive appeared to stem from an online public consultation launched by the Commission in July, we asked the Government whether it was well-publicised in the UK, how many responses were submitted from the UK and how much support there was for the two options presented by the Commission—maintaining existing EU-wide arrangements for switching between summer and winter time at the end of March and October, or abandoning seasonal clock changes altogether across the EU. We also asked:

- whether the Government intended to carry out its own consultation, given the possibility that the UK would be under an obligation to implement the Directive if adopted in the timescale envisaged by the Commission;[20] and
- what position the Devolved Administrations had taken on the proposed Directive and the extent of their powers to apply seasonal time changes (as opposed to powers to determine their time zone).

4.6 As well as voicing our concerns about subsidiarity, we also questioned whether the legal base for the proposed Directive—Article 114 TFEU—gave the EU the competence to divest Member States permanently of the power to determine at national level whether seasonal time changes were necessary and to prevent them from maintaining (or, in the future, re-introducing) seasonal time changes. We requested a more detailed analysis of the scope of the EU's powers under Article 114 TFEU.

4.7 Turning to the Brexit implications of the proposed Directive, we asked whether the Government considered that the Commission's timetable for adopting and bringing into effect the Directive was realistic and, if so, to explain:

- the factors which would inform the Government's decision in determining whether to opt for permanent summer or winter (standard) time arrangements, including the significance of the choices made by the UK's closest trading partners (particularly the Republic of Ireland); and
- whether the UK was at risk of being locked into permanent summer or winter time arrangements as part of any post-exit market access or market integration

20 This also depends on the EU and the UK agreeing to a post-exit transition period during which EU laws would continue to apply as part of the UK's exit negotiations.

> agreement negotiated with the EU or, alternatively, would be free to reintroduce seasonal time variations once any post-exit transition/implementation period had expired.

4.8 In his letter of 19 November 2018, the Parliamentary Under-Secretary of State at the Department for Business, Energy and Industrial Strategy (Lord Henley) observes that the changes contained in the proposed Directive would have "a proportionately larger impact on the UK" as "one of the more northern Member States" and would affect "particular sectors, such as agriculture, energy, health, transport, sport and logistics". He refers us to the Government's Checklist which sets out the "likely implications" of the proposed Directive for a range of sectors within the UK. The Checklist highlights specific sectors, such as energy generation and consumption, road safety, health and agriculture, in which further research would be needed to assess the scale of the impact of ending seasonal time changes and the related costs and benefits. Whilst the choice of permanent 'winter time' or 'summer time' would undoubtedly have some additional impacts, the Minister concludes that "there is insufficient evidence at this stage on which to base a robust assessment as to which outcome would be of greatest, or indeed any significant benefit to the UK". He therefore considers that the Commission has provided insufficient evidence to demonstrate "a strong case" for changing existing arrangements, adding:

> There is limited assessment of the impacts of a change that would affect every citizen in the EU and a timetable for implementation that is unworkable.

4.9 The Minister confirms that the Government "has no plans to change Daylight Saving Time" and is working actively to convince other Member States to block the proposed Directive. He reports that "a significant majority" of Member States have raised concerns about the content of the proposal and the pace at which the Commission is seeking to secure an agreement. Greece and Portugal "spoke out strongly against the proposal" at an informal meeting of EU Transport Ministers in Graz in October and there is widespread agreement that more time is needed for domestic consultation and implementation, as well as a concern to avoid a "patchwork" of time zones across the EU. He adds:

> Amendments to the text to provide for a longer implementation and notification period have been proposed and gained broad support.

4.10 Responding to our request for a more detailed analysis of the scope of the EU's powers under Article 114 TFEU, the Minister observes:

> We believe that the Commission is able to bring forward proposals relating to daylight savings, such as further harmonisation, under Article 114 TFEU. The existing Directive (2000/84/EC) was introduced under the predecessor of this legal base. However, it is clear to me that this new proposal would not change the level of harmonisation across the EU. It would simply change the type of harmonisation and with little evidence that it would improve conditions for the functioning of the internal market. We therefore do not believe that it is appropriate to bring these proposals forward under this legal base as such benefits have not been demonstrated by the Commission.

4.11 He concludes that "the case for change has not been made and the principles of subsidiarity and proportionality have not been met" and that there is no justification for action at EU level as the proposed Directive would not increase the degree of harmonisation.

4.12 The Minister acknowledges the low response in the UK to the European Commission's online public consultation—fewer than 0.02% of the population submitted their views—but says "it is not standard practice" for the Government to publicise Commission consultations. As the Government intends to oppose the proposed Directive, it has no plans to initiate its own consultation.

4.13 The Minister confirms that the Devolved Administrations "have an interest" in the proposed Directive, with the Scottish Government historically keen to maintain the current system of daylight saving "to avoid putting practical difficulties in the way of those making a living in northern and rural areas". The Government is working with the Devolved Administrations "to understand the potential impacts" and has sought their views on the proposed Directive. In terms of the distribution of powers to legislate on seasonal time changes, the Minister explains:

> Timescales, time zones and the subject matter of the Summer Time Act 1972 are reserved to Westminster for Scotland and Wales. There is no equivalent reservation or exception for Northern Ireland, so it is within the gift of the Executive and Assembly to change the arrangements as long as they remain compliant with EU law, for which the UK Government is responsible. The Summer Time Order 2002, which implements the last Directive on this subject, is a single instrument which extends to Great Britain and Northern Ireland.

4.14 Commenting on the impact that the UK's exit from the EU will have on the Government's approach to implementing this and other EU laws during a post-exit transition/implementation period, the Minister says:

> We have been clear that the implementation period should be based on the existing structure of EU rules and regulations, so that people and businesses only need to make one set of changes as we move to our future partnership. Of course we need to discuss how all of this will work in practice in the next phase of the negotiations, including how we'll contribute UK views and share expertise during the period. Beyond the implementation period, the UK's relationship to EU legislation will be a matter for negotiations on the future relationship.

4.15 The Presidency has indicated that it will not be possible to secure a General Approach on the proposed Directive in December. The next available opportunity is likely to be the Transport Council in March 2019. The Minister invites us to clear the proposal from scrutiny or grant a scrutiny waiver "to enable us to vote on this proposal if necessary", adding:

> Let me be clear, we have no plans to change the current arrangements and will continue to oppose this Directive.

Our Conclusions

4.16 **We thank the Minister for his response and his support for the Reasoned Opinion agreed by the House of Commons.**

4.17 **The Minister's letter, in our view, conflates the question of subsidiarity (the need for and "added value" of EU action) with the competence to act. As our earlier Report explained, there are three standard time zones within the EU: Western European or Greenwich Mean Time (GMT) covering the UK, Ireland and Portugal; Central European Time (GMT+1) covering 17 Member States; and Eastern European Time (GMT+2) covering eight Member States. Existing EU law coordinates the dates on which seasonal time changes begin and end, meaning that there is never more than two hours' difference in time across all EU Member States. There is no dispute that the choice of time zone is a sovereign matter for each Member State. The changes proposed in the Directive risk creating four functional time zones (GMT+3), resulting in greater variation than under the current arrangements. We ask the Minister to explain how a legal base which seeks to approximate laws affecting the functioning of the internal market can be used to create more rather than less divergence and whether the Government has sought advice from the Council Legal Service on the use of Article 114 TFEU to this end.**

4.18 **Despite recognising that the proposed Directive, if implemented, would "affect every citizen in the EU", the Government does not see a need to carry out its own consultation as it intends to work with other Member States to block the proposal. It is far from clear whether this strategy will succeed. A recent** Presidency progress report **on negotiations within the Council states that a majority of Member States' Transport Ministers "expressed a positive view" on the abolition of seasonal time changes.[21] It also records general agreement that more time would be needed to consult on the proposed Directive. A revised Presidency text pushes back the date for applying any changes to April 2021—after the date on which the post-exit transition/implementation period envisaged in the draft EU/UK Withdrawal Agreement is expected to end (on 31 December 2020). The text also stipulates that any change in a Member State's time zone would have to be notified to the European Commission at least 18 months before it takes effect (rather than six months in the Commission's original proposal). This change in the notification period would prevent Member States from applying seasonal time changes simply by notifying a change in time zone every six months.**

4.19 **As there is no certainty that the Government's objective of opposing the proposed Directive will be achieved or that the UK will not be required to implement the Directive, once adopted, during a post-exit transition/implementation period, we are not willing to clear the proposed Directive from scrutiny or grant a scrutiny waiver at this stage. We ask the Government to update us on the progress of negotiations and to ensure that we are able to consider any compromise Presidency text before it is brought to the Council or COREPER to agree a General Approach or a negotiating mandate. The Government should also press the Commission to publish a full Impact Assessment. We would welcome further details of the consultation undertaken with the Devolved Administrations and their views on the Commission proposal, as well as on any compromise text being considered within the Council. We would also welcome details of the European Parliament's position once it has been established.**

4.20 **Pending further information, the proposed Directive remains under scrutiny. We draw this chapter to the attention of the Business, Energy and Industrial Strategy Committee and the Exiting the European Union Committee.**

21 See Council document 14224/18 dated 19 November 2018.

Full details of the documents

Proposal for a Directive discontinuing seasonal changes of time and repealing Directive 2000/84/EC: (40063), 12118/18 + ADD 1, COM(18) 639.

Previous Committee Reports

Forty-second Report HC 301–xli (2017–19), chapter 1 (31 October 2018).

5 MFF Digital Europe Programme

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; waiver granted; further information requested
Document details	Proposal for a Regulation of the European Parliament and of the Council establishing the Digital Europe programme for the period 2021–2027
Legal base	Articles 172 and 173(3) TFEU; ordinary legislative procedure; QMV
Department	Digital, Culture, Media and Sport
Document Number	(39900), 10167/18, COM(18) 434

Summary and Committee's conclusions

5.1 The European Commission has adopted a proposal for a Regulation which would establish the "Digital Europe" programme for the period 2021–2027. The proposal sets out a range of initiatives targeted at digital industries as part of the next Multiannual Financial Framework, which the Committee is scrutinising separately as a whole.[22] The Programme proposes approximately £8bn in funding from 2021 to 2027.

5.2 The principal budget lines proposed relate to:

- High Performance Computing (HPC): This primarily concerns the Euro-HPC initiative, a new joint public-private initiative between the EU, Member States, and industry, which seeks to address perceived shortfalls in progress in developing High Performance Computing infrastructure inside the Union. The Committee has scrutinised this project separately and is corresponding with the Minister regarding the possibility of UK involvement in the project.[23] This part of the Programme has a proposed cost of £2.28bn (€2.6bn) from 2021 to 2027.

- Artificial Intelligence: The Programme aims to build up and strengthen core Artificial Intelligence (AI) capacities in Europe. The proposal suggests initiatives including: common European libraries of algorithms that would be accessible to all; co-investment in sites for experimentation and testing in real settings focusing on the applications of AI in sectors such as health, earth/environment monitoring, mobility, security, manufacturing or finance; and large computing and data handling facilities. The Committee has recently scrutinised the communication, "Artificial Intelligence for Europe", which feeds into this aspect of the proposal.[24] This area of the Programme has a proposed cost of approximately £2.19bn (€2.5bn) from 2021 to 2027.

22 Thirty-eighth Report HC 301–xxxvii (2017–19), chapter 18 (12 September 2018).

23 Department for Exiting the European Union, European Memoranda, Proposal for a Regulation of the European Parliament and of the Council establishing the Digital Europe programme for the period 2021–2027 (accessed 21 November 2018).

24 European Commission, Artificial Intelligence for Europe COM(2018) 237. Forty-first Report HC 301–xl (2017–19), chapter 1 (24 October 2018).

- Cybersecurity: The Programme aims to stimulate the building of essential capacities to secure the EU's digital economy, society and democracy by reinforcing the EU's cybersecurity industrial potential and competitiveness, improving capabilities of the public and private sectors to protect European citizens and businesses from cyber threats, and supporting the implementation of the Network and Information Security Directive. It suggests a number of initial activities, including: co-investment with Member States in advanced cybersecurity equipment and infrastructures and ensuring wide deployment of the latest cybersecurity and trust solutions. This area of the Programme has a proposed cost of approximately £1.67bn (€1.9bn) from 2021 to 2027.

- Advanced Digital Skills: This objective will promote long-term training and courses for students, IT professionals and the workforce, short-term training and courses for entrepreneurs, small business leaders and the workforce; and on-the-job training and traineeships for students, young entrepreneurs and graduates. This area of the Programme has a proposed cost of approximately £600.61m (€685m) from 2021 to 2027.

5.3 Additional minor investments totalling £167.32m are proposed to support cross-border digitisation activity across a range of areas including "modernisation of administration" (e-Government), "health", "judiciary", "transport, energy and environment", and "education and culture".

5.4 The proposal includes provisions regarding the participation of third countries in the Programme which are the same as those which apply to most other budgetary proposals. These stipulate that the Programme is open to the participation of individual third countries subject to the conclusion of a specific agreement with the Union which ensures a fair balance as regards contributions and benefits and does not confer "decisional power" on the participating country.

5.5 In the Government's explanatory memorandum[25] the Parliamentary Under Secretary of State at the Department of Business, Energy and Industrial Strategy (Margot James) stated that the UK might wish to continue to take part in programmes which are to the UK and the EU's joint advantage, and that, where this was the case, the UK would want to make an ongoing contribution to cover our fair share of the costs involved. The Minister also stated that the proposal did not raise subsidiarity concerns or have direct financial implications for the UK.

5.6 The Minister has subsequently provided an update[26] in which she requests that the Committee grant a waiver in advance of Telecoms Council on 3/4 December, at which it is anticipated that a partial general approach will be agreed. The Minister emphasises that the vote at the Telecoms Council will not be about UK participation in Digital Europe, but on the proposed text of the Regulation. She adds that the text that is agreed through the partial general approach will not incorporate the final budget and spending figures, and that voting in favour would not commit the UK to any spending requirement.

5.7 The Minister states that it remains the case that the UK may seek to participate in the programme or certain parts of it, but that officials are assessing whether the UK would

25 Explanatory Memorandum from the Department of Business, Energy and Industrial Strategy (4 July 2018).
26 Letter from the Minister to the Chair of the European Scrutiny Committee (21 November 2018).

benefit more from investing in domestic programmes. Nonetheless, the Minister considers that it is important that the Government support the programme in the Council, as failure to do so, particularly if the UK inadvertently became part of a blocking minority, could have a significant negative impact on the UK's ability to participate in it in the future.

5.8 Officials have subsequently clarified that the section of the Regulation relating to third country participation is not expected to be included in the Partial General Approach, and that it is anticipated that virtually all delegations will be able to support the proposed Regulation.

5.9 **We have taken note of the Commission's proposed Digital Europe Regulation, which covers cooperation and funding in a number of high growth areas, including High Performance Computing (£2.28bn), Artificial Intelligence (£2.19bn), and cybersecurity (£1.67bn). Like other specific Programmes, the final budget and spending figures will not be settled until wider negotiations regarding the MFF have concluded.**

5.10 **Like many other MFF Programmes, the proposed Digital Europe Regulation permits third country participation subject to the negotiation of a specific agreement which would entail a fair balance of contributions and benefits and would not confer any "decisional power" regarding the Programme on participating country. This is welcome as the Government has recently confirmed to the Committee that it does not rule out future participation in EU plans to procure High-Performance Computing infrastructure (EuroHPC), and is considering participating in EuroHPC for the duration of Horizon 2020, as "this would allow the UK to continue accessing Horizon 2020 R&I funding for High-Performance Computing projects in 2019 and 2020", which "significantly benefits UK industry and academia."**[27]

5.11 **The Minister states that officials are currently assessing whether the UK would benefit from paying to participate in the Digital Europe programme or whether it would be more effective to invest in domestic programmes.**

5.12 **The Minister requests a scrutiny waiver to support a Partial General Approach (PGA) at TTE Council on 3/4 December 2018. This is on the basis that the PGA will not incorporate the final budget and spending figures and will not commit the UK to any spending requirement. Officials have subsequently clarified that section on participating third countries is expected to be excluded from the PGA, as this is being dealt with as part of wider MFF negotiations. The Minister states that it is "important that the Government demonstrate its commitment to cooperation on digital issues as negotiations are ongoing, and that failure to support the programme … could have a significant negative impact on the UK's ability to participate in it in the future."**

5.13 **We grant the Government a scrutiny waiver to support the proposed Partial General Approach at TTE Council. In the meantime, we retain the proposed document under scrutiny. In the Government's subsequent update we ask for a further update as to whether the UK has decided to participate in EuroHPC for the duration of Horizon 2020, as well as a summary of the engagement the Government has undertaken with the devolved administrations and whether they advocate participation/non-participation in the Programme as a whole or any specific aspects of it.**

27 Letter from the Minister of State for Universities, Science, Research and Innovation (Sam Gyimah) to the Chairman of the European Scrutiny Committee (22 October 2018).

Full details of the documents: Proposal for a Regulation of the European Parliament and of the Council establishing the Digital Europe programme for the period 2021–2027: (39900), 10167/18, COM(2018) 434.

Previous Committee Reports

None.

6 First mobility package: market pillar

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; waiver granted; further information requested
Document details	Proposal for a Regulation amending Regulation No. 1071/2009 and Regulation 1072/2009 with a view to adapting them to developments in the sector
Legal base	Article 91(1)TFEU; ordinary legislative procedure, QMV
Department	Transport
Document Number	(38781), 9668/17 + ADDs 1–3 COM(17) 281

Summary and Committee's conclusions

6.1 As part of its "first mobility package", adopted on 31 May 2017, the European Commission proposed Regulation (EU) 9668/17, which would effect a wide range of changes to the internal market rules governing road transport, amending both Regulation (EC) 1071/2009 governing access to the occupations of road transport operator and transport manager, and Regulation (EC) 1072/2009 governing access to the EU road transport market.

6.2 The principal changes which were proposed are outlined below, together with the Government's position as set out in its explanatory memorandum[28] and a follow-up letter from the Minister (Jesse Norman)[29] in advance of the June Transport Council:

- *Inclusion of Light Commercial Vehicles (LCVs)*: Light Commercial Vehicles (LCVs, or vans) below 3.5 tonnes would be brought into certain establishment requirements of the operator licensing regulations applicable to larger vehicles. The Minister indicated that the Member States had suggested a more proportionate approach which would only apply to vans over a minimum weight threshold doing international work for hire or reward, which would greatly reduce the number of UK operators affected—a position the Government could support.

- *Harmonisation of rules of establishment*: What constitutes an establishment for the purposes of freight operator regulations would be harmonised by removing the ability of Member States to impose additional requirements to those set out in Regulation 1071/2009. To tackle the phenomenon of "letterbox companies", requirements would be introduced for undertakings to hold assets and employ

28 Explanatory Memorandum from the Department of Transport (5 July 2018).
29 Letter from the Minister to the Chairman of the European Scrutiny Committee (8 May 2018).

staff in the Member State of establishment and to ensure that undertakings have a real and continuous activity there. The Minister indicated that the Government supported this aspect of the proposal, provided that the text permitted the Government to require operators in the UK to have sufficient parking spaces for their fleet.

- *Cabotage operations*: The Commission proposed to amend the time period allowed for cabotage operations from the current three operations in seven days to unlimited operations in a five day period. A significant number of Member States took the view that this represented a liberalisation. Officials subsequently updated the Committee that it was probable that this aspect of the Commission proposal would either be scaled back to fewer days, or even to the status quo. Either outcome was acceptable to the Government.

- *Cabotage enforcement*: Evidence of compliance with cabotage restrictions would have to be provided during roadside checks. Member States would also be required to carry out checks on a minimum two per cent of cabotage operations to determine compliance. The Government objected to this requirement on the basis that it would "impose an undue burden on law enforcement bodies … and may impact on their ability to do other, more road safety critical, activity". In working parties, the Member States agreed to remove this requirement, and to limit roadside checks to those which could practically take place at the roadside, addressing the UK's concerns.

6.3 In the event the cabotage reforms proved too intractable for the Bulgarian Presidency to secure a General Approach and it issued a progress report instead.

6.4 The Minister has now written to the Committee in advance of the principal Transport Council of the Austrian Presidency on 3 December, at which it will seek a General Approach on the same file.

6.5 In his update,[30] the Minister states that the latest working text retains the significant changes which outlined in his letter of 8 May (outlined above), with which the Government was broadly content. He also enumerates a number of changes which have been made to the proposed compromise text.

6.6 On cabotage, the Minister states that Member States' positions remain entrenched and polarised, and the Presidency has therefore proposed what appears to be "the least unpopular compromise": maintaining the current maximum of three cabotage operations in seven days. The Minister states that this would be a "balanced outcome", which the Government could support.

6.7 A further change to Regulation 1071/2009 is proposed which would require a vehicle used for international carriage to return to one of its operational centres in its Member State of establishment every four weeks, based on a yearly average, and in any event within six weeks. He states that this provision is intended to address the issue of "letterbox" or "shell" companies which purport to be established in one country but are functionally

30 Letter from the Minister to the Chair of the European Scrutiny Committee (14 November 2018).

based in another. The Minister states that the Government can see some benefit in the average-based limit but considers the hard limit to be unnecessarily prescriptive. He expects that this aspect of the text could yet be further softened in the final text.

6.8 In response to the Committee's question about the implications of the proposed "cooling-off period" for cabotage—which would establish a period of days following the end of a set of cabotage operations during which an operator would not be able to undertake further cabotage in the same Member States—in relation to haulage activity across the Northern Irish border, the Minister states that the provision has been retained in the current compromise text, but with the number of days reduced from 14 to 10. He adds that the UK, along with a large number of other Member States, continues to press for this to be further reduced. The Minister states that his officials have discussed this issue with their counterparts in Northern Ireland and the Republic of Ireland.

6.9 The Minister indicates that the Government is content with the proposals, and that it is unlikely that there will be further substantial amendments ahead of the Council, apart from possible proposed compromises on the "cooling-off" period. He states that he would be grateful if the Committee would clear the proposal from scrutiny, or grant a scrutiny waiver, ahead of the 3 December Transport Council.

6.10 In its most report on 6 June 2018[31] the Committee examined the implications of EU exit for the haulage sector in detail, and concluded, variously, that: the EU single market for road transport was deeply integrated and provided a high degree of reciprocal market access; outside the EU itself, only the EEA Member States participate completely in the internal road transport market, with conventional Free Trade Agreements achieving little in the sector; that, otherwise, bilateral arrangements exist between individual EU Member States and third countries based on systems of quotas and permits; and that the European Conference of Ministers of Transport (ECMT) multilateral permit scheme could only cover approximately 5–10% of the UK's international road transport needs, meaning that it would not provide a substitute for the current arrangements for the majority of operators.

6.11 The Committee also asked the Government a number of questions related to EU exit, to which the Minister has responded.

6.12 Asked to identify any significant benefits or opportunities EU exit offered the sector, the Minister states that the principal benefit will be the ability for the UK to define its own regulatory regime tailored to the specifics of the domestic market.

6.13 Invited to clarify whether the Government intended to scrap or substantially reform the drivers' hours and working time rules applicable to the haulage sector, or the Combined Transport Directive, the Minister states that the Government has "no current plans" to do so.

6.14 In response to the Committee's question as to whether the Government would be able to agree bilateral haulage permit arrangements with individual EU Member States (as opposed to the EU as a bloc), the Minister states first that there are strong mutual interests in reaching an ambitious agreement which will avoid any limits on international haulage, but that the Government is nonetheless preparing for a range of potential outcomes

31 Thirtieth Report HC 301–xxix (2017—2019), chapter 8 (6 June 2018)

including the possibility of no deal. He states that one option includes bilateral agreements. The Minister adds that the Government "expects many bilateral agreements with EU countries to be reinstated once EU law ceases to apply and intends to seek agreements with other countries where there is not a historical arrangement that can be relied upon", some of which will require permits. He adds that the Department would need to take some further steps to bring old bilateral agreements into effect.

6.15 Asked whether specific solutions will be needed for the island of Ireland in the event that cabotage rights cannot be secured in negotiations, given the high incidence of UK-Irish cabotage, the Minister states that, as the Department indicated in its Technical Notice on road haulage,[32] the Government is clear that it "must respect our unique relationship with Ireland, with whom we share a land border and who are co-signatories of the Belfast Agreement". He adds, "we are confident of securing an agreement with Ireland to allow continued access for Northern Ireland hauliers which will replicate the current arrangements", without specifying the nature of this agreement or how it could sit alongside an EU-wide agreement negotiated as part of the future relationship.

6.16 **We thank the Minister for his thorough update on the progress of negotiations regarding the proposed Regulation, on which a General Approach will be sought at Transport Council on 3 December. The previous changes secured to the text in working parties, which addressed the Government's chief concerns, have been retained. On the contentious issue of cabotage operations, the Presidency has opted for "the least unpopular compromise" of maintaining the current maximum of three cabotage operations in seven days, which is acceptable to the Government.**

6.17 **The proposed "cooling-off period" for cabotage operations—which would establish a period of days between batches of cabotage operations, with the aim of tackling the phenomenon of the permanent provision of cabotage services by non-domestic operators in some Member States—has not been removed from the text, although the period has been reduced from 14 to 10 days, with the Government and other Member States pressing for further reductions. We consider that this provision would have disruptive effects for UK-Irish haulage and would impose unnecessary restrictions on Northern Irish hauliers in particular, both while the UK remains a Member State and also, if the Withdrawal Agreement were ever to enter into force, during the implementation period provided for in it. The Minister states that the Government has discussed this issue with Irish and Northern Irish officials and that efforts will be made to minimise the impact, but does not provide any detail as to how this could be done.**

6.18 **We grant the Government a conditional scrutiny waiver to support the proposal at Council on 3 December, on the condition that it make a concerted effort to secure an opt-out from the cooling off period with respect to UK-Ireland trade in the final text of the regulation, due to its potential negative impacts on Northern Irish haulage operators in particular. We note that such an opt out would not be without precedent: we understand that the proposed Regulation already contains a provision which would limit the application of the "return home" provision to Maltese and Cypriot hauliers. We consider that it would be highly contradictory for the EU27, who have insisted on the maintenance of frictionless trade on the island of Ireland in the context of EU**

32 Department for Transport, Guidance: Commercial road haulage in the EU if there's no Brexit deal (24 September 2018).

negotiations, to insist in the context of EU membership on the application of this "cooling-off" provision, designed to address problems in other parts of the Union, to UK-Irish trade when it would have the effect of substantially increasing the frictions encountered by British and Irish hauliers, particularly those based in Northern Ireland, operating across both territories. We leave it to the Government to decide the most appropriate means to pursue this arrangement.

EU exit

6.19 **With regard to EU exit, the Government's guidance for hauliers in a no-deal scenario[33] broadly confirms our previous assessment[34] that the implications of such an outcome would be significant, and advises importers and exporters to consider whether they should use alternative modes of transport should such a situation arise.**

6.20 **In response to the Committee's questions on EU exit, the Minister states that:**

- **the principal benefit EU exit offers the sector is the ability "to shape a domestic road haulage regime tailored to the specifics of the domestic market, for example around developing driving tests that work for the UK";**
- **the Government has no current plans to scrap or substantially reform the drivers' hours and working time rules applicable to the haulage sector, or the Combined Transport Directive; and**
- **the Road Haulage Association (RHA) and the Freight Transport Association (FTA) are members of the Joint Customs Consultative Committee, where they have had the opportunity to provide feedback regarding post-exit customs arrangements.**

6.21 **In response to the Committee's question as to whether the Government could negotiate bilateral haulage agreements with individual EU Member States post-exit, the Minister states that the Government "expects many bilateral agreements with EU countries to be reinstated once EU law ceases to apply and intends to seek agreements with other countries where there is not a historical arrangement that can be relied upon". The Minister adds that some of these agreements will require permits while others will not, and that the Department would need to take some further steps to bring old bilateral agreements into effect. He does not clarify how or to what extent these bilateral arrangements would be legally able to coexist with an overarching UK-EU agreement on freight transport like that which is proposed in the outline of the political declaration,[35] nor how far EU Member States would be constrained by EU law from entering into bilateral agreements with the UK in the event that the there is no Withdrawal Agreement or overarching UK -EU agreement.**

6.22 **In response to the Committee's question about future road transport arrangements with Ireland specifically—of importance due to the high levels of cross-border activity**

33 Department for Transport, Guidance: Commercial road haulage in the EU if there's no Brexit deal (24 September 2018).

34 Thirtieth Report HC 301–xxix (2017—2019), chapter 8 (6 June 2018).

35 Political Declaration setting out the Framework for the Future Relationship between the European Union and the United Kingdom (22 November 2018).

previously identified by the Government[36]—the Minister states that the Government is clear that "we must respect our unique relationship with Ireland, with whom we share a land border and who are co-signatories of the Belfast Agreement" and adds that "we are confident of securing an agreement with Ireland to allow continued access for Northern Ireland hauliers which will replicate the current arrangements".

6.23 **We conclude that the question of competence—i.e., whether the Member States would have the competence to agree bilateral arrangements with the UK independently of the EU in the event of either a negotiated exit or a non-negotiated exit—is complicated in the case of road transport and Brexit. As the policy area is one of shared competence, and the EU has legislated extensively in the sector, the EU would appear to have grounds to assert exclusive external competence under Article 216 TFEU; however, Member States have extensive bilateral arrangements with third countries and continue to negotiate new ones, suggesting that the Commission has not yet chosen to assert exclusive external competence in this field.**

6.24 **It nonetheless appears clear that, in the event of a negotiated exit, the EU would play a major role in negotiating overall UK-EU road transport arrangements. The Political Declaration indicates that the issue will be negotiated within wider negotiations regarding the future relationship, and states that the negotiators will seek to agree "comparable market access for freight and passenger road transport operators, underpinned by appropriate and relevant consumer protection requirements and social standards for international road transport". While this wording is ambiguous, it does not appear to preclude a higher level of reciprocal access than was envisaged in the Commission's previous presentation on transport.[37] This is not a remarkable development: if the EU were to adopt a hard line on this issue—limiting both the level of reciprocal access outside the single market, and the extent to which individual Member States could agree bilateral arrangements with the UK—EU27 hauliers, who currently provide the overwhelming majority of cross-border road transport services to and from the UK, would lose out, and there would be significant disruption to cross-border haulage operators travelling between Northern Ireland and Ireland, due to the loss of cabotage rights. It therefore appears to be, broadly speaking, in the EU27's economic and political interest to retain a higher level of reciprocal market access in this sector.**

6.25 **In the event that the overall UK-EU future relationship in road transport does not maintain current levels of reciprocal market access, in order to avoid significant impacts on Northern Irish hauliers engaged in cross-border trade, it will be necessary either for the UK-EU agreement to include some Northern-Ireland specific provisions, or for the Commission to permit the UK and Ireland to conclude a standalone bilateral agreement on haulage which includes provisions on cabotage.**

36 The Government's sectoral report shows that UK-registered HGVs carried 7.5 million tonnes of freight on cross border movements between Northern Ireland and Ireland in 2014, making Ireland the UK's biggest freight trading partner. The Minister also acknowledged in a letter to the Committee that "cabotage operations are common on the island of Ireland".

37 European Commission, Internal EU27 preparatory discussions on the framework for the future relationship: "Transport" (21 February 2018).

6.26 **In its next update, we ask that the Minister:**

- **provide a clearer account of the extent of the EU's competence with regard to external negotiations regarding international road transport, and how it coexists with the Member States negotiating their own bilaterals with third countries;**
- **provide examples of dormant UK road transport bilaterals with individual EU27 Member States and their effects;**
- **explain how these bilateral arrangements will be able to function if there is an overarching UK-EU trade agreement covering road transport, as proposed in the Political Declaration;**
- **clarify to what extent EU Member States would be constrained by EU law from entering into bilateral agreements with the UK in the event that the there is no Withdrawal Agreement or overarching UK -EU agreement;**
- **explain whether the reference to "comparable market access for freight and passenger road transport" in the road transport section of the Political Declaration means comparable to the status quo, or something else, in the Government's assessment; and**
- **provide some justification for the Government's view that it will be able to conclude an agreement with Ireland "to allow continued access for Northern Ireland hauliers which will replicate the current arrangements", given that the EU appears to intend for the issue to be negotiated on an EU-wide basis.**

6.27 **As above, we grant the Government a conditional scrutiny waiver to support the proposal at Telecoms Council, subject to the condition set out above. In the meantime we retain the proposal under scrutiny.**

6.28 **We draw this report to the attention of the Select Committees for Exiting the European Union, Transport, Business, Energy and Industrial Strategy, and Northern Ireland.**

Full details of the documents:

Proposal for a Regulation amending Regulation No. 1071/2009 and Regulation 1072/2009 with a view to adapting them to developments in the sector: (38781), 9668/17 + ADDs 1–3, COM(17) 281

Previous Committee Reports

Thirtieth Report HC 301–xxix (2017—2019), chapter 8 (6 June 2018); Third Report HC 301–iii (2017–19), chapter 9 (29 November 2017).

7 First mobility package: social pillar

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; scrutiny waiver granted; further information requested; drawn to the attention of the Select Committees for Transport and Business, Energy & Industrial Strategy
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
Legal base	Article 91(1) TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Numbers	(a) (38783), 9670/17 + ADDs 1–5, COM(17) 277; (b) (38784), 9671/17 + ADDs 1–5, COM(17) 278

Summary and Committee's conclusions

7.1 The social pillar of the mobility package, adopted on 31 May 2017, proposed to amend the 'social rules' on the conditions of 'mobile workers' (drivers) in the road transport sector, which the Commission considered to be out of date and difficult to enforce.

7.2 With Regulation (EU) 9670/17 the Commission proposed to amend the existing driving time rules, making a range of changes including:

- the introduction of a requirement that drivers must return home for their weekly rest at least every third week, which would potentially have a small benefit for UK operators through reduced competition; and
- the allowance for drivers to take "reduced" weekly rests of 24 hours for two consecutive weeks.[38]

7.3 In a letter to the Committee,[39] the Minister (Jesse Norman) indicated that this aspect of the proposals broadly struck the right balance between improving working conditions for drivers and ensuring fair completion in the Single Market, but expressed concern

38 At present, EU rules require that a driver must take 45 hours of rest each week, although a 'reduced' weekly rest of 24 hours can be taken on the condition that this is only done once a fortnight and the lost hours are compensated in one of the subsequent three weekly rest periods.

39 Letter from the Minister to the Chair of the European Scrutiny Committee (6 April 2018).

that the reduced weekly rest provision could introduce risks in terms of driver fatigue. However, in a subsequent update[40] he reported that this provision had been removed, while the obligation for drivers to return home periodically was maintained, albeit with the frequency being reduced from every three to every six weeks.

7.4 With proposed Regulation (EU) 9671/17, which related to posting requirements for the sectors and enforcement of the working time rules, the Commission proposed:

- to create a new obligation for Member States to add checks on compliance with the working time rules to existing roadside and premises checks of the driving time rules;
- to specify the maximum administrative requirements that Member States were permitted to impose on operators in order to enforce compliance with the postings rules: for example, Member States would be permitted to require a driver to carry a copy of his or her employment contract or payslips in the vehicle, but not to oblige foreign operators to have an 'agent' on their territory; and
- to set out how the existing rules regarding posting of workers should apply to road haulage workers specifically, by specifying the minimum period of posting—three days during a period of one calendar month—below which the host Member States' rules on minimum rates of pay and on paid annual leave would not apply to international road transport operations. In effect, where hauliers are currently entitled to perform up to three cabotage operations within a seven days period starting the day after unloading following an international transportation, they would be able to provide cabotage services without being subject to these requirements for a three day, rather than a seven-day, period.

7.5 The Minister objected to the proposed requirement to enforce sector-specific working time rules at the roadside on the basis that many of the relevant records were only held at the operator's premises, but subsequently informed the Committee[41] that working groups had resulted in these checks being restricted to those which were practical and not excessively burdensome. The Minister did not express a strong view in relation to the proposed clarification of how the framework for posted workers would apply to the sector but explained that this aspect of the package had made slow progress due to disagreements among the Member States, with some advocating a lengthy exemption from postings rules for transport workers and others insisting on no exemption at all.

7.6 In its report[42] on 6 June 2018 the Committee granted the Government a scrutiny waiver to support a General Approach on the proposal in advance of the 7 June Transport Council, but in the event the Bulgarian Presidency decided that the proposals were not yet ready for a General Approach and instead produced a Progress Report.

7.7 On 14 November 2018 the Minister wrote to the Committee to provide it with an update in advance of the forthcoming Transport Council (3–4 December 2018).[43] He reports that the current Austrian Presidency has made the first phase of the Mobility

40 Letter from the Minister to the Chair of the European Scrutiny Committee (8 May 2018).
41 Letter from the Minister to the Chair of the European Scrutiny Committee (8 May 2018).
42 Thirtieth Report HC 301–xxix (2017–19), chapter 9 (6 June 2018).
43 Letter from the Minister to the Chair of the European Scrutiny Committee (14 November 2018).

Package one of its priority areas and has significantly developed some of the proposals, with a view to unblocking the negotiations and enabling General Approaches to be reached.

7.8 In relation to the driving and rest time proposals, the Minister reports that the Presidency has re-introduced the flexibility in the original proposal to allow two consecutive reduced weekly rest periods of 24 hours (rather than the usual 45 hours) to be permitted, with the caveat that the reduction in weekly rest time would need to be compensated for within three weeks. He acknowledges that this change is "not the UK's preferred outcome", as the potential effects on road safety are unclear, but states that the Government does not consider there to be identifiable adverse safety risks, and that any risk is controlled by the rest compensation rule (i.e. the requirement that the time would have to be compensated for within a three week period).

7.9 The latest text also reduces the proposed obligation for operators to ensure that their drivers return to their home base from every six weeks to every four weeks. This would appear to be an improvement from a UK perspective, given that the Minister previously suggested[44] that the three week period proposed would potentially benefit UK operators through reduced competition—although we note that Department for Transport analysis has previously shown[45] that foreign HGV cabotage accounts for just one per cent of road freight activity within the UK, suggesting that this is not a major concern and any impact would be limited. The Minister indicates that, overall, he is content with the developments on driving and rest time rules.

7.10 In relation to the proposed Directive on enforcement and posting of workers, the Minister states that the proposed enforcement measures set out in his previous letter of 8 May, which strictly limit the roadside check obligations on Member States in respect of the working time rules, have been retained, in line with the UK position, and the specific enforcement provisions around postings, including an exhaustive list of administrative burdens for drivers, have been retained.

7.11 On the politically sensitive issue of the extent to which posting of workers rules should apply to road haulage workers, the original proposal that host state rules on minimum rates of pay and on paid annual leave would not apply to workers posted for no more than three days during a period of one calendar month—which would have permitted drivers from other Member States to provide cabotage operations, through which they compete directly with operators in the domestic market, for up to three days a month without being subject to these requirements—has been substantially revised. The new compromise text would exempt from the application of these rules workers engaging in "bilateral international carriage", while cabotage and 'cross-trade' would not be exempt from the postings rules.[46] The Minister states that this approach "meets the UK's objectives in this area, and would create a clear and logical distinction between two fundamentally different types of work as regards the application of the postings rules". He concludes that this represents an improvement on the Commission's original proposal for a 'days-based' exemption rule.

44 Explanatory Memorandum from the Department of Transport (5 July 2017).

45 DfT, International Road Freight Statistics, United Kingdom, 2014 (26 November 2015).

46 Bilateral international carriage refers to a transport operation between Country A and Country B, by an operator based in country A. Cabotage refers to transport operations within Country B, by an operator from Country A. Cross-trade refers to transport operations between Country B and Country C, by an operator based in Country A.

7.12 The Minister states that these developments have been largely welcomed in working groups, but that negotiations will only be resolved at political level during the Transport Council itself; however, on the basis of the information available, he considers that the General Approach will be acceptable to the UK. He therefore requests a scrutiny waiver in advance of the 3 December Transport Council.

7.13 The European Parliament's position remains in development, since its plenary session in July referred the proposal back to the TRAN Committee to be re-worked.

7.14 **The Minister informs the Committee that the Austrian Presidency has reworked various aspects of the compromise text developed by the Bulgarian Presidency.**

7.15 **The compromise text retains the limit on the roadside check obligations on Member States to those which are practical, in line with the UK position.**

7.16 **The Presidency has re-instated the possibility for drivers to take two consecutive reduced weekly rest periods of 24 hours, which was not the UK's preferred outcome, however the Minister notes that the proposal does not have any identifiable adverse safety risks and that any risks are moderated by the requirement that the reduced rest period would have to be compensated within a three week period.**

7.17 **The compromise text also requires operators to ensure that their drivers return to their home base from every six weeks to every four weeks. This revision could potentially have a beneficial effect on UK operators by reducing the level of competition to which they were exposed to from foreign drivers operating away from their home base, although we note that Department for Transport analysis[47] has shown that foreign HGV cabotage accounts for just one per cent of road freight activity within the UK, suggesting that any such effects would be marginal.**

7.18 **The most significant change proposed relates to the most politically contentious aspect of the package: the application of posting of workers rules to transport haulage workers. Here, it is proposed that drivers engaged in bilateral international trade will not be covered by the rules, whereas workers engaged in cross-trade and cabotage will be subject to posting rules. The proposed exemption from postings for bilateral international carriage will mean that hauliers undertaking such operations will not be subject to the new harmonised administrative requirements, such as the advance submission of a posting declaration. Conversely, cross-trade and cabotage operations (where foreign hauliers are directly competing with domestic hauliers for domestic work) will be explicitly within the scope of postings rules, and drivers undertaking them will be therefore be subject to the prevailing local minimum wage rates for the full duration of their time in a country. Our assessment is that the proposed compromise would address the concerns of hauliers in host countries (including the UK) that they are subject to unfair competition within their domestic markets from operators from other Member States with substantially lower minimum wage requirements. The Minister notes that this approach would create a clear distinction between different types of work as regards the application of the postings rules which the Government considers an improvement on the Commission's original proposal for a 'days-based' exemption rule.**

47 DfT, International Road Freight Statistics, United Kingdom, 2014 (26 November 2015).

7.19 **We grant the Government a waiver to support the proposed General Approach at Transport Council on 3 December 2018, as requested. In the meantime, we retain this proposal under scrutiny. We ask for the Minister to update us on the progress of the procedure, including in the European Parliament, in due course. We draw this report to the attention of the Business, Energy and Industrial Strategy Select Committee and the Transport Select Committee.**

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.

Previous Committee Reports

Thirtieth Report HC 301–xxix (2017–19), chapter 9 (6 June 2018); Fifth Report HC 301–v (2017–19), chapter 7 (13 December 2017).

8 Third mobility package: European Maritime Single Window

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted for a General Approach to be sought at the Transport Council of 3 December 2018
Document details	Proposed Regulation establishing a European Maritime Single Window environment and repealing Directive 2010/65/EU
Legal base	Article 100(2) TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Number	(39720), 9051/18 + ADDs 1–3, COM(18) 278

Summary and Committee's conclusions

8.1 The proposal under scrutiny seeks to address problems encountered with the operation of Directive 2010/65/EU on reporting formalities for ships arriving in and/or departing from ports in Member States (the Reporting Formalities Directive). The Reporting Formalities Directive requires Member States to introduce 'National Maritime Single Windows' (NSMW) to facilitate the electronic transmission of prescribed information — on a ship, its voyage, crew, passengers, cargo and security information — to relevant national authorities.

8.2 The proposed 'European Maritime Single Window environment' (EMSWe) would bring together, in a coordinated and harmonised way, all reporting obligations associated with port calls. This would be achieved by retaining the current system of NMSWs but introducing a European reporting 'gateway' above or on top of national systems (the EMSWe). This widget — or technical interface — would be based upon a common software module developed by the Commission that would provide harmonised user interfaces, procedures and data formats. The Commission labels this approach a 'one-stop-shop for reporting' and states that it will allow for the more efficient (re)use of data between national authorities (e.g. customs and border agencies).

8.3 A full background to the proposal — including the Committee's initial political and legal analysis — can be found in our first Report to the House of 14 November 2018. In response to our questions and requests for further information, Parliamentary Under Secretary of State at the Department for Transport (Nusrat Ghani), wrote to the Committee on 23 November 2018. The Minister addresses the points raised by the Committee and seeks clearance of the proposal from scrutiny or a scrutiny waiver so that the Government can support a General Approach likely to be sought by the Austrian Presidency in the Transport Council of 3 December 2018.

The Minister's letter of 23 November 2018

8.4 In her letter of 23 November the Minister provides an update on the current progress of negotiations on the EMSWe. The Minister states that Working Group discussions on the proposal have been positive and that the proposed text of the General Approach "represents a significant improvement on the Commission's original proposals". On the substance of the proposal, the Minister addresses the three main points raised by the Committee.

8.5 The Committee sought the Government's views on the absence of a customs legal basis for the EMSWe (given its potential use in fulfilment of customs reporting formalities). The Minister informs the Committee that Her Majesty's Revenue & Customs are considering this matter in light of the introduction of a new Article 8b to the proposal which sets out that:

> [The] Regulation shall not prevent the exchange of information between customs authorities of the Member States or between customs authorities and economic operators using the electronic data-processing techniques referred to in Article 6(1) of Regulation (EU) 952/2013…

8.6 The Committee also raised concerns regarding the apparent lack of legal oversight and specific governance arrangements for the storage and transmission of data from the EMSWe to — and between — national authorities. The Minister informs the Committee that it is her understanding that the EMSWe would not store any data *directly* but would rather act to facilitate the exchange of information between declarants and the individual NMSW's of Member States. As such, the Minister suggests that user access rights would be restricted in accordance with national rules. The Committee would add that where fundamental rights are engaged, EU-level legislation — such as the General Data Protection Regulation — will also be applicable.

8.7 The final substantive point the Committee raised in its first Report related to the apparent lack of an explanation or information in the proposal on how data sets would be harmonised (to ensure that standard definitions relating to reporting formalities are adopted across national authorities and Member States). The Minister states that additional material was added during Working Group negotiations to clarify this requirement. This relates, in particular, to guidance that the Commission consider the principles of the Reporting Formalities Convention — specifying that essential reporting information is kept to a minimum — when setting relevant standards.

8.8 In response to the Committee's questions on the likely timeline for the adoption of the proposal, the Minister informs us that the Austrian Presidency are pushing to conclude trilogue negotiations by early 2019 with adoption in late February at the earliest. The proposal currently specifies a transition period of six years after its entry into force. With regard to the UK's withdrawal from the EU, this takes the time by which the proposal would take effect in Member States outside of the transition/implementation period scheduled under the draft Withdrawal Agreement to end on 31 December 2020, barring any extension.

8.9 **We thank the Minister for her letter and the detailed response she has provided to our questions and requests for further information.**

8.10 **We are happy to agree to the requested scrutiny waiver so that the Government can vote in favour of the General Approach to be sought in the Transport Council of 6 December 2018. We do not believe clearance is appropriate given the technical nature of the proposal and wish to retain a watching brief over its progress up to and including trilogue negotiations.**

8.11 **We request a report on the outcome of the 6 December Transport Council detailing how the Government voted by 17 January 2019.**

Full details of the documents:

Proposed Regulation establishing a European Maritime Single Window environment and repealing Directive 2010/65/EU: (39720), 9051/18 + ADDs 1–3, COM(18) 278.

Previous Committee Reports

Forty-fourth Report HC 301–xliii (2017–19) chapter 4 (14 November 2018).

9 Third mobility package: revision of Directive on road infrastructure safety management

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted for a General Approach to be sought in the Transport Council of 3 December 2018
Document details	Proposal for a Directive of the European Parliament and of the Council amending Directive 2008/96/EC on road infrastructure safety management
Legal base	Article 91(1)(c) TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Number	(39722), 9040/18 + ADDs 1 — 4, COM(18) 274

Summary and Committee's conclusions

9.1 The Road Infrastructure Safety Management Directive (RISM)—Directive 2008/96/EC—was adopted in November 2008. The Directive seeks to ensure that road safety—and its improvement—is considered during the planning, design and operation of road infrastructure. In pursuit of reducing the number of people injured or killed in road accidents, the Directive requires Member States to establish road safety procedures on roads that form part of the trans-European transport network (known as TEN-T).

9.2 In light of stalled progress in reducing the number of fatalities on EU roads in recent years, the Commission proposes amending the Directive to:

- Mandate transparency and follow-up of infrastructure safety management procedures (by targeted 'road safety inspections' or remedial action);
- Introduce a 'network-wide road assessment' (a "systematic and proactive risk mapping procedure to assess the 'in-built', or inherent, safety of roads across the EU");
- Extend the scope of the Directive beyond TEN-T to cover motorways and primary roads outside of the core network as well as all roads outside of urban areas built—in whole or in part—using EU funds;
- Set general performance requirements for road markings and road signs; and
- Make it mandatory to consider vulnerable road users in all road safety procedures.

9.3 The proposal is part of the Commission's 'third mobility package' of legislative initiatives and non-binding actions (which is focussed on ensuring Europe's future mobility system is "safe, clean and efficient for all EU citizens"). Under the heading 'safe

mobility', the amended RISM Directive is accompanied by a proposal for the revision of the Vehicle General and Pedestrian Safety Regulation (which the Committee currently holds under scrutiny).

9.4 A full background to the proposal—including detail on the Commission's justification(s) for proposing to amend RISM and the Government's initial legal and political assessment of the proposal—can be found in our first Report to the House of 5 September 2018. In response to our initial questioning, Under Secretary of State at the Department for Transport (Jesse Norman), wrote to the Committee on 8 November 2018. This letter has since been supplemented by further correspondence from the Minister—dated 26 November 2018—requesting that the Committee clear the proposal from scrutiny so that the Government can support a General Approach to be sought in the Transport Council of 3 December 2018.

Minister's letter of 8 November 2018

9.5 The Minister's letter of 8 November covers four substantive points raised by the Committee in its initial Report.

9.6 First, the Committee asked the Government whether—under the proposal—changes would have to be made to UK road infrastructure management procedures, in particular, road safety impact assessments. In response, the Minister informs us that any changes to domestic procedures would be dependent upon the definition of 'primary' road adopted in the proposal. As introduced, the proposal tasked the Commission with defining the Union's primary road network, however, the Minister informs us that after Member States raised concerns with this suggestion at Working Groups, the text of the proposal was changed. It would now be for Member States to define their own primary road network. If this compromise is retained, the Minister is clear that no changes would have to be made to domestic infrastructure management procedures.

9.7 The text of the Presidency compromise includes a further change in this regard. Article 1(3) of the proposal now reads:

> This Directive shall also apply to roads and to road infrastructure projects not covered by paragraph 2 [specifying at 2(a) that Member States shall designate primary roads on their own territory] which are non-built-up roads situated outside urban areas and completed using Union funding…

9.8 The effect of the addition of the wording "non-built-up roads" on UK transport policy is unclear and was not raised by the Minister.

9.9 Second, the Committee asked which domestic agency would be charged with overseeing the proposed road safety procedures and assessing the potential costs associated with instituting these measures. We are informed that, in England, this task would fall to Highways England and could, depending upon the definition of a primary road adopted in the proposal, extend to agencies in the devolved administrations (e.g. the Department for Infrastructure in Northern Ireland).

9.10 Third, the Committee asked whether the delegation of power to the Commission under Article 12a of the proposal—to amend the Annexes to the Directive—was sufficiently clear in its objectives, content, scope and duration. The Minister tells us that

during Working Group discussions Member States raised concerns about the clarity of the wording of the delegation and its duration. As a consequence, it has been rewritten and limited to five years. Furthermore, a new requirement for the Commission to report on its exercise has been included.

9.11 Fourth, we requested that the Government kept us informed of developments on the proposal to set general road performance requirements for road markings and road signs. The Minister tells us that the ability—originally outlined in Article 6c of the proposal—for the Commission to set specifications for markings and signs has been removed at the request of Member States. In its place, a requirement for the Commission to report to the European Parliament and to the Council—on the detectability of road markings and road signs by drivers and automated/connected vehicles—has been included.

Minister's letter of 26 November 2018

9.12 In his letter of 26 November, the Minister summarises the main points of his previous letter—of 8 November—and requests the Committee clear the proposal from scrutiny so that the Government can support a General Approach likely to be sought by the Austrian Presidency at the December Transport Council. The Minister states that the General Approach is "likely to meet the Government's negotiating objectives".

9.13 **We thank the Minister for his letter and the detail with which he has responded to the Committee's questions and requests for further information.**

9.14 **As the Government has satisfactorily outlined its position on the proposal, we are happy to grant a scrutiny waiver for the December Transport Council. We do not believe it is appropriate to clear the proposal from scrutiny given the limited time for which it has been under negotiation.**

9.15 **We request a progress report on the outcome of the December Council detailing the text agreed and an update on negotiations by 7 January 2019.**

9.16 **Furthermore, we seek the Minister's view on the addition of the wording "non-built-up roads" to Article 1(3) of the proposal, in particular if, as a consequence, roads not currently forming part of the UK's strategic road network could fall under the purview of the proposal.**

Full details of the documents:

(39722), 9040/18 + ADDs 1 — 4, COM(18) 274.

Previous Committee Report

Thirty-seventh report HC 301–xxxvi (2017–19) chapter 10 (5 September 2018).

10 Commission Brexit preparedness proposal: Vehicle type approvals

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; waiver granted; further information requested; drawn to the attention of the Transport Select Committee and the Business, Energy and Industrial Strategy Select Committee
Document details	Proposal for a Regulation of the European Parliament and of the Council complementing EU type approval legislation with regard to the withdrawal of the United Kingdom from the Union.
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Number	(39857), 9716/18, COM(18) 397 final

Summary and Committee's conclusions

10.1 EU vehicle type approvals issued by the UK Vehicle Certification Agency (VCA) will automatically become invalid in other EU and EEA countries once EU law ceases to apply to the UK as a Member State. This will occur on March 29 2019, in the event of a non-negotiated exit, or on 31 December 2020 in the event of a negotiated exit, unless other arrangements are negotiated in the interim which allow the UK to retain the effects of EU membership in this policy area post-exit.

10.2 This raises the prospect of significant disruption to UK, EU and global manufacturers who have used the VCA to place vehicles on the EU market, who would potentially have to withdraw VCA-approved vehicles from the EU market, and secure new approvals from EU27/EEA type approval authorities before they could be marketed in the EU.

10.3 To address this situation, which has caused some uncertainty among manufacturers, the Commission has proposed draft Regulation (EU) 9716/18 which would create a mechanism that would permit manufacturers to transfer their VCA-issued type approvals to EU type approval authorities (TAAs) without the need for duplicate testing. In its explanatory memorandum regarding the proposal,[48] the Government indicated that it supported the proposal because it would limit the disruption to industry.

10.4 As anticipated, the legislative procedure has progressed at exceptional speed, as is necessary if manufacturers are to transfer their approvals prior to 29 March 2019. To this end, a mandate was issued through the Committee of Permanent Representatives

48 Explanatory Memorandum from the Minister to the Chair of the European Scrutiny Committee (20 June 2018).

(COREPER) on 24 October 2018, instead of a vote being taken in the Council of Ministers. The UK representative abstained as the scrutiny reserve had not been lifted, as the Committee had not been notified of this in advance.

10.5 In its report on 14 November 2018[49] the Committee noted that the Commission's proposal did not constrain the UK's ability to diverge from EU automotive regulation following EU exit, and indeed implicitly assumed that the UK and the EU would operate autonomous type approval systems.

10.6 The Committee also used its report to review the Government's own "no deal" preparations in the same policy area. In its guidance,[50] the Government proposed to allow the administrative conversion of EU-issued vehicle type approvals into UK approvals without additional testing, irrespective of whether the EU reciprocated, in order to minimise friction to trade. The Committee concluded that this approach was likely to diminish the volume of approvals and testing activity undertaken by the VCA, and to negatively affect its income, as it would make it economically rational for large-scale manufacturers targeting both markets to first secure their EU approvals from an EU TAA and then to administratively convert them into UK approvals, rather than to undergo two costly sets of testing.

10.7 Although the Minister (Jesse Norman) cited a wide range of mitigating factors which might potentially limit this impact—for example, EAA TAAs may not have the capacity to take on all the EU approvals activity currently undertaken in the UK—the Committee concluded that these factors did not alter its assessment. The Committee also sought further information on a variety of points related to the proposal and the implications of EU exit for the sector.

10.8 On 19 November the Minister provided the Committee with a further update[51] in which he provided, at the Committee's request, a list of the principal changes made to the text during negotiations, which he considers will benefit UK manufacturers with VCA-issued type approvals:

- the proposal now includes manufacturers of special purpose vehicles, which means that UK SMEs that convert vehicles for the EU market, such as those that produce wheelchair accessible vehicles, will not be disadvantaged;
- changes were made to improve clarity about the fees that an EU27 approval authority can charge for the transfer of the approval, which gives affected manufacturers greater certainty;
- a further concession will allow UK manufacturers to continue to place vehicles on the EU market that were manufactured under the original approval by VCA, before it was transferred to the EU TAA; and

49 Forty-third Report HC 301–xlii (2017–19), chapter 13 (14 November 2018).
50 HM Government, Guidance: Vehicle type approval if there's no Brexit deal (13 September 2018).
51 Letter from the Minister to the Chair of the European Scrutiny Committee (21 November 2018).

- an amendment provides manufacturers with clarity that the derogations and flexibilities provided by the type approval frameworks[52] will continue to apply to holders of VCA approvals. This will ensure that affected UK manufacturers can continue to use these provisions to place products on the EU market after we have left the EU.

10.9 The Committee also sought further information from the Minister regarding the UK's domestic approach to vehicle type approvals in a "no deal" scenario, including:

- what the impact would be if the Government took the alternative approach of requiring vehicles with EU approvals to undergo full testing and approvals processes in the UK;
- whether the Government assumed that alignment with EU vehicle regulation standards would continue in the long-term, even in a "no deal" scenario; and
- whether the Government had ruled out alignment with US vehicle regulations.

10.10 The Minister indicates that, to inform the decision-making process, the Government did in fact assess the impact of requiring mandatory retesting of EU-approved vehicles before they could be placed on the UK market post-exit. This assessment found that repeating testing for all EU approvals before exit day was "not logistically possible" due to the limited number of trained staff and time available. Furthermore, if the UK were subsequently to adopt this approach post-exit, the VCA would need to recruit "hundreds of additional staff" for ongoing tests and approvals. The Minister cites Society of Motor Manufacturers & Traders (SMMT) figures which suggest that approvals for passenger cars cost between £350,000 and £500,000 per model.[53] On the basis of this analysis, requiring the duplication of testing and approval process for the UK market would thus cost manufacturers "hundreds of millions of pounds in fees and administrative costs", and, if these costs were passed on to the consumer, "would increase the average price paid by those buying a new car by more than £100." The Minister concludes that the Government's approach is intended to avoid the need for costly double testing for access to both markets.

10.11 Asked whether the Government assumed that the alignment with EU vehicle regulation standards that it proposed in the event of a "no deal" scenario would continue in the long-term, the Minister states only that the majority of vehicle safety standards are agreed internationally at United Nations level, and "we will continue to play a leading role in developing those standards". The Government does not explicitly say whether it has ruled out alignment with US standards, stating only that "any decision to align with US standards would require further consideration of the implications for the environment, road safety and the potential impact for UK manufacturers and their customers".

52 For cars the main such derogation is "End of series derogations", which allows a limited quantity of vehicles with an approval that is no longer valid, to be registered for up to one year after the inception of a new standard. For non-road mobile machinery there are an array of flexibilities, which include an allowance that engines manufactured in compliance with regulations have a certain period to be placed on the market or installed in machinery even though the EU type approval is ostensibly no longer valid. There are also provisions that allow continued production of engines that are solely intended as replacement engines for fitment to older machines where the first engine has worn out.

53 https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Brexit-issue-paper-TYPE-APPROVAL.pdf

10.12 The Committee also asked the Government about plans it was developing to establish a company in an EU Member State, which would contract technical services work to the VCA, and whether there were any precedents for the EU agreeing bilateral agreements with third countries to allow the designation of technical services in a third country. The Minister states only that the VCA "is considering all options to ensure it can continue to provide technical services to its customers after exit", and that any arrangement would have to comply with the relevant provisions in Article 68 of the EU's type approval framework, Regulation (EU) 2018/858. We infer from this response that the Government is exploring creative legal arrangements, which it does not wish to discuss due to the sensitivities of the negotiations.

10.13 The Minister cites two precedents for the EU agreeing bilateral agreements with third countries to allow the designation of technical services in a third country: Switzerland and Australia. The Minister states that: "The Swiss arrangement [provides] mutually to recognise one another's approvals provided the two follow a common set of regulations." However, this does not represent a particularly useful precedent in the context of a non-negotiated exit, as ongoing integration of UK and EU goods regulation would clearly not exist in such a scenario. Even in the context of a negotiated exit, we note that Swiss preferential access to the EU single market for goods is linked to the acceptance of the free movement of persons.

10.14 The Minister states that the Australian agreement "recognises the results of testing and conformity of production procedures in areas where substantial regulatory equivalence is established, though there do not appear to be any technical services based in Australia." Having reviewed the relevant section of the EU-Australia Mutual Recognition Agreement[54] it is clear to us that its effects are limited to testing and approvals activity which has been harmonised through the United Nations Economic Commission for Europe (UNECE). The Agreement does not allow Australia to issue EU approvals or to provide the underlying testing services for EU approvals. Such an arrangement would not provide any significant market access over and above that which the UK already possesses through its membership of UNECE and its status as a signatory of the UNECE 1958 Agreement.

10.15 Despite the limited value of these precedents, the Minister nonetheless concludes that he would expect to secure an agreement with the EU on this matter post Exit, because of the "excellent reputation" of UK based technical services.

10.16 The Minister confirms that the proposal has been expedited, and that, as the amendments put forward by the European Parliament's Internal Market Committee are similar to those made in Council working group negotiations, significant changes to the proposal are unlikely to emerge from trilogue negotiations, and "the discussions are likely to be concluded quickly". The Minister indicates that the European Parliament is prepared to approve the expected compromise text in plenary on 11th December, and that the final text will be put to the Council of Ministers soon after this date for adoption.

10.17 The Minister indicates that, as the proposal is intended to minimise disruption in a no-deal outcome and has the support of UK industry, and given that the UK has secured

54 L 229/51 17.8.98 Agreement on mutual recognition in relation to conformity assessment, certificates and markings between the European Community and Australia (sectoral annex on automotive products to the European Community-Australia agreement on mutual recognition in relation to conformity assessment, certificates and markings), page 51.

its principal objectives in the negotiations, the Government will wish to support it in the Council of Ministers. He therefore requests that the Committee now clear the proposal from scrutiny.

10.18 **We thank the Minister for his rapid response to our report. He provides a helpful summary of the principal changes which have been made to the text (see paragraph 8) which are beneficial to manufacturers with VCA-issued approvals and concludes that the Government has secured its objectives in the negotiations. Trilogue negotiations are expected to conclude imminently as the amendments put forward by the European Parliament's Internal Market Committee are very similar to those made by the Member States. It is therefore anticipated that final text of the Regulation will be adopted in the Council of Ministers in December.**

10.19 **As the proposal will limit disruption at the moment of EU exit, and has the support of UK industry, the Minister indicates that the Government will wish to support it in the Council of Ministers, and requests that the Committee clear the proposal from scrutiny.**

10.20 **For clarity, we note that the proposal is strictly limited to VCA approvals issued and transferred to EU TAAs *prior to the moment that EU law ceases to apply to the UK*.[55] The proposal would not therefore mitigate the longer-term implications of EU exit for VCA approvals issued after the UK has left the EU and any implementation period has ended. The legal default, as set out by both the Commission[56] and the Government[57] in their notices to private stakeholders, remains that, post-exit, UK type approval authorities and testing authorities will no longer be able to issue EU whole vehicle type approvals or provide the testing that underpins these approvals,[58] in the absence of a bilateral agreement with the EU.**

10.21 **We do not wish to clear the proposal from scrutiny even at this late stage in case there are unexpected last-minute developments in the negotiations. However, on the basis of the information provided by the Minister we are willing to grant the Government a waiver to support the proposal at Council.**

Brexit implications

10.22 **We have also taken note of the Minister's responses to our questions regarding the Government's own domestic preparations for EU exit in this area.**

10.23 **The Minister confirms that, to inform its decision-making process about how to treat EU vehicle type approvals in such a scenario, the Government did explore the (subsequently discarded) policy option of requiring vehicles with EU TAA-issued approvals to undergo additional testing activity in the UK before being placed on the market. The Government concluded that doing so prior to a non-negotiated exit was not logistically possible, and that to do so post-exit would require "hundreds of additional**

55 This could be either March 29 2019 (in the event of a no-deal exit), 31 December 2020 (in the event of a negotiated exit), or a later date (to be agreed by the negotiators) in the event that the transition period should be extended.

56 Notice to stakeholders—Withdrawal of the United Kingdom and EU rules in the field of type approval of motor vehicles (29 January 2018).

57 UK Government, Guidance: Vehicle type approval if there's no Brexit deal (13 September 2018).

58 With the exception of components and tests which have been harmonised through UNECE.

staff", cost manufacturers "hundreds of millions of pounds in fees and administrative costs" and potentially "increase the average price paid by those buying a new car by more than £100." We have taken note of these impacts.

10.24 **Although the Government's preferred approach (of unilaterally allowing the conversion of EU TAA-issued approvals into UK approvals, without additional testing) will avoid these impacts, we reiterate our view that this approach will have negative impacts on the volume of approvals activity undertaken by the VCA and the income it derives from this activity, as it will make obvious economic sense for manufacturers targeting both the UK and EU markets to secure an EU Whole Vehicle Type Approval via an EU TAA and subsequently to administratively convert it into a UK approval, rather than to undergo two sets of testing.**

10.25 **The Committee has previously expressed doubts regarding the Minister's confidence that arrangements can be made to ensure that the VCA retains the ability to provide technical services to EU type approval authorities post-exit and asked the Minister to provide further information to support this view. The Minister reiterates that he "would expect the UK to secure an agreement with the EU on this matter post Exit", however the precedents he cites offer little encouragement: the EU-Australia Mutual Recognition Agreement he refers to is limited to UNECE approvals, and would therefore not address the implications of EU exit for the VCA. The agreement with Switzerland does provide for full participation in the EU type approvals system, but is part of an overall relationship which involves Switzerland accepting the free movement of persons, and is not compatible with the Government's negotiating position.**

10.26 **As noted above (paragraph 20), we grant the Government a waiver to support the proposal at the forthcoming vote in the Council of Ministers in December. We retain the proposal under scrutiny and ask for an update on the outcome of Council and the final text that is agreed by 16 January 2018. We draw this report to the attention of the Select Committees for Transport and Business, Energy & Industrial Strategy.**

Full details of the documents:

Proposal for a Regulation of the European Parliament and of the Council complementing EU type approval legislation with regard to the withdrawal of the United Kingdom from the Union: (39857), 9716/18, COM(18) 397 final.

Previous Committee Reports

Forty-third Report HC 301–xlii (2017–19), chapter 13 (14 November 2018); Thirty Eight Report HC 301–xxxvii (2017–19), chapter 13 (12 September 2018).

11 Multiannual financial framework 2021–27: Connecting Europe Facility

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; request for clearance from scrutiny or a waiver rejected; drawn to the attention of the Transport Committee, the Business Energy and Industrial Strategy Committee and the Digital Culture, Media and Sport Committee
Document details	Proposal for a Regulation of the European Parliament and of the Council establishing the Connecting Europe Facility and repealing Regulations (EU) No 1316/2013 and (EU) No 283/2014
Legal base	Articles 170 — 172 and 194 TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Numbers	(39885), 9951/18 + ADDs 1–2, COM(18) 438

Summary and Committee's conclusions

11.1 The Connecting Europe Facility (CEF) is the Union's dedicated infrastructure funding programme for the 'trans-European Networks' ('TENs'). Trans-European networks exist in the areas of transport (TEN-T), energy (TEN-E) and telecommunications (eTEN). Financing of 'projects of common interest' on TENs is made through CEF by way of grants, guarantees and project bonds. The Commission—in cooperation with stakeholders—selects projects of common interest based upon their ability to improve infrastructure connections between Member States.

11.2 The proposal under scrutiny concerns the repeal of the current CEF Regulation ((EU) 1316/2013) and the eTEN Regulation ((EU) 283/2014).[59] The proposal is published as part of the Commission's 'Multiannual financial framework' for 2021–27 and is said to be focussed on reinforcing the Energy Union, fulfilling the Union's commitments under the Paris Agreement and consolidating the Union's leadership in the fight against climate change.

11.3 The proposal sets a budget of €42.2 billion (£36.9 billion) for CEF between 2021–27 and outlines the objectives of the programme, its structure and priorities, mechanisms for the delivery of funding and arrangements for monitoring and evaluation. In each of these areas, the proposal is broadly similar to the current iteration of CEF but with small tweaks

59 In addition to the CEF Regulation, Regulations covering TEN-T, TEN-E and eTEN set guidelines for the funding of infrastructure projects in each area. In effect, CEF is the facilitating programme for the realisation of their individual objectives.

suggested to improve the delivery of funding—and the effectiveness of outcomes—and changes designed to exploit synergies between the programme and Union-level objectives in other areas (e.g. the completion of the Energy Union).

11.4 Suggested changes worthy of note include: a nominal increase in budget; the rationalisation of funding types held under CEF (with, for example, dedicated investment instruments being moved to the Union's InvestEU programme); the introduction of a dedicated funding stream for military mobility projects; extending the scope of TEN-E (energy) towards targeted cross-border coordination in renewable energy infrastructure; and redefining the scope of eTEN to focus on the delivery of digital infrastructure as opposed to digital services (to be renamed 'TEN-Digital').

11.5 A full background on the proposal—including a detailed exposition of the programmes objectives and, importantly, in the context of the UK's withdrawal from the EU, the conditions for 'third country' association to CEF—can be found in our first Report to the House of 10 October 2018. In response to the questions asked of Government and our requests for further information, Parliamentary Under Secretary of State for Transport (Baroness Sugg), wrote to the Committee on 26 November 2018. The Minister requests the Committee clear the proposal from scrutiny or grant a scrutiny waiver so that the Government can support a partial General Approach to be sought by the Austrian Presidency in the Transport Council of 3 December 2018.

Minister's letter of 26 November 2018

11.6 The Minister's letter of 26 November fails to directly address the questions asked of the Government in the Committee's first Report. On the substance of the proposal, the Minister describes—at some length—the Commission's justifications for action, however, as explicitly requested, provides very little information on the Government's *own* views on the proposal. For ease of reference, these questions are reproduced in the annex to this Report.

11.7 One point the Minister does respond to clearly is whether the Government has, or plans to have, consultations with stakeholders on proposals to simplify the application process for funding under CEF. In response, the Minister states that "[there] are no plans to do so because the UK will have left the EU before the Regulation comes into effect". Of course, the Minister's response is contingent upon the agreed transition/implementation period under the Withdrawal Agreement ending on 31 December 2020.

11.8 Rather oddly, given the failure to engage with our questioning on the substance of the proposal, the Minister directly addresses our questioning on whether the Government will seek association to CEF as a third country for 2021–27.

11.9 The Minister informs us that if the UK sought association to CEF after withdrawal from the EU—and the EU agreed to this—participation would likely have to be based upon a specific agreement. In this regard, the Minister states that a decision on whether the UK should seek association has not yet been made but that, irrespective of this, the Government has been engaging in Working Group negotiations to ensure that the text of the proposal does not preclude future UK participation.

11.10 Worthy of specific mention is the Minister's contention that whereas the UK makes an average contribution of 13% to the EU budget, for transport, UK receipts have been less than 3% of funding available under CEF. This statement is used in support of the Minister's belief that not participating in CEF after 2021 would have only a limited impact upon domestic infrastructure funding.

11.11 **We are disappointed with the quality of the Minister's response to our first Report to the House of 10 October 2018, in particular, her failure to provide the Committee with a complete account of the Government's views on the substance of the proposed CEF Regulation for 2021–27.**

11.12 **At the time of our first Report, we raised concerns that the Minister's** Explanatory Memorandum **did not adequately address the potential implications of the proposal for UK transport law and policy or its content in light of negotiations on the UK's withdrawal from the EU. Taken together, the Minister's approach to the proposal raises questions regarding her commitment to the effective scrutiny of EU documents.**

11.13 **Against this background, the Minister requests that the Committee clear the proposal from scrutiny or grant a scrutiny waiver so that the Government can support a partial General Approach to be sought by the Austrian Presidency in the Transport Council of 3 December 2018.**

11.14 **As the Minister has failed to clearly set out the Government's position on the substance of the proposal and has not provided the Committee with any indication as to what will be covered by the partial General Approach to be sought by the Austrian presidency, we are not content to clear the proposal from scrutiny or grant a scrutiny waiver.**

11.15 **We request a progress report on the outcome of the December Council detailing the text agreed and an update on negotiations by 7 January 2019.**

11.16 **We draw this Report to attention of the Transport Committee, the Business, Energy and Industrial Strategy Committee, and the Digital, Culture, Media and Sport Committee.**

Full details of the documents:

(a) Proposal for a Regulation of the European Parliament and of the Council establishing the Connecting Europe Facility and repealing Regulations (EU) No 1316/2013 and (EU) No 283/2014: (39885), 9951/18 + ADDs 1–2, COM(18) 438.

Previous Committee Reports

Thirty-ninth report HC 301–xxxviii (2017–19) chapter 6 (16 October 2018).

Annex

- With regards to the substance of the proposal, we seek the Government's views on the following points:
- The proposed budget for CEF and the individual allocations suggested. As has been raised by a number of stakeholders, the allocation for 2021–27 amounts to a decrease in funding—in real terms—versus the 2014 — 20 iteration of the programme;
- If the proposal to utilise CEF in pursuit of new objectives—such as the Union's climate change commitments under the Paris Agreement—and the introduction of new area specific objectives, for example, the promotion of connected mobility on TEN-T, risk undermining the raison d'être of the TENs: to connect and develop Europe's 'hard' infrastructure;
- The discontinuation of eTEN and its replacement with TEN Digital, in particular, the change in focus in this area from funding the development of digital services to hard infrastructure. Furthermore, the specific priorities identified for TEN Digital (e.g. supporting the delivery of Gigabit internet connectivity, high-quality local wireless connectivity and the deployment of 5G mobile networks);
- The changes the Commission is proposing to simplify the application process for project promoters and, whether there has been, or there are plans to, consult UK-based stakeholders on their views;
- The proposal to earmark €6.5 billion of CEF for the improvement of transport infrastructure to support rapid military deployment. Whether such projects should be aimed solely at military applications or should also carry a benefit for civilian usage.
- Given previous Government reservations concerning the Defence Union, if it is content with contributing towards a fund that it would, presumably, have little interest in making use of;
- The changes sought to the framework of CEF/TEN—by way of the repeal of the eTEN Regulation and the inclusion of the substance of TEN Digital in the next CEF Regulation—and if such changes would lead to incoherence (the same can be said of the inclusion of the proposed renewables objectives in the CEF Regulation and not in the TEN-E Regulation); and
- The omission from the proposed CEF Regulation of detailed objectives linked, where applicable, to the individual TEN Regulations and if this could threaten the overall coherence of the future programme.

12 Brexit: EU supervision of UK-based central counterparties

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted; drawn to the attention of the Exiting the EU and Treasury Committees
Document details	(a) Proposal for a Regulation on the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs; (b) Recommendation for a Decision amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank
Legal base	(a) Article 114 TFEU; ordinary legislative procedure; QMV; (b) Article 129(3) TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (38840), 10363/17 + ADDs 1–3, COM(17) 331; (b) (38883), 10850/17

Summary and Committee's conclusions

12.1 During the financial crisis, the lack of transparency in the trading of over-the-counter (OTC) derivatives, like currency or interest rate swaps, led to major financial stability risks. This resulted in the EU adopting the 2012 European Markets Infrastructure Regulation (EMIR), which obliges market participants to 'clear' most types of OTC derivative trades through a central counterparty (CCP), which is paid to take on most of the credit risk of both the buyer and the seller (meaning that, if either counterparty defaults on their obligations, the CCP absorbs most of the loss and insulates the other counterparty).[60]

12.2 Within the EU, the clearing obligation must normally be fulfilled by a CCP based in the European Union, which holds an automatic 'passport' to operate in any EEA country.[61] Alternatively, the trade can be cleared by a non-EU CCP, if it is located in a 'third country' whose regulatory regime has been approved by the European Commission as equivalent to EMIR, *and* the individual CCP has been granted formal recognition by the EU regulator (the European Securities & Markets Authority or ESMA).[62] The UK is home to the world's

60 To ensure these credit risks are managed sustainably rather than simply transferred to the CCP, the central counterparty is subject to strict prudential and organisational requirements.

61 EMIR was incorporated into the EEA Agreement, thereby extending it to Norway, Iceland and Liechtenstein, by Decision 206/2016 of the EEA Joint Committee of 30 September 2016. There are currently no CCPs authorised under EMIR based in those three countries.

62 Under EU law, regulated financial services providers that trade in derivatives—notably banks and investment firms—face additional prudential requirements if they clear transactions on CCPs that are not authorised or recognised under EMIR.

largest clearing industry. For example, its three central counterparties are responsible for clearing three-quarters of euro-denominated interest rate swaps, which are the largest category of OTC derivatives.[63]

12.3 In June 2017, three months after the UK notified its intention to withdraw from the EU, the European Commission proposed amendments to EMIR that would — among other things[64] — introduce a 'location policy' for CCPs. In a nutshell, the proposal means that ESMA could refuse or withdraw recognition from a third country CCP (which otherwise meets all the conditions for offering clearing services within the EU), if by virtue of the size of their operations they have, or could become, "systematically important" to the Union's financial stability. In those cases, the Commission takes the view that such entities should be supervised within the framework of EU law. The logic of the 'location policy' is that loss of recognition would lead to a loss of market access for the CCP in question, thereby incentivising — or forcing — it to relocate its European business to an EEA country. In parallel, the European Central Bank (ECB) also asked for an amendment to its Statute that would give it a separate power to also require CCPs which clear substantial volumes of derivatives denominated in euro to relocate to a Eurozone country.

12.4 Negotiations on both CCP proposals have progressed steadily in the Council of Member States and the European Parliament since 2017. Separately, the UK and the EU in November 2018 agreed in the outline of the political declaration accompanying the UK's Withdrawal Agreement that cross-border market access for financial services after Brexit will be based on 'equivalence' decisions. This effectively confirms that the access of UK-based CCPs to the EU's clearing market after the post-Brexit transitional period[65] will be governed by the equivalence and recognition regime under EMIR, including the proposed amendments relating to systemically important CCPS as and when they take effect. (In the event of a 'no deal' Brexit, the European Commission has said it will seek to declare the UK's regulatory system for clearing services as 'equivalent' for a limited period of time, to avoid immediate disruption to market infrastructure on 29 March 2019.)

12.5 In light of the impact the EMIR equivalence and proposed location policy regime will have on British CCPs after Brexit, the UK Government has consistently opposed the Commission and ECB proposals. All three British-based CCPs will automatically become 'third country' entities under EMIR when the UK leaves the Single Market, and therefore potentially subject to pressure to relocate at least partially to the EU (given their outsized role in the clearing of euro-derivatives, it is not unlikely they will be seen by ESMA as 'systemically important'). The Treasury has argued that the UK has a robust supervisory system in place for its CCPs, and that the proposal "risk[s] fragmenting global derivatives markets" and "increase the cost of trading and clearing". Despite the UK's opposition, both the European Parliament and a majority of EU Member States support the fundamentals of the proposed location policy for 'third country' CCPs. As such, it is likely it will become European law.

63 Commission Impact Assessment SWD(2017) 246.

64 The proposal would also change the way EU-based central counterparties are supervised. See "Background" for more information on the other elements of the Commission proposal and a related proposal to amend the Statute of the European Central Bank.

65 During the proposed post-Brexit transitional period, the UK would continue to apply EU law and remain in the Single Market. As a consequence, UK CCPs would remain authorized to operate throughout the EEA without needing any new authorisations, licences or permissions.

12.6 The Economic Secretary to the Treasury (John Glen) wrote to the European Scrutiny Committee on 21 November 2018, summarising developments in the legislative deliberations on the proposals since May 2018. This reiterates that the location policy has sufficient support among the remaining EU Member States to be incorporated into EMIR in some form in the near future. However, the Minister also noted that MEPs and national governments are exploring substantive amendments that would soften the impact of the original Commission proposal. Options being explored include the possibility of limiting recognition only to certain service lines, rather than simply all or none of a CCP's activities; phasing in any withdrawal of market access from a non-EU CCP through a transitional or adaptation period; and limiting the effects of withdrawing recognition only to new contracts, leaving derivatives already cleared unaffected. It also remains unclear how the location policy powers of the Commission and the ECB would interact.

12.7 The Minister's letter also notes that the European Parliament adopted its formal position on the proposals in May this year. Moreover, in November the Austrian Presidency of the Council also published its latest compromise legal text incorporating the changes referred to in the previous paragraph into the Commission proposal. This text is due to be considered by the Member States, with a view to its possible political endorsement, at a forthcoming meeting of EU Finance Ministers (potentially as early as 4 December 2018). If adopted, this would form the basis for negotiations with the European Parliament on the final text of the changes to EMIR and the Statute of the European Central Bank. The Minister requests a scrutiny waiver in advance of the Council meeting, so the Government can support the compromise legal text if it believes it is in the UK's interest do so.

12.8 If agreement is reached at the meeting between Ministers on 4 December, negotiations with the European Parliament on amendments to the supervision of non-EU CCPs could take place in early 2019. The exact timetable for adoption of the proposals, and therefore the timing of their entry into force, is not yet clear.

Our conclusions

12.9 **We thank the Economic Secretary for his update on these EU proposals relating to supervision of 'third country' CCPs. We appreciate that the Government's position in these negotiations is finely balanced, given that the UK would be affected by the proposed approach to non-EU CCPs more than any other country after it has left the European Union. We note in this respect that the impact will depend, at least initially, on whether the UK's Withdrawal Agreement is ratified. If so, the UK will remain part of the Single Market — with the concomitant 'passporting' rights for its CCPs — until at least December 2020.[66] Any changes to EMIR related to EU-based CCPs that take effect during that period would then also apply to UK central counterparties.**

12.10 **However, at some stage — whether in March 2019 in the eventuality of a 'no deal' Brexit, or at the end of any transitional period under the Withdrawal Agreement — UK-based central counterparties will become 'third country' entities for the purposes of EU law. Under EMIR, they will then effectively lose access to the EU market unless the UK's regulatory regime is formally approved as 'equivalent', and the individual CCP is recognised by ESMA to perform clearing functions for EU-based counterparties. The way in which the 'location policy' proposal could affect UK CCPs will be dependent**

66 Article 132 of the draft Withdrawal Agreement provides for the possibility of an extension of the transitional period by mutual agreement between the UK and the EU.

on the final text of the legislation, although there clearly is a risk that it could be used to put regulatory pressure on them to relocate more of their activities to the European Union after Brexit.

12.11 **We also remain concerned about the complexity of the proposed supervisory arrangements, if the European Central Bank, national regulators, ESMA and the European Commission have concurrent or overlapping supervisory powers over the clearing industry. The Minister's latest letter notes the Member States are seeking to prevent CCPs from receiving conflicting instructions from different regulators, but as negotiations are still on-going it is not yet clear what the final outcome will be.**

12.12 **In light of the broad level of support among the other Member States (and within the European Parliament) for the proposals, including some form of 'location policy' for non-EU CCPs, the Government has sought to take a constructive position in the negotiations. Given the UK's exit from the EU, it is right that the Treasury and Bank of England should be working to ensure the amendments to EMIR are carefully drafted, minimising the risk of unnecessary fragmentation of markets infrastructure that would be detrimental to both the UK and the remaining EU Member States.**

12.13 **Given the above, we are content to grant the Minister the scrutiny waiver he has requested. This means the Government is free to support a general approach within the ECOFIN Council, should it consider it is in the UK's interest do so. If a general approach is adopted in December 2018, we ask the Minister to write to us to explain the substance of the adopted text (especially as regards any changes to the Presidency's latest compromise proposal). Similarly, if no decision is taken at the December 2018 Council because too many contentious issues remain outstanding in the negotiations, we ask the Minister to write to us again before a trilogue mandate is considered by COREPER or the Council at a later stage to indicate what, if any, substantive changes were made to the Council's position in the interim. At that stage, we will consider whether to maintain or revoke the scrutiny waiver.**

12.14 **A separate legislative proposal to overhaul the operation of EMIR more generally to amend the specific clearing and reporting obligations incumbent on financial market participants, referred to as 'EMIR REFIT', is also still under consideration. We understand discussions between the Member States and the European Parliament on the final legislative act have been slow, and it remains under scrutiny. We will consider the implications of this proposal for the UK financial services industry during the post-Brexit transitional further in due course.**

12.15 **We draw these developments to the attention of the Exiting the EU and Treasury Committees.**

Full details of the documents:

(a) Proposal for a Regulation on the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs: (38840), 10363/17 + ADDs 1–3, COM(17) 331; (b) Recommendation for a Decision amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank: (38883), 10850/17.

Background

12.16 In 2012, the EU adopted the European Markets Infrastructure Regulation (EMIR)[67] to address the financial stability risks posed by the trade in over-the-counter (OTC) derivatives, which had become apparent during the financial crisis.[68] It was driven by an international effort to regulate the market for such derivatives more closely, as set out in the G20's Pittsburgh Declaration in September 2009.

12.17 EMIR requires most OTC transactions that involve an EU-based counterparty, for example interest rate or currency swaps, to be 'cleared' through a central counterparty (CCP) (the 'clearing obligation'). This means the CCP steps in if either of the other two counterparties defaults, compensating the other counterparty so that no loss to them occurs (and thereby centralising risk in an entity established with the necessary prudential and organisational requirements to assess the risks of its exposures). Derivatives trade and defaults within the scope of EMIR are reported to a trade repository (the 'reporting obligation'), to enhance the transparency of the market and prevent defaults from building up and threatening financial stability.

12.18 The EMIR Regulation incentivises EU-based counterparties to fulfil their clearing obligation using a CCP based in, and supervised by, a country within the Single Market (or based in a "third country" whose regulatory regime has been formally deemed "equivalent" to EMIR by the European Commission, and subject to firm-specific recognition by the European Securities & Markets Authority ESMA).[69] Such 'equivalence decisions' are currently in place for 16 countries, including the United States, Switzerland, Australia and India.[70] Thirty-two CCPs from these countries have been individually recognised by ESMA to perform clearing services within the EU.[71]

12.19 According to the Bank for International Settlements, the notional amount of outstanding OTC derivatives contracts was $532 trillion (£415 trillion) at the end of 2017, with a gross market value of $11 trillion (£8.6 trillion). The vast majority of outstanding derivatives trades relate to either foreign exchange or interest rate swaps.[72] The Bank for International Settlements has stated that the UK is the single largest venue for OTC derivatives activity. For euro-denominated interest rate derivatives the UK is the largest centre, clearing 75 per cent of all such transactions.[73] There are currently three UK-based CCPs recognised under EMIR.[74]

67 Regulation 648/2012.

68 A lack of transparency of the trade in derivatives masked unsustainable exposures of major market participants, which ultimately led to the collapse of both Lehman Brothers and AIG. OTC derivatives are negotiated privately, and not traded on an exchange.

69 EMIR does not formally prohibit counterparties from clearing their derivatives contracts through CCPs not authorised in or recognised by the EU, but doing so imposes significantly higher capital charges on banks and investment firms.

70 See https://ec.europa.eu/info/sites/info/files/emir-equivalence-decisions_en.pdf. The relevant decisions are listed under Article 25(6).

71 See https://www.esma.europa.eu/file/22275/download?token=UmaBe2-f.

72 See https://www.bis.org/publ/otc_hy1805.pdf.

73 Commission Impact Assessment SWD(2017) 246.

74 ICE Clear Europe Limited, LCH, Clearnet Limited and LME Clear Limited. There are 16 CCPs authorised across the EU as a whole.

Proposals to enhance EU supervision of CCPs

12.20 In June 2017 — only three months after the UK's formal notification of its withdrawal from the EU — the European Commission proposed amendments to EMIR relating specifically to the supervision of both EU and non-EU ('third country') CCPs, and the conditions for the latter's access to the EU market for OTC derivative clearing.

12.21 With respect to EU-based CCPs, the proposed Regulation would introduce new supervisory powers for the European Securities & Markets Authority (ESMA) and the "Central Bank of Issue" or CBI (i.e. the Central Bank which issued the currency of the OTC transaction, which would usually be the European Central Bank). The Commission also sought to give ESMA a larger role in the granting or withdrawing of authorisation for CCPs, and in the day-to-day oversight of such firms.

12.22 However, the most controversial elements of the proposal were aimed at increasing EU oversight of non-EU CCPs via ESMA and the European Commission. Notably, it would introduce a 'location policy' power allowing the Commission to, exceptionally, refuse recognition to a third country CCP considered systemically-important to the EU's financial stability.[75] A loss of recognition would effectively shut them out of the EU market for clearing services, acting as a powerful incentive to relocate the necessary parts of their business to the EU. An explicit act of non-recognition would need to be approved by a qualified majority of EU Member States.[76] The stricter supervisory standards for third country CCPs were driven, by the Commission's own admission, by the UK's departure from the EU and the perceived need to increase EU-level oversight of British-based CCPs that fulfil critical functions for liquidity in the European economy.[77]

12.23 Separately to the Commission proposal, the European Central Bank also asked for an amendment to its Statute in relation to CCPs.[78] This would authorise it to implement its own version of the 'location policy', requiring clearing houses with a large exposure to euro-denominated derivatives to relocate to the Eurozone, and thus come under the direct supervision of the ECB.[79] (A previous attempt by the ECB to enforce its supervisory powers in this area where struck down by the European Court of Justice in 2015 at the request of the UK Government, on the basis that the Bank lacked the explicit legal authority to do so.)[80]

75 Actual or potentially systemically-important CCPs are referred to as "tier 2" in the draft Regulation.

76 A decision to refuse recognition would be made by the European Commission in the form of an Implementing Act, acting on a recommendation from ESMA.

77 The Explanatory Memorandum accompanying the original Commission proposal notes that "a substantial volume of euro-denominated derivatives transactions (and other transactions subject to the EU clearing obligation) is currently cleared in CCPs located in the United Kingdom". This, it argued, would lead to a "distinct shift in the proportion of such transactions being cleared in CCPs outside the EU's jurisdiction" which would in turn imply "significant challenges for safeguarding financial stability in the EU that need to be addressed".

78 Two other EU legislative proposals related to CCPs — one referred to as 'EMIR REFIT' which would amend the specific circumstances in which the reporting and clearing obligations apply to companies trading in derivatives, and one on crisis interventions in a failing CCP — also remain under scrutiny, but are not covered by this Chapter.

79 A change to the ECB's Statute would previously have required a motion of approval in both Houses of Parliament under the European Union Act 2011 as part of the UK's enhanced parliamentary scrutiny of certain EU decisions. However, the relevant section of the 2011 Act was abolished by regulations under the European Union (Withdrawal) Act 2018 in July 2018, and consequently the Government can now allow the changes to be adopted — including by voting in favour or by abstaining — without needing explicit parliamentary consent

80 Judgement in case T-496/11 (4 March 2015).

12.24 The UK Government has strongly opposed the proposed relocation powers for either the Commission or the ECB, which the Treasury has argued would "risk fragmenting global derivatives markets", which in turn would "increase the cost of trading and clearing, acting as a drag on growth and could discourage firms from hedging their risks using derivatives markets". Its position has, naturally, been coloured by the fact that British CCPs will become 'third country' entities after the UK leaves the Single Market at the end of the post-Brexit transitional period. As such, the Commission proposals were clearly intended, in part, to extend the EU's supervisory oversight and regulation to British clearing houses even after Brexit, in the most extreme cases shutting them out from the EU market to encourage them to relocate an EU Member State.

12.25 Despite the UK's opposition, in April 2018 the Economic Secretary to the Treasury (John Glen) informed us that both the Member States and the European Parliament were likely to accept the proposal to allow recognition to be withheld from systemically-important non-EU CCPs, but that concerns had been raised about the 'location policy' as drafted by the Commission.[81] We set out the detail of the Commission and ECB proposals in some detail in our Reports of November 2017 and May 2018.

Developments since May 2018

12.26 The Economic Secretary provided a further update by letter dated 21 November 2018, with information about the various elements of the Commission and ECB proposals.

ESMA and Commission supervision of non-EU CCPs

12.27 The Minister's letter explained that European Parliament's Economic & Monetary Affairs Committee in May 2018 by a large majority called for amendments to the proposal to mitigate the impact of the Commission's 'location policy'. Notably, MEPs recommended that the Commission's refusal of a CCP's recognition could be partial (meaning in respect of certain asset classes it could still fulfil the clearing obligation under EMIR, while for other service lines it would need to establish an EU-based entity), and have sought to introduce an ability to narrow the scope of a "denial of recognition" decision to new derivatives contracts only, rather than existing ones.

12.28 Deliberations on the proposal have also continued among the Member States in the Council, albeit at a slower pace. Under the latest set of amendments produced by the Austrian Presidency in early November 2018, it would still be an option for the European Commission to refuse recognition to non-EU CCPs (on the ground that they were of such systemic importance that they should be based in the European Union). However, under this compromise text, the location policy could only be invoked on the basis of "robust evidence" (such as a quantitative technical assessment of the costs and benefits and consequences of a decision not to recognise a non-EU CCP for the purposes of the clearing obligation under EMIR). It also contains similar mitigating provisions as the Parliament's text, for example relating to limiting recognition to specific service lines and

81 The Minister noted at the time that some other Member States, notably Sweden, shared the UK's misgivings about the location policy for non-EU CCPs. In addition, the US authorities have noted that the proposal "goes beyond the US framework and indicated that the US may need to reconsider their regulatory framework in response to the final outcome" of the EU's legislative process.

introducing transitional periods to cushion the impact of a third country CCP leaving the EU market. The Member States have not yet decided whether to collectively accept these changes as drafted by the Presidency.

Supervision of CCPs by the European Central Bank

12.29 In parallel, the Parliament and Council have also been considering the ECB's request for new supervisory powers — including its own 'location policy' — for CCPs that clear substantial volumes of euro-denominated derivatives.

12.30 The Minister's latest update explained that the European Parliament has favourably viewed the Bank's request. However, MEPs have "attempted to balance the independence of central banks against the need to ensure CCPs do not receive conflicting instructions from ESMA and the ECB", by requiring the ECB to act "with due regard […] and in a manner which is fully consistent" with "the legal acts of the European Parliament and the Council and with measures adopted under such acts" (that is to say, any decisions relating to recognition of individual CCPs under the revised EMIR Regulation).

12.31 The Council is also considering its own approach to amending article 22 of the ECB's Statute, having agreed — in the Minister's words — that it was "essential to better understand the role of central banks of issue in EMIR in advance of discussing the proposal in depth". The latest compromise text circulated by the Austrian Presidency would involve the ECB in the processes for recognition of third country CCP as outlined in EMIR (compared to the European Parliament's approach as described above, which gives the ECB concurrent powers with ESMA and the Commission).[82]

The Government's position on EU supervision of non-EU CCPs

12.32 The Minister's letter states that both the European Parliament and the Presidency compromise text relating to EMIR and the ECB Statute "could be considered an improvement on the original [Commission proposal] in some areas", especially when it comes ensuring recognition decisions are based on a "robust analysis" of the potential impact on the European economy. However, the Government still has concerns about the fundamentals of the 'location policy' which — even in the forms proposed by the Parliament and the Austrian Presidency — risk "cutting the EU off from the global liquidity pools" provided by UK-based CCPs and "will ultimately raise costs for EU businesses".

12.33 The Minister also said that the final amendments to the EMIR legislation should:

- "properly reflect" the principle of regulatory deference, meaning that the EU's legal framework for systemically-important third country CCPs should normally allow them to be supervised by their home regulator (e.g. the Bank of England);
- "not constrain EU authorities in making appropriate judgements that protect the proper functioning of global markets" (that is to say, the law as amended should not require ESMA and the Commission to refuse recognition where that is clearly detrimental for the EU's access to international market infrastructure); and

82 The Presidency's compromise text for the ECB Statute would allow the Bank to "take part in procedures under Union law related to the recognition of such clearing systems for financial instruments".

- "avoid the potential for conflict" in instructions issued to CCPs by the different regulatory bodies by whom they would be overseen, given the complex interplay between the proposed responsibilities of ESMA, the Commission, national regulators and the European Central Bank in the field of clearing.

12.34 Another issue of contention, which the Minister does not refer to in his letter, will be whether a decision to refuse recognition to systemically important third country CCPs would be made by Delegated Act — giving both the European Parliament and the Member States the power to block the decision — or Implementing Act (in which case only the Member States would be asked to approve the decision by qualified majority). The Parliament is likely to push for a Delegated Act, given this would increase its control over the process.

Supervision of EU-based CCPs

12.35 The final element of the amendments to EMIR under discussion relate to the way in which EU-based CCPs are supervised, and the division of responsibilities between ESMA and national regulators. The Minister's letter of 21 November 2018 notes that European Parliament has established a position this aspect of the proposal, which "makes some changes to the original Commission proposal" but apparently leaves the fundamentals unaltered.[83]

12.36 Within the Council, discussions among Member States have led to some "progress on the framework for EU CCPs". The Minister explained that the Austrian Presidency's latest compromise proposal is to make changes to the college framework, the system that brings together all relevant national regulators in the EU plus a representative of ESMA (given that the activities of CCPs will often be relevant to more than one EU Member State). In parallel, an overarching "CCP Supervisory Committee" would be established inside ESMA, with two different configurations responsible for EU and third country CCPs. Under this revised text, ESMA would take on some additional responsibility in the supervision of EU CCPs, including providing draft opinions on some regulatory decisions to be taken by national competent authorities, but "to a lesser extent than envisaged in the original Commission proposal".

Next steps in the legislative process

12.37 The Economic Secretary's latest letter noted that the Austrian Presidency was looking to secure formal support among the Member States for its compromise texts for both the EMIR and ECB Statute proposals, in the form of a 'general approach', possibly as early as the meeting of EU Finance Ministers on 4 December 2018. This would then allow the Presidency to begin negotiations with the European Parliament on the final text of the amendments, with a view to their formal adoption in 2019.

12.38 The Government is hoping to secure an acceptable legislative compromise that it can support, and in view of this the Minister has requested a scrutiny waiver enabling the UK to vote in favour of a general approach as and when it is formally considered by the Council.

83 See our Report of 22 November 2017 for more information on the proposals relating to EU-based CCPs. Given the importance of the 'third country' framework for the UK in the context of its withdrawal from the EU, it has been the focus of this chapter.

Implications of Brexit for clearing of OTC derivatives

12.39 As the Minister recognises, the proposed changes to the supervision of non-EU CCPs are of critical importance for the British clearing industry in the context of the UK's withdrawal from the European Union. Despite their crucial role in providing liquidity for the European economy, after the UK leaves the Single Market they will automatically lose their 'passporting' right to provide clearing services throughout the European Economic Area. Instead, British CCPs will fall within the scope of the 'third country' provisions of EMIR, as amended, when the UK leaves the Single Market.

12.40 The draft Withdrawal Agreement on the UK's exit from the EU, if ratified by both sides, provides for a transitional period during which the UK would remain in the Single Market and bound by EU law (including EMIR). Any amendments to EU legislation that take effect during that period — which is due to last until 31 December 2020, but could be extended under Article 132 of the Agreement — would also be binding on the UK. That will include the proposed changes to supervision of EU-based CCPs under EMIR, if they are adopted by the Council and the European Parliament and become applicable during the transition.

12.41 However, the transitional arrangement will only postpone the moment of the UK becoming a 'third country', at which point the proposals described above would apply to British CCPs.

Future UK-EU financial service agreement: equivalence of regulation

12.42 In its EU exit discussions with the European Commission, the Government previously pushed for a new UK-EU financial services agreement which avoided, or at the very least substantially modified, the application of the 'third country' regime under EMIR to the UK clearing industry. Its original proposals, set out in a speech by the Chancellor on 7 March 2018, would see a legally-binding commitment to continued cross-border market access between the UK and the EU (but, crucially, without continued UK adherence to EU financial services law and without relying on 'equivalence').

12.43 The EU consistently rejected this approach,[84] and the draft outline of the Political Declaration — the joint outline of the future UK-EU partnership — published on 14 November 2018 explicitly recognises that post-Brexit trade in financial services with the EU will be based on equivalence. It notes that both sides will "take equivalence decisions in their own interest" respecting their "regulatory and decision-making autonomy". This would also include the ability for the UK and the EU to withdraw equivalence decisions unilaterally, ending any preferential market access or prudential privileges that flowed from it. If the draft Withdrawal Agreement is ratified, both the UK and the EU would commit to "commencement of equivalence assessments" — including under EMIR — "as soon as possible after the United Kingdom's withdrawal from the Union, endeavouring to conclude these assessments before the end of June 2020".

12.44 Separately, in the event of a UK withdrawal from the EU *without* a Withdrawal Agreement, the European Commission has said that it would propose a temporary

84 For example, on 26 April, the EU's Chief Negotiator Michel Barnier said that "the EU cannot accept mutual market access without the common safeguards that underpin it", namely "EU rules [and] common EU supervision and enforcement tools".

equivalence decision relating to the UK to pre-empt any "risks to financial stability […] deriving from a disorderly close out of positions of EU clearing members in the UK central counterparties". This would allow EU counterparties to continue clearing derivatives in the UK in the immediate aftermath of the UK's exit from the Single Market, although the Commission has said that an equivalence decision adopted in a 'no deal' scenario would be "under strict conditionality and with limited duration". The Commission has also encouraged UK-based CCPs to "pre-apply to the European Securities and Markets Authority (ESMA) for recognition", so that the relevant legal decisions can be taken swiftly in March 2019 to avoid disruption.[85]

12.45 Under either scenario therefore, the scope of the 'equivalence' regime under EMIR (as eventually amended by the proposals described above) is likely to be crucial, given that UK CCPs — as the world's largest clearing sector — will fall within the category of firms which could be considered as systemically important to the EU. It appears likely the UK's overall regulatory approach will be deemed 'equivalent', given that it will be based on EMIR itself and 16 other countries have already had their domestic supervisory approaches of central counterparties successfully assessed by the Commission. However, the location policy powers being considered would add additional hurdles for individual British CCPs when seeking recognition from ESMA after the UK has left the Single Market. In extreme cases, if they are considered (potentially) systemically important, they could be partially or wholly shut out from the market for euro-denominated derivatives, or be forced relocate parts of their activities to the EU.

12.46 As such, the proposed amendments to EMIR are crucial to the UK clearing industry under any Brexit scenario, as they will affect the statutory baseline for the granting of equivalence — whether in the absence of an overall Withdrawal Agreement, or as part of regulatory cooperation between the UK and the EU during a transitional period and beyond. We have therefore retained the proposals under scrutiny, awaiting further information from the Treasury about the final outcome of the legislative process and an analysis of the implications for the UK.

Previous Committee Reports

Second Report HC 301–ii (2017–19), chapter 20 (22 November 2017) and Twenty-seventh Report HC 301–xxvi (2017–19), chapter 4 (9 May 2018).

85 The Governor of the Bank of England (Mark Carney) told the Treasury Committee on 20 November that he had welcomed the Commission's announcement in relation to cleared derivatives, but that a "difference of opinion" still exists between the UK and the EU about the risks of £30 trillion of uncleared derivatives (i.e. those not subject to the clearing requirement under EMIR). For these, the UK thinks there is still a significant financial stability risk. The European Commission, however, has stated that "there does not appear to be any generalised problem of contract performance in the case of a no-deal scenario" although "certain so-called life-cycle events (for example contract amendments, roll-overs and novations) may however in certain cases imply the need for an authorisation or an exemption, given that the counterparty is no longer an EU firm".

13 Regulation of covered bonds

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted
Document details	(a) Proposal for a Directive on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU; (b) Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds.
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39544), 7064/18 + ADDs 1–2, COM(18) 94; (b) (39555), 7066/18 + ADDs 1–2, COM(18) 93

Summary and Committee's conclusions

13.1 In March 2018, the European Commission proposed a new EU-level regulatory framework for covered bonds. Its aim is to address divergent national regulatory practices with respect to the technical aspects of the EU's covered bond market and increase their uptake within and outside the Single Market under a harmonised regulatory framework. The proposal forms part of the wider efforts to construct a European Capital Markets Union (CMU), a set of legislative and non-legislative initiatives to widen the EU's pool of capital across Member State borders.

13.2 Covered bonds are a type of debt obligation issued by banks. They areseen as very safe investments because they are secured against a ring-fenced pool of high-quality, low-risk assets (typically residential mortgages), which holders can access directly as preferred creditors if the bank issuing the bond cannot make its contractual payments. The UK market is estimated to amount to €121 billion (£107 billion) of outstanding covered bonds.

13.3 The low-risk nature of these bonds allows the issuing bank to offer a low interest rate, making them a relatively cheap way of raising capital that can then be used to finance business and consumer loans. For the same reason, EU prudential legislation (the Capital Requirements Regulation) contains certain regulatory and prudential reliefs for EU-based financial institutions, such as investment funds, banks and insurers, which purchase covered bonds issued by EU banks. However, the EU has not to date substantively regulated matters relating to the actual issuance of covered bonds, such as prudential, governance or transparency requirements.

13.4 Concretely, the proposed EU Directive would set minimum harmonising standards for the issuance of all covered bonds within the European Union (such as who can issue them and how the cover pool must be designed). Products that are compliant can carry the label 'European Covered Bond' (ECB). Purchase of an ECB by an EEA-based investment fund, bank or insurer would trigger the application of the existing regulatory or prudential

reliefs (the latter of which will be subject to tighter requirements under a parallel proposal to amend the Capital Requirements Regulation) in a way that the purchase of a covered bond issued outside the Single Market would not.

The Government's position on the Covered Bonds Directive

13.5 The Economic Secretary to the Treasury (John Glen) submitted an Explanatory Memorandum with the Government's views on the proposal in April 2018. The Government has been broadly supportive of the proposed legislation but will seek to "ensure that [the] proposals will enhance comparability, transparency and market stability by helping investors better understand the profile and risks of a programme as they undertake their due diligence".

13.6 In the context of Brexit, it was especially relevant that the Commission proposal does not contain an 'equivalence' provision which would allow the EU to recognise the regulatory framework for covered bonds of a "third country" (like the UK after it leaves the Single Market) as equivalent. Were such a mechanism included, it could mean for example that bonds issued in that country would trigger the same prudential and regulatory reliefs as EU-issued covered bonds. Instead, EU banks investing in covered bonds issued outside the EEA would remain entitled to an existing, more limited prudential relief with respect to their liquidity buffer. The proposal would also allow individual EU countries to prohibit banks from including non-EU assets in their cover pool.

13.7 The new Directive would require the Commission to assess within three years of the new framework becoming operational "whether a general equivalence regime for third-country covered bond issuers and investors is necessary or appropriate". The Minister 'noted' this fact in his Explanatory Memorandum, but made no further comment on the matter.

Previous parliamentary scrutiny of the proposals

13.8 The European Scrutiny Committee first considered the proposal on 25 April 2018, and retained it under scrutiny pending the outcome of the legislative process (and in particular to see whether the Government would be able to successfully push for 'equivalence' provisions in the Directive). We summarised the possible impact of the new legislation in the context of the UK's EU exit as follows:

- if the Covered Bonds Directive becomes applicable while the UK is still in the Single Market, namely before the end of the post-Brexit transitional period, it would have to apply the new legislation and covered bonds issued by British banks would trigger the same prudential and regulatory reliefs as for those issued by the remaining EU banks;
- after the UK leaves the Single Market, or if the Directive only becomes applicable after that date, the Government would be free to modify the domestic regulatory framework for covered bonds but such bonds issued by British banks would no longer entitle EU-based banks to prudential and regulatory reliefs and they could be excluded from cover pools under national legislation;

- however, if the Treasury were to seek 'equivalence' between the EU's and the UK's covered bonds regime (should this become possible under the Covered Bonds Directive), its practical room to make amendments to domestic UK regulations on covered bonds would likely be constrained, unless it was willing to risk having the equivalence decision revoked by the European Commission.

Developments since April 2018

13.9 The Economic Secretary provided further updates to the Committee's by letters dated 6 August, 11 October and 21 November 2018. The Minister's letters provide information on Member States' deliberations on the proposal in the Council, and the likely substance of the amendments they will seek to make to the text of the Directive in future negotiations with the European Parliament.

13.10 The Minister's latest letter confirmed that EU Finance Ministers were expected to endorse a common position—a so-called 'general approach'—when the EU Council meets in Brussels on 4 December 2018. Following discussions within the Council, the Minister explained the general approach (which is still under negotiation) was likely to recommend several amendments to the Commission proposal for negotiation with the European Parliament. The areas affected would be:

Prudential requirements and eligibility of assets

13.11 The Council has discussed ways of ensuring a balance between introducing EU-wide harmonised requirements for the quality of assets against which covered bonds are secured (so there is a guaranteed level of quality of the pool) against the need to consider the "specificities and differences across national covered bond regimes" (which are well-developed and established in a number of EU countries, notably Denmark and Germany).

13.12 In particular, a sub-set of EU countries has argued that the eligibility requirements for assets included in the cover pool (against which covered bonds are secured) should be more flexible, in particular for countries where many counterparties may not qualify for the highest credit rating (the so-called 'credit quality step') required by the original Commission proposal. The Council is therefore likely to support an amendment allowing the use of derivative counterparts qualifying only for a lower credit rating ('credit quality step 3')[86] under "specific conditions". Similarly, some Member States have called for the option of including exposures to banks with a lower credit rating and short-term exposures in the liquidity buffer (the ring-fenced liquid assets that ensure issuing banks have sufficient capacity to make covered bond repayments even if they go insolvent), although individual Member States would have the ability to exclude such assets from eligibility for the liquidity pool in their domestic legal frameworks.

13.13 Although the UK has "reservations over the inclusion of exposures with a lower rating (credit quality step 3) into the covered bond framework, [other] Member States have supported this" and therefore room for further changes ahead of the Council meeting in December 2018 is limited. The Treasury also "expect[s] that the compromise text will provide a Member State option to include loans involving public undertakings" in the cover pool, subject to certain safeguards on safety and soundness criteria".

86 Credit quality steps (CQS) map a financial institution's credit rating against the systems used by the two largest credit rating agencies (S&P and Fitch's). CQS3 is the lowest investment-grade rating.

Duplication of prudential requirements

13.14 To avoid the imposition of duplicated prudential requirements incumbent on banks under the Covered Bonds Directive (the liquidity buffer) and the existing Capital Requirements Regulation for banks (the Liquidity Coverage Requirement), EU countries are looking for an exemption allowing[87] them to dis-apply the liquidity buffer provisions altogether where the LCR requirement already applies.[88]

13.15 The Government supports the approach to avoiding a duplication of prudential requirements between the CBD and the CRR, with the Minister explaining in his latest letter that, if these requirements are not reconciled, "firms will be subject to a double liquidity requirement for covered bond outflows".

Transitional measures

13.16 To ensure that covered bonds issued before the new Directive takes effect remain valid (even if they are not compliant with all its requirements), the original Commission proposal contained a transitional measure in Article 30 that would maintain the validity of such bonds so long as they were in compliance with the applicable national rules when issued.

13.17 In addition, the Member States want to make an amendment to create a specific grandfathering provision for covered bonds sold by the technique of 'tap issuance'. This means that a bond, after it has been issued, can be reopened for additional offerings to the market after it has been initially introduced. The Minister informs us that "this technique is uncommon in the UK but used more widely in other Member States", and without a specific amendment pre-issued bonds in this category would not "reach the volumes originally intended, resulting in lower levels of liquidity and discouraging investors". The Government therefore supports this change.

Equivalence for non-EU issuers of covered bonds

13.18 Equivalence is a mechanism under EU financial services law that allows the regulatory regime of a non-EU country to be declared 'equivalent' to that of the European Union. The effects of such a determination vary sector-by-sector, but can create preferential levels of market access for firms from the 'third country' in question to operate within the EU, or remove regulatory hurdles for European banks or investment firms to engage in transactions with firms from that country. Equivalence can, however, be unilaterally withdrawn by the EU if it believes the regulatory approach of a non-EU country has stopped delivering equivalent outcomes.

13.19 Once the UK leaves the Single Market, whether in March 2019 in a 'no deal' Brexit scenario or at the end of any transitional period under the Withdrawal Agreement, UK-issued bonds will automatically cease to be covered by the new Directive and could not be marketed a 'European Covered Bond' within the EU. As the Commission proposal for a Covered Bonds Directive contains no equivalence mechanism, there will be no legal mechanism for UK-issued bonds to be treated in the same was as EU-issued bonds for the

87 This exemption would be optional for Member States to use at their own discretion.

88 Under the Commission proposal, assets held to cover the liquidity buffer for covered bonds could not be used to count towards a bank's general Liquidity Coverage Requirement (and vice versa).

purposes of the Directive. Consequently, EU banks and investment firms would no longer benefit from prudential reliefs if they purchase UK covered bonds, decreasing the latter's attractiveness to institutional investors within the EU.

13.20 The Government had sought the introduction of an equivalence mechanism into the draft Directive during the legislative process in the Council, but has been unsuccessful. The Economic Secretary has nevertheless "welcomed the Commission's openness to developing a third country regime in the future", and has secured the support of other Member States for a review of the possibility of introducing equivalence for covered bonds within two years after the Directive takes effect (rather than three years, as originally proposed by the Commission). This is likely to bring the date of the review forward from 2023 to 2022.

13.21 We also understand that the European Parliament's Economic & Monetary Affairs Committee *has* called for an equivalence mechanism for covered bonds.[89] However, it remains to be seen whether it will be included in the final Directive, given there does not appear to be sufficient support for the immediate introduction of 'equivalence' among the remaining Member States.

Next steps in the legislative process

13.22 As noted, EU Finance Ministers are expected to adopt a 'general approach' on the Directive at the Council meeting on 4 December 2018. This would serve as the basis for future negotiations with the European Parliament on the final text of the legislation (the proposal is subject to the ordinary legislative procedure, meaning it must be jointly agreed by the Parliament and the Council).

13.23 In light of this, the Minister says he believes "there is a pathway to reaching a compromise that would serve as a robust EU framework and reflects the well-functioning UK covered bond market". The Government therefore expects to support the general approach at the December Council meeting, and has therefore requested the Committee grant a scrutiny waiver enabling it to vote in favour.

13.24 On the European Parliament side, the Economic and Monetary Affairs Committee adopted its position on the covered bonds proposal on 20 November 2018. Consequently, the Government expects negotiations between the Parliament and the Council on the final text of the Directive "to commence [soon] for an overall agreement to be found before the end of this European Parliament's term" in spring 2019. The Directive would then most likely become applicable at some point in late 2020, as the Member States have called for a transposition period of 18 months.

Our conclusions

13.25 **We thank the Minister for the comprehensive information he has provided on the Covered Bonds Directive throughout the legislative process, in particular in relation to the question of an 'equivalence' regime for third country issuers and the prudential requirements that will underpin the 'safe' nature of a covered bond issued within the EU under the new legislation.**

89 The European Parliament Committee voted on the proposal on 20 November 2018.

13.26 **Given the ambition for adoption of the Directive before the European Parliament elections in spring 2019, it is likely the new legislation would become applicable during the UK's post-Brexit transitional period (if the draft Withdrawal Agreement is ratified).[90] At that point, EU law would apply as if the UK were still a Member State, and consequently the Directive would have to be transposed into domestic law. As such, it is right that the Government has been actively involved in the legislative negotiations and we are pleased the Treasury believes the compromise found with other Member States would not disrupt the UK's existing market for covered bonds. We hope the outcome of the upcoming negotiations with the European Parliament will not affect that overall assessment.**

13.27 **The implications of the Directive for the UK after it leaves the Single Market currently appear negligible. The UK would be free to disregard the provisions of the Directive as Parliament sees fit. However, by extension UK-issued covered bonds—while they could still be sold to EU-based investors—would also no longer entitle EU financial market participants to any prudential or regulatory reliefs, potentially making them less attractive for international investors. If the Directive included a mechanism for granting 'equivalence' to the covered bonds regime of a non-EU country, such preferential treatment could be extended to bonds issued outside of the EU. We note however that there the prospect of an equivalence regime being included in the first iteration of the Directive seems remote, given that there has been no widespread support for it among Member States. However, a Commission review would take place early in the next decade to assess whether one should be established.**

13.28 **It is also clear from the Minister's letters the Government is actively seeking the introduction of an equivalence mechanism for covered bonds. This is linked clearly to the Political Declaration on the future UK-EU partnership, which unequivocally states that post-Brexit trade in financial services between the two will take place on the basis of 'equivalence'.[91] This will effectively allow both sides to determine, autonomously, in which sectors financial services firms from the other party should have preferential access to its domestic market, including in areas like investment services,[92] clearing of derivatives[93] and—potentially at a future stage—covered bonds. Those decisions could also be modified or revoked unilaterally.**

13.29 **We reiterate our concerns that reliance on equivalence for post-Brexit UK-EU trade in financial services is potentially problematic. It could either see the UK constrained to stay in tandem with development of EU financial services law without any say over future amendments (given that the UK exports more financial services to the EU-27 than vice versa), or risk losing market access for its financial services industry at short notice where it diverges from the EU's regulatory approach in a given area. This is a matter that Parliament should keep under review as it monitors the substance of the equivalence decisions, work on which would begin in spring 2019 shortly after the UK's formal withdrawal from the EU.**

90 The transitional period would last until 31 December 2020, but could be extended for an (unspecified) period of time under Article 132 of the Withdrawal Agreement.

91 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/756378/14_November_Outline_Political_Declaration_on_the_Future_Relationship.pdf.

92 See our Report of 28 February 2018 on prudential requirements for investment firms for more information on equivalence for investment services.

93 See the separate chapter of this Report on supervision of central counterparties for more information on equivalence for clearing of derivatives.

13.30 **With respect to the Covered Bonds Directive specifically, given that the Government appears to be satisfied overall with the direction of travel in the Council, we are content to grant the Minister a scrutiny waiver to enable the UK to support the adoption of a general approach. We ask the Minister to write to us again to inform of us the outcome of the trilogue process with the European Parliament in good time before formal adoption of the final legislation in 2019.**

Full details of the documents:

(a) Proposal for a Directive on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU: (39544), 7064/18 + ADDs 1–2, COM(18) 94; (b) Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds: (39555), 7066/18 + ADDs 1–2, COM(18) 93.

Previous Committee Reports

See (39544), 7064/18 + ADDs 1–2, COM(18) 94: Twenty-fifth Report HC 301–xxiv (2017–19), chapter 5 (25 April 2018).

14 Digital Services Tax

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Select Committee
Document details	(a) Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services; (b) Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence; (c) Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence
Legal base	(a) Article 113 TFEU; special legislative procedure; unanimity, (b) Article 115 TFEU; special legislative procedure; unanimity, (c)—
Department	Treasury
Document Numbers	(a) (39585), 7420/18 + ADDs 1–3, COM(18) 148 ; (b) (39586), 7419/18 + ADDs 1–3, COM(18) 147; (c) (39590), 7421/18, C(18) 1650 final

Summary and Committee's conclusions

14.1 Current global tax rules were designed for 'brick and mortar' businesses and have not kept pace with the changing nature of value creation in the digital economy, in which intellectual property, users and data are paramount. 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 in it.

14.2 Digital economy businesses, on average, pay significantly lower levels of tax within the EU than traditional brick and mortar businesses. The European Commission's statistics 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%).[94] 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.

14.3 The Government and the European Commission have both arrived at the view that multilateral action is needed to tackle this issue, and had hoped that the OECD's Task Force for the Digital Economy's (TFDE) interim report to the G20 in spring would present meaningful policy options. However, following the failure of the TFDE report to do so, the Commission brought forward two legislative proposals in March 2018:

- Directive (EU) 7420/18, which would introduce an EU-wide tax on an interim basis (until the necessary reforms were made at an international level), applicable at 3% on certain digital activities for which user participation is considered to

94 See Fifth Report HC 301–v (2017–19), chapter 10 (13 December 2017).

constitute an essential input and an important source of value. This proposal aligns closely with the latest Treasury position paper on taxation of the digital economy[95] in which the Government indicated that a revenue levy applied to digital service providers was its preferred interim solution.

- Directive (EU) 7419/18, which would enable Member States to tax profits generated in their territory, even if a company does not have a physical presence there, by deeming digital platforms who fulfil the applicable criteria to have a "virtual" permanent establishment based on the concept of "significant digital presence".

14.4 Both proposals are explained in detail in the background section of our report of 13 June 2018;[96] however, this report focuses on Directive (EU) 7420/18 establishing a Digital Services Tax (DST), on the basis that the Austrian Presidency has prioritised this proposal.

14.5 In the Government's initial response to the Commission's proposal,[97] the Chief Financial Secretary to the Treasury (Mel Stride) indicated that the proposed DST conformed to the principal of subsidiarity, as there were "significant benefits to interim solutions such as a revenue-based tax being implemented on a multilateral basis". The Minister expressed support for central aspects of the proposal, including the fact that it would apply exclusively to revenue streams through which user participation generates revenue for businesses, and the fact that businesses below a certain threshold[98] would not be subject to it. However, the Minister indicated that further work was needed on other points, including whether the scope of the measure could be made more targeted, whether the Commission's suggested revenue thresholds were appropriate, and whether the Commission's proposed flat 3% rate was the most appropriate level.

14.6 The proposal was debated on the floor of the House as part of a Conservative-led debate on Digital Taxation,[99] in which the alignment of the Commission's proposals with the Treasury's own proposals was noted.

14.7 In its report on the proposals on 13 June 2018[100] the Committee acknowledged the similarities between the Government's thinking and that of the Commission, and that unanimity would required for both proposals in the Council of Ministers, meaning that, ultimately, it was unlikely that either proposal would be agreed. The Committee also asked the Minister a number of questions about the proposals and EU exit.

14.8 On 21 July 2018, the Minister wrote to the Committee[101] to provide responses to the questions contained in its report:

14.9 The Minister stated that the UK could in principle introduce a similar measure to the DST unilaterally, and that if it was identical to the DST the theoretical yield would likely be similar in both cases, as the UK would be asserting a taxing right on revenues from the

95 HM Treasury, Corporate tax and the digital economy: position paper update (March 2018).
96 Thirty-first Report HC 301–xxx (2017–19), chapter 4 (13 June 2018).
97 Explanatory Memorandum submitted by the Treasury (4 May 2018).
98 Two thresholds would have to be met for a company to be subject to the tax: the company or the consolidated group to which it belongs would have global revenue from all sources of €750mn a year; and the company or the consolidated group to which it belongs has revenue taxable under the DST of €50mn (£44,207,500) a year in the EU.
99 HC Deb, 27 March 2018, volume 638.
100 Thirty first Report HC 301–xxx (2017—2019), chapter 4 (13 June 2018).
101 Letter from the Minister to the Chair of the European Scrutiny Committee (21 July 2018).

same set of services. Asked what proportion of the estimated €5bn overall yield from the DST would accrue to the UK, the Minister noted that €5 billion was the upper limit of the Commission's estimates, and cautioned that, although the Commission estimated that the UK would account for 30% of the yield, it was not advisable to assume that the UK would receive 30% of the €5bn estimate (€1.5bn).

14.10 On 21 November 2018 the Minister provided the Committee with a further update,[102] in which he said that, based on the latest version of the ECOFIN agenda, Directive 7420/18 might be put to a vote in December.

14.11 In his update, the Minister states that the overall text of the Directive remains subject to negotiation in several areas, including the date at which the Directive should be transposed, a potential sunset clause, and the appropriate scope of the Directive. However, he does not provide any information about the nature of negotiations on these points or the outcomes which would be acceptable to the Government. In line with the Government's explanatory memorandum and subsequent updates, he indicates that the Government would be willing to support changes that would ensure only a targeted and proportionate Directive is agreed, which would involve ensuring that the scope is focused on those activities which derive material value from user participation. On this basis the Minister requests that the Committee grant a scrutiny waiver so that he can support the proposal at Council, "subject to getting the detail right."

14.12 **The Minister has written to inform the Committee that the Austrian Presidency may seek a vote on Directive 7420/18, which would take place at ECOFIN Council on 4 December 2018, and requests a scrutiny waiver so that he can participate at Council.**

14.13 **The Minister has previously indicated the Government's support for aspects of the proposed Digital Services Tax, and the Chancellor recently announced that the Government intended for its own Digital Services Tax to be introduced from April 2020. The Minister indicates, in broad terms, that the Government would be willing to support changes that would ensure that only a targeted and proportionate Directive is agreed, which would involve ensuring that the scope is focused on those activities which derive material value from user participation, "subject to getting the detail right."**

14.14 **While we accept this overall position as reasonable and in line with the Government's previous updates, the Minister also refers to a number of aspects of the proposal in relation to which negotiations are ongoing, which include the transposition date, a potential sunset clause, and, most importantly, the scope of the Directive. The Minister provides little information regarding the specifics of the negotiations on these points or of the outcomes which would be acceptable to the Government. This is disappointing, particularly given that there have been reports in the media regarding the sunset clause proposed in the latest compromise text (a period of ten years is reportedly suggested),[103] and suggesting that text has been added to the Directive to clarify that the supply of regulated financial services by regulated financial entities is excluded from scope.[104] Nor does the Minister provide any further clarity regarding points which the Government had previously indicated were of importance to it in**

102 Letter from the Minister to the Chair of the European Scrutiny Committee (21 November 2018).

103 Politico Pro, "EU digital tax set for 10 year lifespan" (15 November 2018).

104 Politico Pro, Financial firms to be exempted from EU digital tax (20 November 2018).

the negotiations, including how the question of "revenue pass-through" has been addressed,[105] whether the Commission's suggested revenue thresholds are appropriate, whether the scope of the Directive is appropriate or should be more targeted, and whether the Commission's proposed flat rate 3% rate is the most appropriate level.

14.15 **Although we do not currently take issue with the broad shape of the proposal itself, which appears to conform in its essential features to current UK policy, and are inclined to consider that, in the context of EU exit and given the contentious nature of this issue internationally, it would be helpful to the UK if the EU Member States were also to introduce a Digital Services Tax, we are nonetheless not willing to grant a scrutiny waiver on the basis of the limited information provided.**

14.16 **We have taken note of the Minister's assessment that if the UK introduces a Digital Services Tax unilaterally when it is no longer an EU Member State the theoretical yield would likely be similar, as we would be asserting a taxing right on revenues from the same set of services.**

14.17 **We retain the documents under scrutiny and ask for a more detailed update covering the above points in advance of any further vote. We draw this report to the attention of the Treasury Select Committee.**

Full details of the documents:

(a) Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services: (39585), 7420/18 + ADDs 1–3, COM(18) 148 ; (b) Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence: (39586), 7419/18 + ADDs 1–3, COM(18) 147; (c) Commission Recommendation of 21.3.2018 relating to the corporate taxation of a significant digital presence: (39590), 7421/18, C(18) 1650 final.

Previous Committee Reports

Thirty-first Report HC 301–xxx (2017–19), chapter 4 (13 June 2018); Fifth Report HC 301–v (2017–19), chapter 10 (13 December 2017).

105 In some cases, suppliers of (for instance) online advertising may record revenues which include money that is passed directly on to a host website but recorded as a separate payment. The Government indicated in its explanatory memorandum that it may or may not be appropriate to charge tax on the whole amount of such revenues.

15 Improving cross-border law enforcement access to financial information

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 and the Justice Committee
Document details	Proposal for a Directive laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences and repealing Council Decision 2000/642/JHA
Legal base	Article 87(2) TFEU, ordinary legislative procedure, QMV
Department	Home Office
Document Number	(39666), 8411/18 + ADDs 1–2, COM(18) 213

Summary and Committee's conclusions

15.1 The European Commission has proposed a Directive which is intended to make it easier to gather the evidence needed to advance a criminal investigation or prosecution by improving access to financial information for law enforcement purposes. Our earlier Reports (listed at the end this chapter) provide a detailed overview of the proposal and the Government's position. In summary, the proposed Directive would require Member States to:

- give designated national law enforcement authorities and Asset Recovery Offices *direct* access to bank account information held in their Member State's central bank account registries (or electronic data retrieval systems) where necessary to prevent, detect, investigate or prosecute a serious criminal offence;
- strengthen the exchange of financial information and analysis between their own designated national law enforcement authorities and Financial Intelligence Units (national centres which collect information on suspicious or unusual financial activity) as well as between Financial Intelligence Units in different Member States;[106]
- introduce a three-day time limit for the exchange of information between Financial Intelligence Units in different Member States (24 hours in "exceptional and urgent cases"); and
- give Europol indirect access to bank account and other financial information or analysis via each Member State's National Europol Unit.

106 Whilst it would be for each Member State to designate the relevant national law enforcement authorities, they must include the National Europol Unit.

15.2 As the proposed Directive is a criminal law measure, it is subject to the UK's Title V (justice and home affairs) opt-in and will only apply to the UK if the Government decides to opt in. In his Explanatory Memorandum of 12 June, the Minister for Security and Economic Crime (Mr Ben Wallace) indicated that the proposal was "broadly in line with existing UK legislation and practice on the sharing of financial information" but expressed concern that it might compromise the operational autonomy of national Financial Intelligence Units (FIUs) and questioned whether a request from a FIU in another EU Member State should be handled with greater urgency than a request from a FIU in a non-EU country. In his letter of 24 July 2018, he told us that "all other Member States have similar concerns to the UK" and that he was "hopeful that the changes we wish to see made to the text will be made". He confirmed that the three-month deadline for notifying the Council of the UK's opt-in decision would expire on 17 August.

15.3 The Minister informed us in his letter of 20 September 2018 that the Government had decided to opt into the proposed Directive as participation would "bring benefits to the UK through ensuring that our operational agencies are able to seek and receive financial intelligence, including bank account details, where appropriate, in order to tackle both money laundering and wider criminality". In our response, we noted that the Government's opt-in decision meant the UK would be under an obligation to implement the Directive if (as seemed likely) it had to be transposed into domestic law during the post-exit transition/implementation period envisaged in the draft EU/UK Withdrawal Agreement. We inferred that the Government's decision to opt in at this late stage in the negotiations on the UK's exit from the EU was intended to demonstrate a commitment to maintaining close cooperation in tackling cross-border financial crime within the framework of a new post-exit internal security treaty with the EU. We requested regular reports on the prospects for such a treaty and the progress being made in negotiations.

15.4 We noted the Government's intention to seek amendments to prevent any encroachment on the decision making autonomy of Financial Intelligence Units ("FIUs"), so that they would have the final say in deciding whether to share information, and to ensure that requests for information made by FIUs outside the EU were given the same priority as those made by FIUs within the EU. We asked the Minister to provide a further update on the progress made in securing these amendments ahead of any Council or COREPER meeting which might be asked to agree a general approach or mandate to open negotiations with the European Parliament.[107]

15.5 In his latest letter of 19 November 2018, the Minister reiterates that the Government "strongly supports the intention behind the Directive of improving the sharing of financial information, including bank account details, and financial analysis, to support law enforcement investigations and prosecutions". He continues:

> While we, along with all other Member States, had some concerns with the original draft of the text, particularly regarding the proposed mandatory sharing of information by Financial Intelligence Units, which the UK believed contravened the Fourth Money Laundering Directive, and the timeframes for sharing information, which the UK believed was contrary to existing international standards, these issues have now been negotiated out of the text. The mandatory requirement for the Financial Intelligence

107 See the letter dated 10 October from the Chair of the European Scrutiny Committee to the Minister for Security and Economic Crime (Ben Wallace).

> Units (FIU) to share information and analysis has been removed from all sections of the text where such a requirement occurred. Any such sharing is now a matter for the FIU.

15.6 The Minister informs us that the Presidency intends to seek a "General Approach" which the Government would like to support at a meeting of Member States' Permanent Representatives to the EU (COREPER) on 21 November. He invites us to clear the proposed Directive from scrutiny or to grant a scrutiny waiver to enable the Government to vote for the proposal, failing which the Government will abstain.

Our Conclusions

15.7 **The Government's decision to opt into the proposed Directive, and the pace of negotiations, suggest that the Directive is likely to be adopted and take effect during the post-exit transition/implementation envisaged in the draft EU/UK Withdrawal Agreement, meaning that the UK will be bound by and required to implement the Directive until the end of transition. We understand why the Minister wishes to support the General Approach while the UK is still able to influence and vote on the outcome of negotiations. It is nonetheless wholly unrealistic to expect scrutiny clearance or a scrutiny waiver to be granted with only two days' notice of the meeting at which the Presidency will seek to secure a General Approach.**

15.8 **We remind the Minister that our scrutiny reserve applies to decisions taken by Ministers within the EU's Council of Ministers, not to decisions taken by officials within COREPER. Nonetheless, where (as in this case) the political agreement is to be reached at COREPER level, the Government should provide as much notice as possible and sufficient detail on the content of any Presidency compromise text to enable the scrutiny committees in both Houses to express a view ahead of the COREPER meeting. It is deeply regrettable that the Minister has not done so in this case.**

15.9 **We note the Minister's assurance that the compromise text to be considered by COREPER addresses the Government's concern to preserve the autonomy of Financial Intelligence Units and to mitigate the risk that requests for information from a Financial Intelligence Unit within the EU would be treated with greater urgency than requests from a Financial Intelligence Unit in a non-EU country. We ask him to provide a copy of any compromise text agreed by COREPER, once the meeting has taken place, along with details of how the UK voted. We also ask him to provide details of any changes proposed by the European Parliament once it has agreed its position. Meanwhile, the proposed Directive remains under scrutiny. We remind the Minister that we have requested regular reports on the prospects for concluding a new post-exit internal security treaty with the EU and would welcome an update once the final text of the Political Declaration setting out the framework for the future relationship between the EU and the UK has been agreed. We draw this chapter to the attention of the Home Affairs Committee and the Justice Committee.**

Full details of the documents:

Proposal for a Directive laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences and repealing Council Decision 2000/642/JHA: (39666), 8411/18 + ADDs 1–2, COM(18) 213.

Previous Committee Reports

Thirty-seventh Report HC 301–xxxvi (2017–19), chapter 17 (5 September 2018) and Thirty-third Report HC 301–xxxii (2017–19), chapter 6 (27 June 2018).

16 Preventing the dissemination of terrorist propaganda online

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 Home Affairs Committee, the Justice Committee, the Digital, Culture, Media and Sport Committee and the Joint Committee on Human Rights
Document details	Proposal for a Regulation on preventing the dissemination of terrorist content online
Legal base	Article 114 TFEU, ordinary legislative procedure, QMV
Department	Home Office
Document Number	(40069), 12129/18 + ADDs 1–3, COM(18) 640

Summary and Committee's conclusions

16.1 In his State of the Union speech in September 2018, European Commission President Jean-Claude Juncker announced that the EU would be proposing "new rules to get terrorist content off the web within one hour — the critical window in which the greatest damage is done".[108] The purpose of the Commission's proposal for a Regulation is to introduce harmonised rules ensuring that online terrorist content is identified and removed as quickly as possible whilst safeguarding freedom of expression and information. It would require online platforms to take proactive measures to prevent the dissemination of terrorist content; empower national authorities to issue a legally binding removal order to take terrorist content off the web within an hour; introduce penalties for platforms which fail to remove terrorist content promptly; and strengthen cooperation amongst Member States and with Europol. The new power to issue a removal order would operate alongside existing voluntary referral mechanisms, but with a clear obligation on hosting service providers to put in place the necessary operational and technical measures to ensure that referrals are dealt with expeditiously.[109] The proposed Regulation includes a range of safeguards in recognition of "the fundamental importance of freedom of expression and information in an open and democratic society".[110] Our earlier Report agreed on 24 October 2018 provides a detailed overview of the proposal.

16.2 The proposed Regulation cites an internal market legal base—Article 114 of the Treaty on the Functioning of the European Union (TFEU)—as the Commission considers that harmonised rules will provide "clarity and greater legal certainty", strengthen trust in the online environment and prevent the emergence of different regulatory approaches across the EU which would impede the functioning of the internal market, "creating unequal

108 For an overview of the Commission's proposal, see the European Commission's fact sheet published on 12 September 2018, A Europe that protects: Countering terrorist content online.

109 Article 5.

110 See Articles 3(1) and 6(4).

conditions for companies as well as security loopholes".[111] The Commission is keen to secure the adoption of the proposed Regulation before the next European Parliament elections in May 2019 (meaning that it would have to approved by March 2019 at the latest) and envisages that the proposal would take effect six months after its formal adoption and entry into force.

16.3 In his informative Explanatory Memorandum (see part one and part two), the Minister for Security and Economic Crime (Mr Ben Wallace) welcomed the prospect of EU regulatory action to tackle online terrorist content. Whilst acknowledging the value of voluntary cooperation with service providers, he considered that tech companies had "not gone far enough or fast enough" and that the approach taken by the Commission in seeking to balance public security and fundamental rights (notably, freedom of expression and freedom to conduct a business) established "a helpful precedent" and would "lay the groundwork and support our own intention to legislate on illegal online content", following the publication later this year of a White Paper covering "the full range of online harms". He shared the Commission's view that a fragmented framework of national rules would be burdensome for companies operating within the EU's digital single market and that Article 114 TFEU, rather than EU Treaty provisions on justice and home affairs matters, was the appropriate legal base.

16.4 The Minister underlined the need for "automated tools and proactive action" by tech companies to counter the speed at which terrorist content is disseminated and expressed "full support" for the provisions in the proposed Regulation requiring hosting service providers to take proactive measures to prevent the dissemination of terrorist content. Whilst the Government would have preferred to go further in fleshing out the proactive measures to be taken by hosting service providers, he recognised that the Commission had to act "within the limiting parameters of the E-Commerce Directive" which prevents Member States from imposing on service providers a general obligation to "monitor the information which they transmit or store" or "actively to seek facts or circumstances indicating illegal activity".[112]

16.5 The Minister expressed concern that the provisions on penalties would leave too much discretion to Member States, creating a risk that they could choose to set a low bar to attract investment by tech companies, and anticipated that the Commission would be invited to produce guidance "to harmonise penalties across Member States".

16.6 We asked the Minister:

- how much support there was for the proposed Regulation amongst Member States and how likely it was to be adopted before the UK leaves the EU, so that the UK would have a vote on the final text agreed;
- whether the Government intended to seek changes to the proposal during negotiations; and

111 See p.5 of the Commission's explanatory memorandum accompanying the proposed Regulation and recital (1) of the proposed Regulation.

112 See Article 15 of Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce) and recital (19) of the proposed Regulation.

- whether it would be necessary to amend domestic law to implement the proposed Regulation.

16.7 Noting the Minister's concern about the provisions on penalties, we asked:

- how great a risk there was that Member States might seek to undercut one another to attract higher levels of investment by hosting service providers;
- whether the Commission guidance would be non-binding and, if so, how effective it would be;
- whether the Government would support the inclusion of more specific penalties within the Regulation itself and, if so, whether this would be consistent with the use of an Article 114 TFEU legal base or require the addition of a Title V (justice and home affairs) legal base, bringing into the play the UK's Title V opt-in Protocol;
- whether the proposed Regulation should indicate what degree of non-compliance might be considered "systematic" (attracting a fine of up to 4% of the hosting service provider's global turnover in the previous business year); and
- whether such open-textured and ill-defined wording might induce excessive caution on the part of hosting service providers and have a chilling effect on freedom of expression.

16.8 We questioned whether the proposed Regulation (including its recitals) provided sufficient clarity and legal certainty regarding the obligations applicable to the providers of information society services under this and other EU laws, especially the E-Commerce Directive, and sought the Minister's views. We also asked him to clarify the circumstances in which it would be appropriate to make a referral rather than issue a removal order under the proposed Regulation, given that for referrals there is no set time limit within which hosting service providers would be required to remove the offending content or disable access to it.

16.9 In his letter of 7 November 2018, the Minister informs us that Member States are "broadly supportive" of the proposed Regulation and that the Presidency is likely to invite the Council to agree a general approach in December. Whilst Member States are keen to secure an overall agreement by end March 2019, meaning that the UK would be able to vote on the proposal before leaving the EU, this will depend on the European Parliament agreeing its own position in time. The Government has not put forward any specific textual changes to the proposed Regulation, focusing instead on "seeking greater clarification where the text is vague" and questioning how some of the provisions (for example, on proactive measures) would work in practice. The Council has, however, agreed a change which would give Member States twelve rather than six months in which to make any adjustments needed to give effect to the Regulation once it has been formally adopted. The Minister does not consider that any changes to domestic law will be necessary.

16.10 At the time of writing, the Minister says that there has been no substantive discussion of Article 18 on the penalties applicable to hosting service providers if they fail to comply with the obligations set out in the proposed Regulation. As the Commission has made clear that it is for Member States to define the type and level of penalties, he

does not anticipate that this part of the proposal is likely to change. He confirms the Government's view that the inclusion of criminal sanctions would require the addition of a Title V (justice and home affairs—"JHA") legal base and bring into play the UK's Title V opt-in Protocol. He continues:

> The Commission have made clear that they would not want to change the legal base from Article 114 TFEU or combine with a JHA legal base (a position we have supported). Member States have also suggested whether there could be a minimum penalty threshold, alongside the 4% maximum, however the Commission stated that there was no precedent in EU law for this and therefore would not take this suggestion forward.

16.11 The Minister acknowledges the risk that leaving detailed rules on penalties (bar the 4% maximum) to the discretion of each Member State could lead to a fragmented approach and the possibility that hosting service providers might choose to locate their headquarters or legal representative in the Member State with the lowest penalties. Whilst it is "not certain" that Member States would intentionally undercut one another to secure investment, the Government would support some agreed non-binding principles or 'guidance', coordinated by the Commission or Presidency, to mitigate this risk. He continues:

> This could include greater clarity on what is deemed 'effective, proportionate and dissuasive' as well as the degree of non-compliance that might be considered as 'systematic failure' and trigger the maximum penalty of 4% global turnover—a question the UK has raised in negotiations. Should the Commission pursue this idea, any guidance or agreed principles for Member States would be separate to the Regulation and therefore would be non-binding. Despite this, we believe it would still be a useful agreement to have in place.

16.12 The Minister notes our concern that a lack of clarity in the type and level of penalties and the risk of a large fine might induce excessive caution on the part of hosting service providers ("HSPs") and an "overzealous" approach to removals. He makes clear, however, that Member States would be required to provide "clear detail, including a URL and where necessary, additional information enabling the identification of the content referred" and that removal orders would have to match "clear parameters of terrorist activity and terrorist content" and would be judicially reviewable. These and other safeguards (for example, requirements on transparency and an effective mechanism for complaints) mean that there would be "very limited instances of HSPs taking down content that is not illegal, goes against the principles of freedom of expression or goes further than the request made by the Member State". The Minister adds that there has been some discussion about the possibility of setting up a central oversight mechanism at EU level to monitor the removal orders being sent to hosting service providers.

16.13 The Minister explains that the proposed Regulation intentionally includes a mechanism to make a referral (placing the onus on the hosting service provider to assess the nature of the content) and to issue a removal order so that Member States have the flexibility to decide "which to use and when". He continues:

> For the UK, we have been working to prevent terrorist use of the internet for many years and the Met's Counter Terrorism Internet Referral Unit (CTIRU) have established a good relationship with some of the major HSPs, taking on trusted flagger status. This has given us a good response rate from companies following referral of terrorist content and has meant that we have relied on the referral mechanism rather than resorting to removal orders (which the UK's Terrorism Act does provide for). However, not all companies are/will be cooperative and it is in these cases, where a HSP shows a reluctance or ambivalence to engage with law enforcement on terrorist content, that a legally binding removal can usefully be imposed on them.

16.14 Finally, the Minister considers that the proposed Regulation provides sufficient legal certainty for HSPs who are also bound by the E-Commerce Directive ("ECD"):

> Our current view, supported by the Commission, is that the proactive measures called for in Article 6 of the draft Regulation can be reconciled with Article 15 of the ECD, in view of the fact that it would constitute 'specific' identification of terrorist content and targeted measures, as opposed to a 'general obligation to monitor'. This is supported by the recitals which also include reference to the ability of this Regulation to derogate from the 'general monitoring' approach.

16.15 He would nonetheless support the inclusion of specific wording within the operative parts of the proposed Regulation (the Articles themselves rather than simply in the recitals) to clarify the relationship between the obligations set out in this proposal and in the E-commerce Directive.

Our Conclusions

16.16 **We are grateful to the Minister for addressing the questions we raised in our earlier Report. The only change of substance in negotiations so far is to extend the time available to Member States—from twelve months rather than six—to make any adjustments needed before the Regulation becomes applicable at national level. This short extension means that the Regulation is still likely to take effect during the post-exit transition/implementation period envisaged in the draft EU/UK Withdrawal Agreement and so would be binding on and directly applicable in the UK, at least until the end of transition.**

16.17 **We note the Presidency's intention to seek a general approach on the proposed Regulation at the Justice and Home Affairs Council on 6/7 December 2018. Given the Government's support for regulatory action at EU level to tackle online terrorist content, we can see some advantage in bringing the matter to the Council while the UK is still able to influence and vote on the general approach. As the compromise text to be brought to Council is unlikely to necessitate any changes to domestic law, we are willing to grant a scrutiny waiver for the forthcoming Council so that the Government is able to express its support. We ask the Minister to report back to us on the outcome of the Council, to explain whether any decision has been made to set**

up a central oversight mechanism at EU level to monitor removal orders being sent to hosting service providers, and to provide a summary of any changes sought by the European Parliament once it has agreed its position.

16.18 **Meanwhile, the proposed Regulation remains under scrutiny. We draw this chapter to the attention of the Home Affairs Committee, the Justice Committee, the Digital, Culture, Media and Sport Committee and the Joint Committee on Human Rights.**

Full details of the documents:

Proposal for a Regulation on preventing the dissemination of terrorist content online: (40069), 12129/18 + ADDs 1–3, COM(18) 640.

Previous Committee Reports

Forty-first Report HC 301–xl (2017–19), chapter 6 (24 October 2018).

17 Workplace safety: amendments to the Carcinogens and Mutagens Directive

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted for a General Approach to be sought in the ESPCO Council of 6 December 2018; drawn to the attention of the Health Committee and the Work & Pensions Committee
Document details	Proposal to amend Directive 2004/37/EC on the protection of workers from the risks related to exposure to carcinogens or mutagens at work (Phase 3)
Legal base	Articles 153 (1) and 153(2) TFEU; ordinary legislative procedure; QMV
Department	Health and Safety Executive
Document Number	(39612), 7733/18 + ADDs 1 — 3, COM(18) 171

Summary and Committee's conclusions

17.1 Cancer is the leading cause of work-related deaths in the EU. In the UK, around 3,500 people die each year from occupational cancer caused by exposure to carcinogenic substances. To reduce these numbers, the EU has legislated to prevent dangerous levels of workplace exposure to carcinogenic substances in the form of the Carcinogens and Mutagens Directive (CMD). Since May 2016, the Commission has published three separate sets of amendments to the CMD to further restrict the use of certain carcinogenic substances in the light new scientific advice (respectively, labelled Phases I to III).

17.2 On 5 April 2018, the Commission published a proposal for a third phase of amendments to the CMD (that under consideration). The phase 3 amendments set out occupational exposure limit values (OELVs) for five substances: Cadmium, Beryllium, Arsenic acid, Formaldehyde and MOCA.[113] These amendments would also set a skin notation for MOCA,[114] a notation for skin sensitisation to formaldehyde, and a notation for both skin and respiratory sensitisation to Beryllium.

17.3 Minister of State at the Department for Work & Pensions (Sarah Newton), submitted an Explanatory Memorandum on the Phase III proposal on 24 April 2018. She "broadly welcome[s]" the new exposure limits, noting that current UK legislation already requires employers to consider "all routes of exposure to carcinogens to be considered, including skin" and ensure any exposure to carcinogenic substances is "controlled to as low a level as is reasonably practicable".

113 MOCA is an anacronym for 4,4'-Methylene-bis(2-chloroaniline). MOCA is listed as a 'substance of very high concern' by the European Chemicals Agency.

114 A notation for 'skin sensitisation' is made where exposure to a substance can cause an adverse skin reaction.

17.4 The proposed EU-wide exposure limits are lower than those provided for domestically (except for MOCA where the UK's domestic workplace exposure limit is lower than that suggested by the Commission).

17.5 In response to the Committee's initial Report to the House of 15 May 2018, the Minister wrote to the Committee on 5 September. The Minister informed the Committee that after consultations with stakeholders, the Government was concerned that industry would have difficulty meeting the proposed OELVs for Formaldehyde, Beryllium and Cadmium. These concerns were said to have been raised with other Member States with a view to gauging support for changes to the proposed OELVs and/or the timescales for their introduction.

17.6 The Minister now writes—21 November 2018 —requesting "a waiver should a vote in Council come swiftly…". After discussions with officials at Departmental-level (the Health & Safety Executive) it has been clarified that the Minister is seeking a scrutiny waiver so that the Government can support a General Approach to be sought by the Austrian Presidency in the in the EPSCO Council of 6 December 2018.

17.7 The Minister provides a brief—if at times unclear—update on the progress of negotiations on the proposal. Of the Minister's previous concerns, she informs the Committee that the UK has been able to secure a three-year transitional period — in addition to the two-year implementation period under the Directive—before the proposed OELV on Formaldehyde would apply to the embalming/funeral sector.

17.8 On the proposal for a revised OELV on Cadmium, the Minister informs the Committee that UK officials have been working with counterparts from other Member States on the introduction of a revised limit alongside the "biological monitoring of workers". The Minister is silent on the Government's previous concerns regarding the introduction of a more stringent—versus domestic legislation—OELV for Beryllium.

17.9 Through discussions with officials at the HSE—as not explicitly stated in the Minister's letter—we have ascertained that the Government intends to vote in favour the General Approach to be sought at the December EPSCO Council providing that it retains the derogation secured for the embalming/funeral sector.

17.10 **We thank the Minister's officials for clarifying that a General Approach will be sought at the December EPSCO Council and for outlining the Government's voting intentions. We are disappointed that this was not made clear in the Minister's letter to the Committee of 21 November 2018.**

17.11 **We are happy to agree to the requested scrutiny waiver so that the Government can vote in favour of the General Approach to be sought in the EPSCO Council of 6 December 2018. This waiver is provided on the basis that the Government has made clear to the Committee that it will only vote in favour of the General Approach if it includes the Formaldehyde derogation—said to have been secured during Working Groups— for the embalming/funeral sector.**

17.12 **We request a report on the outcome of the 6 December EPSCO Council detailing how the Government voted by 17 January 2019. This report should explain whether the**

Government still holds reservations regarding the introduction of an EU OELV for Beryllium and, if it does, the steps it has taken to ensure these are considered during negotiations.

17.13 **We draw this Report to the attention of the attention of the Health Committee and the Work & Pensions Committee.**

Full details of the documents:

Proposal to amend Directive 2004/37/EC on the protection of workers from the risks related to exposure to carcinogens or mutagens at work (Phase 3): (39612), 7733/18 + ADDs 1–3, COM(18) 171.

Previous Committee Reports:

Twenty-seventh Report HC 301–xxvi (2017–19) chapter 6 (9 May 2018).

18 Recast of the Brussels IIa Regulation

Committee's assessment	Legally important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted; drawn to the attention of the Justice Committee
Document details	Proposal for a Regulation on jurisdiction, the recognition and enforcement of decisions in matrimonial matters and the matters of parental responsibility; and on international child abduction (recast)
Legal base	Article 81(3) TFEU; special legislative procedure; unanimity
Department	Ministry of Justice
Document Number	(37909), 10767/16 + ADDs 1–2, COM(16) 411

Summary and Committee's conclusions

18.1 Regulation 2201/2003 (the Brussels IIa Regulation) sets out rules of private international law[115] relating to cross-border matrimonial matters,[116] parental responsibility[117] and international child abduction (which includes wrongful removal or retention of a child). This includes rules for deciding (a) which court has jurisdiction, (b) the extent to which a judgement given by the court of one Member State must be recognised by the court in another,[118] (c) the enforcement of judgments in another Member State, and (d) co-operation between Central Authorities designated in each Member State to co-ordinate the handling of child abduction cases.

18.2 This proposed recast focusses on the child abduction aspects of this Regulation. Our first Report in September 2016 highlighted a variety of legal and policy issues that were of concern to the Government.

18.3 The UK participates in the Brussels IIa Regulation. The then Minister (Sir Oliver Heald) notified the Committee in October 2016 that the UK had opted in to this proposal in the light of broad support from interested parties. The Minister (David Gauke) provided the Committee with a detailed update on the progress of negotiations by letter dated 17 July 2018 now supplemented by a letter of 20 November 2018. He indicates that the Council is shortly likely to be seeking agreement to its General Approach in readiness for trilogue negotiations with the European Parliament.

115 I.e. the law relating to the handling of cross-border disputes between private parties.

116 Divorce, legal separation and marriage annulment.

117 Including custody and rights of access.

118 A judgment of a court in one Member State is "recognised" when it is accepted by the Court of another Member State, particularly for the purposes of subsequent proceedings in which the first judgment is relevant e.g. a divorce in Member State A may need to be recognised by a court in Member State B dealing with the division of matrimonial property.

18.4 The Minister explains in detail how the text meets concerns raised by the Government as outlined below. The main outstanding issue is clarification of the duty to hear the child. It is not currently envisaged that the recast would enter into force until 1 July 2022.

18.5 The UK general objective is that post-Brexit there will be a close cooperation in civil judicial co-operation such as in this area, although nothing appears in the current *Outline of the Political Declaration setting out the Framework for the Future Relationship between the European Union and the United Kingdom.*

18.6 The Government's Guidance of 13 September 2018 on Handling civil legal cases that involve EU countries points out that the UK has signed up in its own right to a number of Hague Conventions on family law which cover many of the same areas as the Brussels IIa Regulation. It indicates that in the event of no deal the UK would repeal existing EU rules and a switch to the relevant Hague Conventions.

18.7 **We are grateful for the Minister's full update and we grant a scrutiny waiver, expiring at the end of the year, for him to be able to agree to a Council General Approach in anticipation of trilogue discussions with the European Parliament.**

18.8 **We ask him to update us in the New Year, and in doing so identify the main elements of the proposal that are likely to be the centre of discussion with the European Parliament, and to address the prospects of agreement with the EU on the subject area of this proposal, and its likely shape.**

18.9 **In the meantime the proposal remains under scrutiny.**

Full details of the documents:

18.10 Proposal for a Regulation on jurisdiction, the recognition and enforcement of decisions in matrimonial matters and the matters of parental responsibility; and on international child abduction (recast): (37909), 10767/16 + ADDs 1–2, COM(16) 411.

The Minister's letters of 17 July 2018 and 20 November 2018

18.11 The Minister indicates that the Council text has largely evolved in a manner the Government finds satisfactory. Broadly:

Procedures supplementing the 1980 Hague Convention regarding child abduction

- The "override provision" found in Article 26 of the proposal (which allows a custody judgment from the state of habitual residence of an abducted child to override a non-return order from the state of abduction) has been reformulated to make it clear it does not create new obligations;
- Deadlines for courts to work to are now considered workable;
- A requirement to have a limited number of specialised courts has been replaced by encouragement for this in the form of a recital;

- The concept of ordinary appeal has been clarified in respect of common law jurisdictions; and
- Requirements for courts to provide specified information in judgments has been removed and replaced with a recital requiring courts to refer only to the relevant articles of the Hague Convention on which refusal to order return was based.

Placement of a child in another Member State (Article 65)

- The procedure for consent of the competent authority in the Member State of placement is not applicable where the placement is with close relatives or where the relevant member State does not require consent;
- The consent procedures have been streamlined; and
- A recital requires the child's ethnicity, religion, cultural and linguistic identity to be taken into account and that where there is a cross-border connection the relevant Member State's consular authorities should be notified and asked for information.

Automatic recognition of judgments

- The grounds for refusal of automatic recognition of judgments from another Member State "non-privileged" decisions[119] are public policy, irreconcilability with a judgment of the state in which recognition is sought, lack of effective service in cases of default of appearance, lack of opportunity for holders of parental responsibility to be heard, lack of opportunity for the child to be heard, and non-compliance with the consultation procedure for cross-border placement; and
- The position of defendants in respect of "privileged" decisions, which are already automatically recognised has been strengthened by creating a legally binding certificate to accompany such decisions which will be capable of being rectified or withdrawn in the Member State of origin.

Enforcement of decisions

- The text now omits harmonising features of the Commission proposal in respect of enforcement procedures, by removal of a provision requiring specific standards of enforcement (Article 32(2)), removal of a requirement for explanation in cases where enforcement takes more than six weeks, and leaving the competence of courts to deal with enforcement to national law.
- Provisional or protective measures (such as supervision of contact) ordered by a court which would not otherwise have jurisdiction, would be capable of enforcement in other Member States where the court is considering the return

119 Decision other than "privileged" decisions. The latter cover contact with children, custody decisions entailing the return of an abducted child.

of an abducted child. This should alleviate concerns where, for example there is an allegation of abuse by the left behind parent of an abducted child and also alleviate concerns over re-abduction.

Cooperation between Central Authorities

- Whilst not all the potential new burdens on the central authorities have been removed the critical provisions requiring adequate resources to be provided to central authorities has been turned into a recital.

Authentic Instruments[120] and Agreements

- Recognition and enforcement of authentic acts is subject to safeguards.

Hearing the child

- The UK has secured agreement that the obligation to hear the child should be in accordance with national law and procedure and is negotiating supplementary clarifications.

Previous Committee Reports

Tenth Report HC 71–viii (2016–17), chapter 7 (7 September 2016).

120 An Authentic Instruments is a certificate by a publicly recognised authority (for example a notary public) recording a legal act or fact (for example a matrimonial settlement).

19 Services Directive notification procedure

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; update requested
Document details	Proposal for a Directive of the European Parliament and of the Council on the enforcement of the Directive 2006/123/EC on services in the internal market, laying down a notification procedure for authorisation schemes and requirements related to services, and amending Directive 2006/123/EC and Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System
Legal base	Article 53(1), 62 and 114 TFEU, Ordinary legislative procedure, QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38450), 5278/17 + ADDs 1–2, COM(17) 821

Summary and Committee's conclusions

19.1 On 13 January 2017 the European Commission published a proposed Directive[121] which would strengthen the notifications procedure which forms part of the Services Directive (EC) 123/2006,[122] in order to address concerns about the poor implementation of the Services Directive. In its Explanatory Memorandum,[123] the Government indicated its broad support for the proposal, stating that it was a strong supporter of a liberalised EU services market, had called for better enforcement of the notifications procedure, and that the proposal addressed many essential areas for improvement.

19.2 Following working groups within the Council, a General Approach was agreed at the Competitiveness Council on 29–30 May 2017. In it, the Member States reduced the scope of the proposal by excluding insurance schemes from the scope of the Directive and deleting a clause which would have meant that a breach of one of the elements of the procedure would have rendered it unenforceable vis-à-vis individuals. The Parliamentary Under Secretary of State at the Department of Business, Energy and Industrial Strategy (Lord Henley) provided a comprehensive overview of these changes in his letter of 12 December 2017.[124]

121 Proposal for a Directive of the European Parliament and of the Council on the enforcement of the Directive 2006/123/EC on services in the internal market, laying down a notification procedure for authorisation schemes and requirements related to services COM(16) 821 final.

122 Directive (EC) 2006/123 of the European Parliament and of the Council of 12 December 2006 on services in the internal market.

123 Explanatory Memorandum from the Minister, BEIS, to the Chairman of the European Scrutiny Committee (30 January 2017).

124 Letter from the Minister, BEIS, to the Chairman of the European Scrutiny Committee (12 December 2017).

19.3 The Committee welcomed the exhaustive information provided by the Minister regarding the general approach,[125] and accepted that the proposal, which would continue the incremental liberalisation of the Single Market for Services, was beneficial to the UK. Even in the context of a non-negotiated EU exit, the UK would continue to benefit from the proposal in those cases where individual Member States' services regulation does not discriminate between EU and third country nationals.

19.4 On the implications of EU exit for those services covered by the Directive, the Committee concluded that the impact of a shift from EU membership to third country status would be uneven: UK access to the EU market in unregulated sectors (e.g. marketing, management consulting) was likely to be relatively unaffected, whereas service sectors for which more developed EU-level frameworks exist (e.g. legal services, accountancy, audit) would be more adversely impacted. The Committee noted the UK Trade Policy Observatory's statement that the STRI shows that outside the Single Market, "it is in professional services sectors … where access for foreign providers is restricted", and that UK lawyers and accountants looking to provide services in the EU would be up against "major restrictions". [126]

19.5 The Government indicated its intention to preserve the Provision of Services Regulations 2009, which implements the EU Services Directive. However, the Committee noted that, even if the UK retained its regulations implementing the Services Directive in domestic law, the EU27 would no longer be required to reciprocate (as Union law would no longer apply to the UK), and EU Member States would therefore be permitted to discriminate against UK service providers, within the scope of their commitments in the context of the World Trade Organisation (WTO) General Agreement on Trade in Services (GATS).

19.6 The Committee also sought further clarification from the Minister as to how the Government proposed to modify the Provision of Services Regulations 2009[127] using the powers under the EU Withdrawal Act. In response,[128] the Minister stated that these powers would be used to correct "technical deficiencies in the Provision of Services Regulations (PoSR) 2009". The Minister did not give any indication of the policy approach that would be taken to these changes, stating only that "we seek to build a future economic partnership with the EU, which maintains current levels of services trade" and that further details of how the UK's domestic services regime will operate will be set out by the Statutory Instruments.

19.7 The Minister also updated the Committee regarding the progress of trilogue negotiations,[129] indicating that the European Parliament's amendments were generally more ambitious than those of the Member States and therefore in line with the UK's objectives, given that the UK sought an ambitious approach in this area. The Minister stated that:

125 Eleventh Report HC 301–xi (2017—2019), chapter 1 (24 January 2018).
126 Written evidence to the House of Lords EU Internal Market Sub-Committee from the UK Trade Policy Observatory (TAS0085).
127 Provisions of Services Regulations 2009.
128 Letter from the Minister to the Chair of the European Scrutiny Committee (21 February 2018).
129 Letter from the Minister to the Chair of the European Scrutiny Committee (12 April 2018).

- in terms of scope, the European Parliament objected to the exclusion of professional liability insurance requirements from the scope, and sought to include professional rules on commercial communications;
- the compromise text included a three-month consultation period for draft measures, and a two-month period for member states and the Commission to make comments following notification; and
- the European Parliament wished to reintroduce the deleted provision on 'substantial procedural defects', which would mean that the adoption of measures in breach of the procedure should constitute a "substantial procedural defect of a serious nature" [130] which might result in a domestic court finding the measure to be inapplicable.

19.8 On 20 November 2018 the Minister wrote further letter to the Committee[131] to explain that, although the Government had intended to support the outcome of trilogue negotiations when he last wrote, progress in trilogues had subsequently stalled, for two reasons.

19.9 First, the Visser Vastgoed ruling of the Court of Justice of the European Union (CJEU) (C-360/15 & C-31/16) clarified that the scope of the notification obligation of the Services Directive extends to urban land use / zoning plans, where those plans impose restrictions on service activities such as retail.[132] The Minister reports that this has prompted concern from some Member States about the increase in the administrative and financial burden placed upon local authorities and led to suggestions that there should be an exemption included for spatial structure plans or urban land use plans at the local level. The Minister states that the UK position is that the compromise text should seek a balance between the need to avoid excessive administrative burden whilst ensuring that the exemption on urban land use plans is not used as a means of avoiding notification of measures that affect the ability to provide services.

19.10 Secondly, the Minister states that concerns (which the UK does not share) have been expressed by some Member States regarding the legality of the decision power that allows the Commission to request Member States to refrain from adopting new measures which do not comply with the requirements of the Services Directive, and have been seeking not only to limit the Commission's powers in respect of the additional measures that are brought in scope of the Notifications Directive, but also to limit its powers under the existing procedure contained within the Services Directive. The Minister states that the Council Legal Service have highlighted that the decision power in the amended notification procedure mirrors that of the decision power contained within the Services Directive, and considers that it does not contradict the principles of institutional balance and proportionality.

19.11 Setting out the UK position in advance of the final trilogue meeting and anticipated subsequent adoption of the final text in Council, the Minister observes that the UK's primary interest of securing a proportionality assessment for notifications has been retained within the compromise text, and that the UK is pleased that the scope of

130 European Scrutiny Committee, Eleventh Report, chapter 1 (24th January 2018).
131 Letter from the Minister to the Chair of the European Scrutiny Committee (20 November 2018).
132 Judgement of the Court of Justice of the European Union, Visser Vastgoed (C-360/15 & C-31/16) (30 January 2018).

the requirement to make a notification is to be broadened. He indicates that, should the Austrian Presidency succeed in securing a balanced compromise on urban land use plans and is attempting to address Member State concerns regarding the Commission's decision powers and achieve an agreement with the European Parliament which continues to meet the Government's negotiating objectives, the Government would wish to vote in favour in any subsequent Council meeting.

19.12 Officials have indicated that, if such a mandate is agreed, it is likely to be accepted by the European Parliament on 15 November, with the final text going to Council for adoption at one of the three remaining Council meetings in 2018: ECYS Council (26–27 November), Competition Council (29–30 November), or EPSCO council (6–7 December).

19.13 **We thank the Minister for his thorough updates regarding the General Approach agreed by Council and the progress of trilogue negotiations. The Government is content that the UK has secured its primary interests in the negotiations of securing a proportionality assessment for notifications and ensuring that the scope of the requirement to make a notification is to be broadened. On this basis, the Minister requests that the Committee clear the file from scrutiny, so that the Government can support the anticipated adoption of the final text in November/December 2018.**

19.14 **The proposal is beneficial for the UK as having a more effective notification mechanism of this kind will make it more difficult for Member States to introduce protectionist domestic regulations that restrict the right of establishment and the freedom to provide services, where these are not non-discriminatory, proportionate and justified by public interest objectives. This will continue to benefit the UK when it ceases to be a Member State in those instances where individual Member States' services regulation does not discriminate between EU and third country nationals. We have previously considered the wider implications of EU exit for service providers covered by the Services Directive[133] and do not repeat that analysis here.**

19.15 **In response to the Committee's questions about how the Government will treat services covered by the Services Directive, the Minister states that the Government intends to preserve the Provision of Services Regulations 2009, and will use the powers conferred on it by the EU Withdrawal Act to correct "technical deficiencies" which will arise as a result of EU exit. The Minister does not clarify whether this means that the Government will remove the preferential arrangements which currently apply with respect to EEA providers, stating only that "we seek to build a future economic partnership with the EU, which maintains current levels of services trade" and that further details of how the UK's domestic services regime will operate will be set out by the Statutory Instruments. We infer that, because the reciprocal provisions in the Services Directive which provide reciprocal preferential market access for EU Member States will no longer apply to the UK, even if they are retained in UK law, the Statutory Instrument will proposed to delete the preferential arrangements for EU providers from the Provision of Services Regulations. Further, we note that, because the UK has a less restrictive approach to regulating some service sectors than other EU Member States, it is probable that, in this scenario, EU service providers will retain a superior degree of access to UK services markets than vice-versa, and the UK's WTO GATS commitments and MFN rules will limit the Government's ability to address this imbalance by applying a more restrictive approach to EU service providers specifically.**

133 Eleventh Report HC 301–xi (2017—2019), chapter 1 (24 January 2018).

19.16 **To provide greater clarity on this point, we request that the Minister provide us with further clarification on how the proposed statutory instrument will treat EU service providers, to be shared with the Committee no later than when the relevant statutory instrument is published (and in addition to the relevant explanatory memorandum). We request that this update specify the principal effects that the SI will have on access to the UK market, broken down by type of service provider, in the event of a non-negotiated exit. As this question does not relate to the substance of the legislative proposal under scrutiny we are content to pursue the issue through correspondence.**

19.17 **We now clear the proposal from scrutiny in advance of its anticipated adoption at one of the forthcoming meetings of the Council of Ministers.**

Full details of the documents:

Proposal for a Directive of the European Parliament and of the Council on the enforcement of the Directive 2006/123/EC on services in the internal market, laying down a notification procedure for authorisation schemes and requirements related to services, and amending Directive 2006/123/EC and Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System: (38450), 5278/17 + ADDs 1–2, COM(17) 821.

Previous Committee Reports

Eleventh Report HC 301–xi (2017–19), chapter 1 (24 January 2018); Second Report HC 71-xxxi (2017–19) chapter 9 (22 November 2017); Thirty-Third Report HC 71–xxxi (2016–17), chapter 2 (1 March 2017).

20 The EU's schedule of services commitments — compensatory adjustments under the General Agreement on Trade in Services

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny; further information requested; drawn to the attention of the International Trade Committee
Document details	Council Decision on the conclusion of the relevant agreements under Article XXI GATS with Argentina, Australia, Brazil, Canada, China, the Separate customs territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei), Columbia, Cuba, Ecuador, Hong Kong, China, India, Japan, Korea, New Zealand, the Philippines, Switzerland, and the United States, on the necessary compensatory adjustments resulting from the accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Austria, the Republic of Poland, the Republic of Slovenia, the Slovak Republic, the Republic of Finland and the Kingdom of Sweden to the European Union
Legal base	Articles 91, 100(2), 207 and 218(6)(a)(v) of TFEU
Department	International Trade
Document Number	(40169), 14018/18 + ADDs 1–17, COM(18) 733

Summary and Committee's conclusions

20.1 The General Agreement on Trade in Services (GATS) governs international trade in services between World Trade Organisation (WTO) members.

20.2 The trade in services commitments of all EU Member States are presented under a consolidated EU schedule, which is annexed to the GATS. This is legally binding and guarantees a level of market access and national treatment provisions for foreign service providers, subject to any specified limitations or derogations. Member States are each able to specify their own WTO limitations in the EU's services schedule.

20.3 Following successive enlargements of the EU to 15 and then 25 Member States by 2004, the EU sought to bring the GATS commitments of the new Member States in line with prevailing EU commitments. Seventeen WTO members claimed that they were adversely affected by the modification and/or withdrawal of certain commitments and Article XXI GATS negotiations resulted in the conclusion of a series of compensatory agreements with affected WTO members.

20.4 A draft Council Decision on the conclusion of the compensatory agreements, which formed the basis of a new consolidated schedule of commitments for the EU25, was approved by the Council in 2007. These agreements have been ratified by all EU Member States, including the UK,[134] with the sole exception of France, where ratification has been held up by constitutional issues relating to the authentic linguistic version of the agreements. As a result, the EU25 consolidated schedule of services commitments has not entered into force in the WTO.

20.5 Following the Court of Justice judgment of 16 May 2017 on the balance of competences in the EU free trade agreement (FTA) with Singapore, which opined on provisions falling within the EU's exclusive competence, mixed competence (shared between the EU and the Member States) or Member State only competence, the Commission is 're-submitting' the Council Decision on the conclusion of the compensatory agreements as 'EU-only', on the basis that all provisions fall within EU exclusive competence (and will therefore not require ratification by Member States in accordance with their own domestic processes).

20.6 In his Explanatory Memorandum of 14 November 2018, the Minister of State for Trade Policy (George Hollingbery) states that this is purely a "procedural exercise" that approves the conclusion of the compensatory agreements on the terms agreed in 2006, allows the EU25 schedule to come into force at the WTO and provides "legal certainty for all EU Member States that joined the EU after 1994".

20.7 The Minister stresses that the "proposal does not present an obstacle to the process the UK will undertake at the WTO to certify its schedule of commitments", on the basis that it "will be independent of that undertaken by the EU for the EU25 schedule, and the UK has already chosen to reflect in a UK-specific schedule the same level of commitments found in the EU25 schedule" that will "come into effect after the IP [transition/implementation period], allowing WTO Members to continue enjoying the current level of access to the UK's services market which is guaranteed under GATS".

20.8 **We note the Minister's full support for this proposal and that it is expected to be approved by COREPER on 5 December 2018 and Council on 19 December 2018. We clear the document from scrutiny but ask the Minister to update us on the outcome of the negotiations and vote in Council.**

20.9 **Furthermore, noting that:**

- **The UK is a member of the WTO in its own right, but its commitments are currently set out in the EU's services schedule annexed to the GATS and the UK will therefore need to establish its own WTO services schedule post-exit (in the event of 'no deal') or post-transition/implementation period;**
- **WTO rules and UK-specific WTO schedules set the default position that will govern the UK's trade with the EU and other third countries post-exit (in the event of a 'no deal' scenario) or post-transition/implementation period, and provide the baseline from which the UK will negotiate more preferential trade relationships with third countries; and**

134 The European Communities (Definition of Treaties) (Agreements concluded under Article XXI GATS) Order 2009 (SI 2009/220).

- **A footnote to Article 129 of the draft Withdrawal Agreement of 14 November 2018 states that the EU will notify third countries that the UK should be treated as a Member State for the purposes of international agreements during the transition period, which the Minister states "includes retaining the UK's existing rights and obligations under the EU's GATS schedules",**

a) **we ask the Minister to:**

- **provide an update on the progress made in the Government's preparations to establish a UK-specific services schedule in the WTO after UK exit from the EU, including Most Favoured Nation (MFN) treatment exemptions under the GATS;**[135] **and**

- **explain how any extension to the transition/implementation period or triggering of the Protocol on Northern Ireland/Ireland could impact the UK's certification process and negotiation of FTAs.**

20.10 **We draw the document and our conclusions to the attention of the International Trade Committee.**

Full details of the documents:

20.11 Council Decision on the conclusion of the relevant agreements under Article XXI GATS with Argentina, Australia, Brazil, Canada, China, the Separate customs territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei), Columbia, Cuba, Ecuador, Hong Kong, China, India, Japan, Korea, New Zealand, the Philippines, Switzerland, and the United States, on the necessary compensatory adjustments resulting from the accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Austria, the Republic of Poland, the Republic of Slovenia, the Slovak Republic, the Republic of Finland and the Kingdom of Sweden to the European Union: (40169), 14018/18 + ADDs 1–17, COM(18) 733.

Previous Committee Reports

Seventeenth Report HC 5–xvi (2009–10), chapter 4 (30 March 2010); Twelfth Report HC 19–xi (2008–09), chapter 7 (18 March 2009); Twenty-first Report HC 41–xxi (2006–07), chapter 12 (9 May 2007).

135 See 'Trade White Paper: Preparing for our future UK trade policy — government response' of 5 January 2018.

Documents not raising questions of sufficient legal or political importance to warrant a substantive report to the House

Cabinet Office

(40173) 12404/18 —	Commission Recommendation of 12.9.2018 on election cooperation networks, online transparency, protection against cybersecurity incidents and fighting disinformation campaigns in the context of elections to the European Parliament A contribution from the European Commission to the Leaders' meeting in Salzburg on 19–20 September 2018.

Department for Environment, Food and Rural Affairs

(40160) 13765/18 COM(18) 717	Proposal for a Council Decision on the position to be taken on behalf of the European Union in the seventh Meeting of the Parties of the Agreement on the Conservation of African-Eurasian Migratory Waterbirds with regard to certain amendments to Annex 3 to the Agreement.
(40162) 13800/18 COM(18) 731	Proposal for a Council Decision on the position to be taken on behalf of the European Union, in the thirty-eighth meeting of the Standing Committee of the Convention on the conservation of European wildlife and natural habitats, with regards to amendments to Appendices II and III.

Department for Exiting the European Union

(40156) 13542/18 +ADD 1 COM(18) 491	Report from the Commission Annual Report 2017 on relations between the European Commission and national parliaments.
(40163) 13537/18 +ADD 1 COM(18) 490	Report from the Commission Annual Report 2017 on the application of the principles of subsidiarity and proportionality.

Foreign and Commonwealth Office

(40194)	Council Decision amending Decision 2010/452/CFSP on the European Union Monitoring Mission in Georgia, EUMM Georgia
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(40195)	Proposal to amend Council Decision 2017/2303/CFSP of 12 December 2017 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.
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(40198)	Council Decision amending Decision (CFSP) 2010/788 concerning restrictive measures against the Democratic Republic of the Congo
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(40199)	Council Implementing Regulation (EU) implementing Article 9 of Regulation (EC) No 1183/2005 imposing certain specific restrictive measures directed against persons acting in violation of the arms embargo with regard to the Democratic Republic of the Congo
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Formal Minutes

Wednesday 28 November 2018

Members present:

Sir William Cash, in the Chair

Martyn Day	Mr David Jones
Mr Marcus Fysh	Andrew Lewer
Kelvin Hopkins	Michael Tomlinson
Darren Jones	Dr Philippa Whitford

Scrutiny Report

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 21 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Forty-sixth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

[Adjourned till Wednesday 5 December at 1.45pm

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)

Geraint Davies MP (*Labour/Cooperative, Swansea West*)

Martyn Day MP (*Scottish National Party, Linlithgow and East Falkirk*)

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*)