

Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Brexit: EU Budget

Wednesday 11 January 2017

10.20 am

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Members present: Baroness Falkner of Margravine (Chairman); Lord Butler of Brockwell; Lord Desai; Lord Haskins; Baroness Liddell of Coatdyke; Earl of Lindsay; Lord Shutt of Greetland; Lord Skidelsky; Duke of Wellington; Lord Woolmer of Leeds.

Evidence Session No. 2

Heard in Public

Questions 11 - 24

Witnesses

I: Rhodri Thompson QC, Matrix Chambers, and Professor Takis Tridimas, Matrix Chambers and Chair of European Law, King's College London

Examination of Witnesses

Rhodri Thompson QC, Matrix Chambers, and Professor Takis Tridimas, Chair of European Law, King's College London.

Q11 The Chairman: Good morning. Can I welcome Rhodri Thompson QC and Professor Takis Tridimas to our inquiry on Brexit and the implications for the EU budget? I have to go through some housekeeping points briefly for you. Thank you very much for coming in. You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session of the Committee and a full transcript will be taken. This will be put on the public record in printed form and on the parliamentary website. You will be sent a copy of the transcript and you will be able to revise it in terms of any minor errors. The session is on the record. It is being webcast live and will be subsequently accessible via the parliamentary website.

I wonder if either of you or both of you would like to make any introductory comments, but before I direct you to that I need to declare an interest: I am currently a visiting professor in the Policy Institute at King's College. Professor Tridimas, that may be of note for you. Thank you. Do you have any opening comments?

Rhodri Thompson: I do not think we have anything that will not emerge in discussion, apart from the same point that was made at the start of the last session: there are quite a lot of difficult questions here and some uncertainties. We will do our best.

Professor Takis Tridimas: I simply voice the same. The area of EU finances is highly complex and in some of the questions that the Committee will be minded to ask, it will be very difficult to have definitive answers.

Q12 The Chairman: That takes me directly into the complexity. We have been grappling with the legal status of the Multiannual Financial Framework 2014-2020, and it is not clear to us whether the UK is legally committed to paying its full share until 2020, even if it leaves the European Union before 2020. At the moment, we know the Government's ambition is to try to do this by 2019. Are we legally committed to that and, alongside that, depending on your answer, I have a follow-up that I will come back on. Professor Thompson, would you like to go first?

Rhodri Thompson: I should say I am not a professor.

The Chairman: You are just a silk!

Rhodri Thompson: Exactly. By way of general comment, which may be helpful, the MFF is in the form of a regulation, which is well known as in principle a directly applicable piece of legislation, which is recognised by Section 2 of the European Communities Act, so it is a binding measure. The decision, which is the basis for the own resources under Articles 311 and 312, is a form of mini-treaty between the Member

States. Measures of this kind are generally recognised under Section 1(3), and therefore Section 2(1), of the European Communities Act. Both as a matter of EU law and domestic law, they are, as it stands, binding legislation subject to the interpretation by the Court of Justice, and, under Section 3 of the 1972 Act, what the Court of Justice says about what that means goes.

Of course, all that is now up for discussion in the form of both the negotiations and any amendment to the 1972 Act that may be made either on a transitional or final basis in parallel, under what is called the Great Repeal Act. That is the general position, but Professor Tridimas can give you some more specific guidance as to how this all works.

Professor Takis Tridimas: It may be worth very briefly outlining the legal framework that governs EU finances. As I understand it, this legal framework is based on three pillars. The first pillar is the principle of own resources; the EU has its own resources to finance its expenditure. The second pillar is the multiannual financial framework, and the third one is the annual budget.

The multiannual financial framework is an instrument of financial budgetary discipline. The idea is that the Member States agree on a priority of financial objectives. This is agreed usually on a five-year basis, and the framework itself contains maximum ceilings of expenditure. It is agreed unanimously by the Council and is in the form of regulation, which means that it has binding legal consequences.

Coming to your question of whether the United Kingdom will be bound, there are two issues. One is whether the multiannual financial framework can be revised. The second question is what happens if it does not get revised. On the first limb, in fact the regulation that establishes the MFF provides for the possibility of its revision in unforeseeable circumstances. This is Article 17 of the regulation. We can agree that Brexit is an unforeseeable circumstance, which would justify revision.

There is a more complicated issue here, which is how revisions are to be made. Normally a regulation will be revised according to the procedure that was followed for its adoption. One would think that unanimity in the Council is required. Article 50, which is the provision of the treaty on the European Union that provides the legal basis for Brexit, does not provide for unanimity; it facilitates Brexit on the basis of an agreement between the United Kingdom on the one hand and 20 of the Member States on the other hand. The procedure is different.

The Chairman: 27, if I can correct you.

Duke of Wellington: Did you say 20 or 27?

Professor Takis Tridimas: I said 20 because the withdrawal agreement is to be agreed by a special qualified majority. It is not to be agreed by unanimity, which in some respects makes things easier for the withdrawing country, in the sense that possibly the withdrawing country

can agree a deal with the majority and create alliances. It does not need to have unanimity on the part of the EU.

There are competing procedures here. To revise the MFF, one would need to have unanimity. It would not be possible, in other words, to do it by recourse to the Article 50 procedure. This is my view. We do not have any precedent, we do not have any authority on that, but to my mind finances take priority and this is what the treaty provides for this kind of regulation. In conclusion, the multiannual financial framework regulation can be revised. Brexit is a ground for revision, but unanimity will be required to effect it.

Rhodri Thompson: Can I just add that Parliament has a role, under Article 312(2), which is the MFF, where it has a consent role. Effectively, you would have to get approval of the Parliament. Under 311, in relation to the Own Resources Decision, it has a right of consultation but not a right of consent, so there is a further issue, particularly in relation to the MFF.

The Chairman: Professor Tridimas, you say that in your view it can be revised. Do you see a political deal on this as a possibility? You have described how it could happen, but in terms of the raw politics of it, where do you think the UK stands now?

Professor Takis Tridimas: There is a good possibility for a political deal. It would be wise to have one. It would be in the interest of both parties and it would save a lot of trouble if it were to be achieved.

Rhodri Thompson: It will raise some rather familiar issues, namely about who sets the terms of the deal, who is responsible for interpreting the deal and how much it is going to cost. Those three issues will undoubtedly arise in relation to any deal.

The Chairman: On the issue of who interprets the deal, do you have any thoughts?

Rhodri Thompson: It does move to exactly the areas that we are all very familiar with: that the UK would probably like the UK courts to deal with it; the EU will assume that the Court of Justice will deal with it, and no doubt it will lead to some interesting political discussions.

The Chairman: As a lawyer, you would not hedge.

Rhodri Thompson: It is probably the next question, which is if no agreement is reached, how will you decide what the position is, as of, for example, 1 April 2019? We can address that now or I suspect we will come on to it in a moment.

Q13 **Lord Butler of Brockwell:** I have two questions. You said that the MFF sets a maximum, so there is not a compulsion that that money should be spent. If the UK were to withdraw in 2019 as subscription stopped, presumably the EU could set a budget, without changing the MFF for 2020, which was below the maximum in the MFF.

Professor Takis Tridimas: This is a key question. It is correct that the MFF sets a ceiling. It is clear that it has a binding effect. Now the extent of its effect is not clear. The reason for this is as follows. It is important to decouple the MFF on the one hand from the annual budget on the other hand. The annual budget contains the obligations of the EU to incur expenditure under specific headings, but the obligation of the Member States to contribute to EU finances does not depend on the annual budget; it depends on two things. It depends on the Own Resources Decision—this is the Council decision that establishes what the sources of the EU's income are—and the MFF.

The combination of these two measures may suggest that Member States enter into a commitment over a five-year period to provide the EU with certain finances. The reason for that is that even if a budget is not agreed for a particular year, the EU rolls back to the budget for the previous year on a one-12th basis. My understanding of the system is that one needs to decouple the annual budget on the one hand from the financial commitments of the Member States, which necessarily would need to look beyond the cycle of a single financial year.

You are absolutely right: the MFF does not make that clear. It is not, in other words, clear what exactly the financial commitment is, but it is common sense that although the EU is not necessarily committed this year to spending a certain amount of money in 2019 or 2020, someone will need to pay the civil servants of the EU at that time. They have a right to be paid. It is a grey area here. One cannot be definitive, but it is not unreasonable to suggest that Member States undertake a concrete obligation to finance the EU within the limits of the financial cycle provided within the Multiannual Financial Framework.

The Own Resources Decision is unlimited in time. The decision by which Member States acquire the obligation to pass certain moneys to the EU does not last for five years; it is for an indefinite period. The truth is that the two—the own resources on the one hand and the MFF on the other hand—are negotiated as a package every five years or so. The two would need to be taken together.

Rhodri Thompson: Can I just chip in on the budget? The budget is a fairly arcane area, as I understand it. I cannot say I have ever done any cases in this area but it is an annual budget on a calendar basis. In the current year, 2017, that has just started, the budget was agreed by a procedure that started in July, went through and I assume was agreed. The budget for 2018 will be agreed during the course of this year and presumably the UK will play a full role. The budget in relation to 2019 could be controversial because it will be in the middle of the negotiations and potentially there will be a period of months after the UK has left. That may be an interesting discussion.

The budget for 2020, where we would still be within the MFF, may be negotiated after the UK has left, on current timetables. There may be an interesting question about the default mechanisms, about whether, if the budget is not agreed in any one of those years, you will then be stuck

with the contributions from the previous year. That could change over time in the individual years.

Lord Butler of Brockwell: May I just pursue that with one further question? Let us take 2020 and let us suppose that the UK has left in 2019; therefore the UK would not be part of the machinery for deciding the 2020 budget. In that case, supposing there was no agreement on that budget and one defaulted to the twelfths of the 2019 budget, is there any way in which the UK could be made liable for its contribution to that 2020 budget?

Rhodri Thompson: We have obviously discussed this interesting question.

Professor Takis Tridimas: It is not unreasonable to take the view that the UK may indeed be liable, the reason being that one would need to look at the obligation of the Member States within the cycle of the MFF, not within the cycle of the individual budget.

Q14 **Duke of Wellington:** I should declare that I was an MEP in the 1980s, and indeed was a member of the Budget Committee at that time. I should also say that I am a former Chairman of King's College London. My memory is probably rusty but I seem to remember that the annual budget as agreed by the procedure already described also contains—or used to contain—commitments for future years as part of the budget lines. I do not know if it is still the case, but if it is then any member state joining in the process of agreeing the annual budget I think will be considered to be committing themselves to contribute to the commitments contained for future years in the annual budget.

I may be wrong but I would be very interested to know whether I am correct in remembering that element of the forward commitments and whether it would therefore seem implicit in that that we, as a member state participating in the process through the Council, are committed to contributing to those future commitments.

Professor Takis Tridimas: Yes, that is also my understanding of the budget. The term “commitment”, when it is included in the budget, may not correspond necessarily to what a lawyer would understand by the term “commitment”. It is also correct to say that the expenditure that is entered in the budget is not necessarily incurred in the financial year. In that respect, the disbursement may occur in a subsequent financial year. My understanding is that your recollection and your reading are entirely correct.

Duke of Wellington: Now of course I cannot remember, but there is presumably a figure attached to the future commitments contained in each annual budget. I seem to remember that that is the case. In which case, in agreeing the budget, we are in a certain sense—I think you are confirming this—agreeing to contribute to the future commitments contained in the budget, and that is a figure we will quite easily be able to determine. I assume we will be able to do that on analysis.

You have referred to the Own Resources Decision. The Own Resources Decision by the Council is that each Member State should contribute a certain percentage of VAT, as I remember, unless that has changed. That is a clear formula that is accessible and, therefore, I cannot quite see how we could get out of our obligation to be levied up to that limit on these future commitments.

Professor Takis Tridimas: That is correct. Commitments that have been accrued before the time that the United Kingdom leaves the EU will need to be honoured by all Member States, including the United Kingdom.

Duke of Wellington: During the budgetary process, which normally would have ended just before Christmas late at night, did the UK put down any markers about future commitments in the annual budget? Do you know that?

Professor Takis Tridimas: That I am not sure of.

Lord Haskins: Putting myself in the position of David Davis dealing with this—

Lord Desai: You would do a better job.

Lord Haskins: The issue is how much the UK's ongoing relationship with the EU will affect the outcome of the financial settlement. In other words, if it is a complete breakdown then we are talking about a massive horse deal. On the other hand, if you start negotiating this before you have dealt with the other aspects and the ongoing relationship, it will be different; the figure will vary enormously according to what that relationship is going to be.

Rhodri Thompson: Yes, I am sure that is true. Being lawyers, we have tried to compartmentalise things as best we can but it is true that in the end the whole thing will be a large-scale negotiation. There are questions coming along later about, for example, the pension liability and possible payments along the Norway model. In practice, that would all be part of a single negotiation, but at the moment, if you look at the position in the absence of a deal and just as a pure question of law, what we are saying is that there is at least an argument that there will be a significant liability.

The point that I was forecasting before was that there is at least an argument, both under UK and EU law, that the quantification and analysis of that liability would fall to the Court of Justice in the absence of agreement and in the absence of amendment of Section 3 of the European Communities Act. There is going to be a very important question about whether or not either of those things change before 1 April 2019 and, if so, how they change: whether the Government or Parliament accept that at least until we leave and in relation to the position when we leave, the issue will be decided ultimately by the Court of Justice. That is how it seems to me.

The Chairman: You say "ultimately". What sort of time horizon would

you expect?

Rhodri Thompson: There is a question about when that issue arises and crystallises, which could be very late on in the process. The judicial process takes a degree of time.

The Chairman: A degree, in your experience, of what time?

Rhodri Thompson: How long it takes for a complicated case to be heard through the Court of Justice. There is a certain domestic case that has gone through as fast as any case ever, which has taken about six months, so I doubt you could expect it to be any quicker in Luxembourg.

- Q15 **Lord Desai:** Because the MFF has a maximum limit and annual budgets are negotiated before the year starts, I presume sometime in the negotiations the EU 27 will know that the UK will not be part of the 2020 budget. Does the budget leave some room for discretion? Some expenditures are long-term commitments, but there must be something that can be shrunk because you know money is not coming, or do you assume money has to come regardless of withdrawal? The annual budget is then a very rigid thing.

Professor Takis Tridimas: My understanding is that there is some margin for flexibility, in the sense that a provision can also be made that is unallocated for expenditure that may arise. The bottom line is that if the UK ceases to contribute, one of two things will need to happen: either the other Member States will need to increase their contribution, or expenditure will need to be lowered. There cannot be any obligation on the other EU states to increase their contribution—certainly not a legal obligation. Whether the expenses can be lowered, it is very difficult to say in advance; to the extent that there is some discretion, yes. The trouble is that it is very difficult to know who is going to rely potentially on a concept of acquired rights or legitimate expectations. Yes, I agree that there is some room for manoeuvring, but it is very difficult to pinpoint where that lies.

Rhodri Thompson: In the previous session there was a golf club analogy; I guess if you sign up, decide not to play and leave after a week, the golf club may say, "That is tough. You continue with your subscriptions for the period you agreed."

Lord Woolmer of Leeds: In terms of common sense—I know law does not always come down to common sense—a member of the public may say, "Article 50 says that you have to leave in two years. There is no choice about it; you have to." Somebody then comes along and says, "That is true, but you still have to pay for four years." There seems to be, in terms of common sense, a conflict here that was not necessarily considered many years ago when at least the legal possibility of withdrawal was under consideration.

How does one balance the imperative of limited time—two years—and the fact that, if you do not agree, you leave on the terms dictated by the European Union and you are out, with the fact that, apparently, on the

legal side the remaining 27 EU Member States nevertheless have in their back pocket the obligation of the departing state to continue to pay for two years or four years? It could even go to 2023 in terms of expenditure.

Rhodri Thompson: I am not an expert in land law either but if you give notice to leave a premises that is on a 10-year lease and you leave after six months, you may well still be liable on the full term of the lease. From the EU's point of view, the UK did not have to give notice and still does not have to give notice.

Lord Skidelsky: The difference is that if you give notice, you are giving notice. You are deciding the period that you want to remain in the premises, but here there is an external stipulation that if you give notice you have to depart within a certain period of time. It is rather different, is it not? Lord Woolmer is right. There seems to be a conflict between an externally imposed period of notice and an obligation to go on paying beyond that period.

Professor Takis Tridimas: I would not necessarily see it in terms of conflict. The Member States have a sovereign right to withdraw from the European Union. There is no doubt about it; this is established by Article 50 as indeed is the procedure. There is a two-year period after giving notice for negotiation. If negotiation does not reach an agreement then EU law ceases to apply to the withdrawing state. A Member State has a sovereign right to withdraw. It does not have, and could not possibly have, the unilateral right to determine the terms of withdrawal. That is why a procedure is provided under Article 50.

A similar situation could arise not only in the context of the EU but in any international organisation. In the EU it is more intense because the degree of integration has been more intense and because it has been an agreement that has subsisted for a number of years. This situation is not unique to EU law. The Vienna Convention on the Law of Treaties provides expressly in Article 70.1(b) that a termination of a treaty does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination. Therefore, undertaken obligations under the treaty do not disappear when a contracting party decides to denounce that treaty. Yes, it is difficult and this is why it is very wise to have a political deal, but I do not think it is unique to the European Union.

Rhodri Thompson: I did not answer immediately but the legal question and probably, in the end, a question of common sense is whether the UK committed to certain things, for example, in 2013 and, if it did, whether there is any injustice in its being held to those commitments.

Lord Skidelsky: It is the speed of the withdrawal that is being determined by someone else.

Rhodri Thompson: The UK was a Member State when that was agreed.

Lord Desai: The ideal thing would be to delay by one year the notice of Article 50, then the budget and everything will be caught up.

Professor Takis Tridimas: I just want to make the point with regard to the speed of the withdrawal that that does not place the United Kingdom in a more difficult situation. There is a set period of two years and that may work to the advantage or disadvantage of either party. It simply really depends on the economic and political power of the two parties in holding the negotiations. For those who would wish to have a long, smooth transition, the two-year period is an impediment. For those who would wish to go out immediately, the two-year period is an impediment from the opposite perspective.

In other words, I see the procedure of Article 50 as being politically neutral. It simply crystallises the underlying bargaining power of each of the parties. It may work to the advantage of the EU or it may work to the disadvantage of the EU and, correspondingly, to the advantage of the withdrawing state.

- Q16 **Lord Butler of Brockwell:** I think you have answered this question but I would just like to make it explicit. Suppose that, by 1 April 2019, Article 3 of the 1972 Act has been repealed and any dispute has not been settled by the European Court of Justice. Could the UK at that point reject the jurisdiction of the European Court of Justice, or would we be bound by the treaty obligation, which you quoted a moment ago, to continue to accept the European Court of Justice's ruling?

Rhodri Thompson: There is a question of law and then there is a question of jurisdiction that, at the moment, we accept the Court of Justice as the final arbiter on points of EU law and, indeed, it is one of the provisions of the Treaty that the Member States have to not take other routes; they have to follow the procedures laid down in the Treaty. If we change that by an Act of Parliament within the UK that would no longer be the case, but there obviously would be significant international implications if the UK was not prepared to comply with international obligations. You would then have to find another forum to decide that question.

The Chairman: Professor Tridimas, what would the Vienna Convention on the Law of Treaties say on that particular point?

Professor Takis Tridimas: Once the United Kingdom withdraws, EU law ceases to apply so the United Kingdom is not, strictly speaking, bound by the jurisdiction of the European Court of Justice. That may be a breach of Article 70 of the Vienna Convention, but then the enforcement mechanism would be one of international law. It would no longer be that provided for by European Union law and, being one of international law, it is imperfect. It would be difficult to see what would be the forum before which the European Union could bring the United Kingdom to account. Once we move into the sphere of pure international law, enforcement becomes, from the legal perspective, rather imperfect. A country might risk an international problem and a loss in political power

but this is something to be taken into account in weighing various options.

- Q17 **Lord Callanan:** Is the practical effect not that once the UK has withdrawn, assuming we have withdrawn in April 2019, the EU will have no way of enforcing an extra year's budget contributions because, subject to negotiation, the UK presumably could argue that the reason it has taken two years to withdraw is purely that that is what Article 50 stipulates? We may have wanted the negotiations to take three years but they cannot because Article 50 stipulates two years. If we are not subject to the Court of Justice, how could the EU even enforce any extra years' contributions?

Rhodri Thompson: Ultimately, as a matter of our law, the domestic basis for it is the 1972 Act. It all depends what that says. It could be amended one way or the other.

Lord Callanan: That would be repealed by then, presumably.

Rhodri Thompson: It is going to be changed but nobody quite knows how.

- Q18 **Lord Haskins:** We have been trying, all the time, to measure the scale of the liabilities and commitments. We have had various figures thrown at us, from £20 billion to £55 billion. We have various ongoing liabilities that date from 2023 to 2030, I think Mr Schäuble said. On distinguishing between where the main liabilities and ongoing liabilities are coming from, that will be from the MFF rather than the annual budget, which starts on April 2019, and we will have nothing to do with it. Our liabilities on the annual budget finish on March 2019. I am sure I am wrong and that there are certain ongoing liabilities in the budget, but the big liabilities will be commitments made under the MFF. Is that right?

Rhodri Thompson: The MFF sets caps over a projected period whereas the budget sets the actual figures on an annual basis. The point I was trying to get at is that the process is going to proceed, at least as far as the EU is concerned, annually over the period of the negotiations. There will be a question about what is agreed. If the UK agrees anything in 2018, presumably somebody will at least think about what the implications are for 2019.

Lord Haskins: One of the concerns I have about all this is that lots of businesses and local authorities here are in the process today of bidding for EU funds. It is not going to be very easy for them to negotiate successful deals with all this uncertainty hanging over their heads.

Rhodri Thompson: Yes. What we tried to say was that in default of agreement there is at least an argument that the budget commitments will roll on for the period of the MFF. There would be a question about whether the entitlements, not only of local authorities but also of individual farmers or the UK at the central level, will go on in parallel. That was a later question that we can maybe address now if that will be helpful.

Lord Haskins: It is following Lord Desai's point that if this was all terminated on March 2020, it would be an awful lot neater. We are talking about the twelve months between the end of Article 50 in March 2019 and 2020. That is what the big argument is going to be: about what the liability is then.

Rhodri Thompson: Yes. Again, in rather general terms, the entitlement regimes are specific and themselves complex. For example, if you are a Welsh sheep farmer then you may have rights to certain types of subsidy, and the question will be whether that subsidy regime continues and whether you can make a claim either against the UK authorities or possibly directly against the EU under that subsidy scheme. That is going to be case-specific to that scheme, and likewise for things that are made centrally to the universities or local authorities. Each will have their own particular incidents and will not necessarily follow the same pattern as either the MFF or the budget.

Lord Haskins: I should have declared my farming interest, which I do belatedly. Taking the farming issue, it seems to me that the UK Government must have in place new policies for agriculture well before March 2019.

Rhodri Thompson: Not necessarily, if it is agreed that everything will stay in place until the end of 2020, which might make it easier for everyone.

Q19 **Lord Woolmer of Leeds:** If there are already agreed contracts—agriculture, universities, research and so on—will they be legally guaranteed under EU law or UK law, depending on what happens in the Great Repeal Act? I think you implied, Mr Thompson, that a Welsh sheep farmer may have to take action, if needed, against the UK Government after exit if they were not getting the funding that they were promised because of a deal that was done that reneged on that particular arrangement.

Rhodri Thompson: We are being told that the UK may seek to match the situation until 2020. What I was talking about was that the UK has an extensive implementing role, for example under the common agricultural policy, and normally it is responsible for operating it. There is a question, if those obligations roll on at the EU level, about whether the correct procedure is to claim against the UK authority or to claim against the EU if, for some reason, the UK authority says, "It is nothing to do with us because we have left".

Lord Woolmer of Leeds: If, at the moment, as Lord Haskins said, various interests are already making proposals for future grants and arrangements, and some already have them in place and are expecting a stream, what would be your advice to institutions in that situation looking forward as to what they would wish to see happen in negotiations? Is it within the negotiations that the UK Government and the EU Government could reach an arrangement whereby those commitments no longer exist for the EU?

If that is the case, the UK Government, in parallel to those discussions with the EU, would have to have in place a substitute for it by the time an agreement was reached. In other words, there are commitments. There could, as part of the political deal, no longer be a commitment going forward after 2019 and even after 2020. If that is the case, what is the position of those institutions? Should they be saying to the UK Government, "Do not, for goodness sake, renege on your commitment to the MFF because, if you do, we will lose our legally binding revenue streams"?

Rhodri Thompson: At one point there was a question about contracts. One point that is perhaps important is that the EU has full legal personality and so, in so far as the EU has entered into a contract, that will be a contract. It could be a UK contract, it could be an EU contract, but in so far as it has entered into one, it will be bound by it. As far as more public benefits are concerned, which may or may not be agreed in the future, I would have thought that is much more the area for negotiation. If the UK says, "We are not paying you a penny," that may well have implications for any future funding from the EU.

Professor Takis Tridimas: It is a difficult issue but it is clear, and it makes common sense, to have an agreement of the finances. That will make life easier for everybody. From the legal perspective, I would differentiate between two things: first of all, any obligation that the EU has undertaken vis-à-vis companies, individuals or institutions to make disbursements on the one hand; and any obligation that Member States may have to contribute to the EU finances.

In other words, if there is a finance scheme whereby the EU undertakes to provide grants to universities or to provide subsidies to a specific industry, this is an obligation undertaken by the EU. In so far as it has been undertaken before the withdrawal of the United Kingdom, the EU has an obligation to honour it. If I am a recipient, I would not necessarily care where the EU finds the money from. This is one aspect, but it really is an issue of contractual rights or property rights. One would need to look at the finance scheme and examine it and determine exactly what the EU obligations are to this effect. That is one aspect.

The other aspect is the obligations that Member States have vis-à-vis the EU to contribute to the EU finances, which was covered by the previous questions. It is reasonable to take the view that the Member States have these obligations under the Multiannual Financial Framework.

Lord Desai: In case of dispute, who would the UK universities go to—the Supreme Court or the Court of Justice?

Professor Takis Tridimas: Ultimately, it will be the European Court of Justice, in so far as the finance scheme is governed by European Union law. In most cases, they will need to begin proceedings before domestic courts but the court that has ultimate jurisdiction would be the European Court of Justice under EU law.

Rhodri Thompson: There is a wrinkle there, in that the ways in which matters get to the Court of Justice at the moment is not by way of appeal but by way of a preliminary ruling on a point of law, and that mechanism is very likely to go under EU law, let alone under UK law. It may be that, if the complaint is against the EU, one would need to bring some form of direct action in Luxembourg against one of the EU institutions, whereas if you were claiming against a UK institution, it may be a matter that ultimately would have to be decided in the UK without guidance from the Court of Justice on a tricky point of EU law. That is a further interesting area, from a lawyer's point of view.

Lord Haskins: Any of these are going to take years.

The Chairman: There are an awful lot of people in the House of Lords who are connected to higher education institutions. It is a point that is extremely interesting to Members of this House, as it is to the institutions themselves.

Q20 **Lord Shutt of Greetland:** Can you shine any light on pensions? It seems that there is no fund. Pensions are paid on a pay-as-you-go basis as far as people who have formerly worked for the European Union are concerned. What do you believe is the position on a withdrawal? Has the UK got a continuing liability for its share of pensions for all time until every one of them has died off? We are told that 8% of the pensioners are from the UK but of the people on the payroll at the moment there are only 4% from the UK. Does that have any bearing on this at all? What do you think is the position? Indeed, would that be sought as a capital sum, or would it be a case of a diminishing revenue figure?

Rhodri Thompson: If I have a go, no doubt Professor Tridimas will correct me. We talked about whether this was a pay-as-you-go scheme. It is a defined benefit scheme and it is also the case that, as part of your EU salary, a sum goes into the budget as a part. It is not entirely a pay-as-you-go scheme, though, as we all know, there is a risk of a mismatch between the amount that employees have paid in over the years and their entitlement given the rates of interest, etc., going forwards. As I understand it, that is reflected in the budget with a figure of what I think was said to be some £50 billion, as a budget figure forecast relating to pensions.

So far as the liability goes, there is no match between Member States and their employees, as I understand it. The employees are employees of the EU and the liability is that of the EU. I would expect, certainly from the EU perspective, the starting point to be that any liability in relation to the capital sum—if that was going to be crystallised on 1 April 2019—would be the UK's proportionate share of that total sum, not by reference to its employees. In terms of UK pensioners, unless something else was agreed, I would not assume they would be passed over to the UK. I would assume, for example, the pension rights of the former members of the Court of Justice or the Commissioners would be against the EU going forward. It would be part of the negotiations as to whether the UK would be required to pay, for example, the net present

value of a proportion of the liability. In default of agreement, no doubt this would potentially be an area of litigation where the same issues about the role of the Court of Justice will come in.

Professor Takis Tridimas: That is entirely correct. My understanding corresponds to that of Mr Thompson. Pension expenditure is part of the EU budget. It is part of the so-called administrative expenses of the EU, and the overarching principle of the EU budget is the principle of universality, which is provided in Article 6 of the Own Resources Decision, which means that contributions made by Member States to the EU budget are in no way ring-fenced for any particular expenditure. They are to be used without distinction for all EU expenditure, so there is no correlation between the contribution that Germany makes, for example, and the pensions that the German civil servants receive—that is to say, EU civil servants having German nationality and so on and so forth. That is entirely right.

I also share the scepticism about classifying the scheme as a pay-as-you-go scheme. The pension contributions that are made in relation to EU civil servants do not go to a separate pension scheme; they go to the EU budget. The way the system is conceived, or at least the way the Commission understands the system to be conceived, is that it is not the case that the costs of the current pensions are met by the contributions of the current employees. It is rather the idea that employees every year make a contribution towards a pension to which they have a vested right upon the end of the financial year.

I am not sure if describing it as pay-as-you-go is necessarily the best way of describing it. The bottom line is, Article 83 of the staff regulations expressly states that benefits paid out of the pension scheme are to be charged to the EU budget and that the Member States are to guarantee them jointly. Member states jointly guarantee payment of the pensions. To my mind, the United Kingdom will remain liable for any pension benefits that will have been accrued at the point it decides to leave the EU.

Lord Shutt of Greetland: As far as pay-as-you-go is concerned, there is no fund of investments held in Europe. That is the point. It is not like the English local government schemes—there are several of them—where there are several investments held that pay for the pensions.

Professor Takis Tridimas: That is correct, but there is a provision whereby the pension contributions, which are made every year, are not necessarily paid out on the same year. There is no correlation. They are held and they receive some kind of interest, but you are correct that there is no separate pension scheme.

Lord Butler of Brockwell: This is a very important point. I feel I must have misunderstood it because as I now understand it, you are saying that the employees have paid into the pension fund, they are now entitled to the pension—they have an entitlement from the EU—and Member States guarantee that. However, the UK has no continuing

liability for it at all after it has left, because this is an EU liability for which the employees have already paid.

The Chairman: Professor Tridimas, I thought you said they were jointly guaranteed by Member States and the EU.

Professor Takis Tridimas: That is correct. This is what the staff regulations state. I said earlier that the United Kingdom, to my mind at least, would be liable to make a contribution towards pension benefits that have accrued until the time it leaves and the EU laws cease to apply it. That must be right. The question that arises is about what happens after that. The EU continues to have a civil service. Those EU fonctionnaires that have British nationality will continue to be there. They have tenure.

The question is whether that creates an ongoing obligation on the part of the United Kingdom to contribute towards the pensions of EU civil servants beyond the MFF period. This is an open question. It would not be unreasonable to suggest that some kind of obligation subsists. I would not be able to quantify but it would not be impossible to do so.

Lord Butler of Brockwell: It seems to me that it would not subsist. These are EU employees who are entitled to a pension and, as you have said, their nationality is immaterial. It seems to me to follow from that that the UK has no continuing obligation to meet these pension liabilities.

Duke of Wellington: It seems to me, listening to what you have said, that if we have been told that these pensions to which current employees are contributing are jointly and severally guaranteed—if the future pension for that employee who is now contributing is guaranteed jointly and severally by all the Member States—then, as with all guarantees, that only becomes called if the entity, in this case the EU, cannot actually make the payments that they are committed to make. In the event that the EU is not able to make those payments 20 or 30 years hence, surely there is then a fall-back on the guarantee.

Lord Butler of Brockwell: That seems to me absolutely correct but until that point the UK has no liability.

The Chairman: I have several other people, and let us direct our questions to the witnesses.

Lord Desai: I gather that when the MEPs were nominated, the UK Government undertook to pay their pensions, but now that they are elected, their pensions are paid by the EU. They, of course, will drop out. Will their pensions continue to be paid by the EU or will they be paid by the UK?

Secondly, if the pensions depend upon a members' guarantee—that corpus of members was 28 when the guarantee was given—because one drops out, does it mean that the dropout has no obligations? I will ask you one more question. Even if the UK has pension obligations, why should they be capitalised and the UK have to pay £60 billion? It could

say it will go on paying year after year towards the pension pool.

The Chairman: Either of you can answer; whoever has the answer.

Rhodri Thompson: I do not know whether the Earl of Lindsay wanted to ask his question, or shall I try to answer that one?

The Chairman: Throw it in.

Earl of Lindsay: I wanted to pick up on the line that Lord Butler took and, perhaps, disagree with the comment that the Duke of Wellington made. Going back to your golf club analogy, as I understand it, in normal circumstances, if you are a member of a club, for as long as you are a member you might have certain obligations to that club. When you cease to be a member it would be unusual, unless there is some specific "in perpetuity" obligation that you have committed to, for you to then have to have a post-membership obligation accord upon you. If a company goes bust long after you cease to be a shareholder, or a club goes bust long after you cease to be a member, I would be surprised if you were then retrospectively called in to honour a previous guarantee that you had made.

Rhodri Thompson: Yes. I must confess that I was not seeing it in those terms: that someone might bring a claim against the UK in 20 years' time if the EU ceased to be able to meet its pension obligations. I was thinking it was more likely that there would be some form of exit payment to reflect the UK's share of the liabilities that had been built up over the previous 40 years.

Earl of Lindsay: Can I come back there? Surely if you resign from a club—leave a club—it is still very unusual to have a capitalised figure for a future obligation presented to you and a demand that you pick up a share of it, unless it is specifically stated that that is a part of your membership responsibility.

Rhodri Thompson: Yes. I am aware that there is a shortage of time and it does seem to me that it comes back to the same question about what the rule is, who is going to decide the rule and whether the UK is going to comply with that decision. My suggested approach is one that would at least be put forward and, given the uncertainties of litigation, it is possible that it might succeed.

The Chairman: Since you have mentioned the shortage of time, are you able to stay until 11.45?

Rhodri Thompson: Yes, certainly.

The Chairman: Thank you. In reference to Lord Desai's point, Professor Tridimas.

Professor Takis Tridimas: If I can continue for one minute on the last point and then I will take Lord Desai's point, yes, the golf club analogy is a useful analogy. The difficulty here, in the case of the EU is, because of

the distinct character of the EU as an organisation, the length of time the United Kingdom has been a member and the intensity of the obligations that it creates, it is very difficult to identify which obligations are in perpetuity and which are not. The trouble is when these arrangements are made—financial contributions and any internal market obligations or arrangements—they are made on the assumption that Member States will continue to be Member States. No provision was made specifically for the event that a Member State leaves. That is why it is best to have a negotiated agreement. The difficult job for the lawyers is to try to determine what the content of legal obligations would be in the event that agreement is not reached. That is very difficult to do. Some of these obligations have to be seen on a long-term basis.

Turning to Lord Desai's questions, I do not know the specific status of the pension rights for the MEPs. They are in a distinct category because they represent a political body of the EU. They are not civil servants. I am not sure of the extent to which the staff regulations apply to them. They are not employees of the European Union. Whether the United Kingdom will continue to have an obligation is an open question. It is very difficult to determine, but it is not beyond contention that they do not have such an obligation.

Lord Shutt of Greetland: I will put a hypothetical point. I do not recommend it but if each year three states were to withdraw from the European Union, the whole thing would collapse in nine years. Who then would be paying these pension bills? Surely, anybody thinking about this would have to be thinking in those terms.

Lord Desai: If your firm collapses, you lose your pension and it is tough luck.

Professor Takis Tridimas: One would have thought that arrangements would be made as part of the dissolution of the EU, in your hypothetical example, providing for the assumption of liabilities.

Lord Woolmer of Leeds: Mr Thompson's point was not that the UK would have an obligation for well into the future—30 or 40 years in some staff's cases—but rather about the value of the obligation at the point at which the UK left. If somebody had been an employee of the EU for 10 years, looking forward to another 20 years, the UK's liability would be for the value of the pension forecast for those 10 years. In other words, it is the vested value at the point at which the UK left, not that there would be ongoing obligation for the next 50 or 100 years.

Rhodri Thompson: I was thinking of it in terms of an exit payment. If you were part of a club that had commitments going on over 10 years and you had entered it in full knowledge that that was the case, then you might be required to pay your share of the net present value of the remaining part of the 10 years. That was the sort of approach I was considering. It is not an area that is by any means certain.

The Chairman: I want to move on, but I would just like clarification on

what you have just said. When you join the club, and it subsequently transpires that the terms of your being able to leave are made easier or actually become apparent—that was the Lisbon Treaty when Article 50 was inserted—if that was not foreseen when the decision that you could leave the club whenever you wanted was taken, is it justiciable? On the basis of the staff handbook, Article 83, does the actual employee of the European Commission go to the Court of Justice, or does the European Commission, on behalf of the individuals, go to court?

Rhodri Thompson: For example, let us take a former judge of the Court of Justice. If, when the UK left, the EU said, “You are no longer going to be paid your pension,” they would have a pretty unanswerable claim against the EU for their pension. The question we are talking about is whether the UK will have some liability—either on exit or afterwards—in relation to the collective pension bill.

The Chairman: Could the individual sue the UK? That is what I am trying to get at.

Rhodri Thompson: No, there would not be any entitlement against the UK.

Q21 **Baroness Liddell of Coatdyke:** I am going to switch from liabilities to assets. You will have seen from a previous evidence session before Christmas that we had a discussion about what the EU’s assets were and whether the UK would be entitled to a share of them on Brexit. At that time, Professor Begg estimated that they might be around €20 billion but no one could give any definitive answer as to whether or not there was any process that would allow the distribution of those assets. It was felt that legal expertise was needed. Can legal expertise help us out with this one?

Professor Takis Tridimas: I do not think the assets of the EU are provided for in the budget in terms of an accounting exercise. It would encompass mostly financial instruments and the other categories one would expect to find in sovereign or financial institutions. Is the United Kingdom entitled to a share of those assets? I do not believe it is. The EU is based on the principle of own funding or own finances. It is an international organisation that has legal personality. It has its own assets and its own liabilities. I do not think it is the case that when a member state leaves the EU, it can take back its share of those assets. I cannot see any legal basis for that. How would a share be calculated? There would be two ways of calculating a share. One would be to divide the EU’s assets by 28, and each Member State takes one-28th. The other is to look at the proportion of assets that is equivalent to the UK’s contribution. I understand that in 2015 the net contribution of the United Kingdom amounted to around £8.5 billion and it was 7% of the EU budget for 2015.

These are the two possible ways of calculating one’s contribution. If you look at it in those terms, then presumably the Member State that leaves also has to take a share of the EU’s liabilities. If you take assets, you

also need to take liabilities. In legal terms, it is not possible to think that way. The EU has its own personality. Under the treaty it enjoys diplomatic immunity in each of the Member States and the whole system of EU finances is based on own resources.

Baroness Liddell of Coatdyke: What about the issue of the breakup of Czechoslovakia, which was a paper exercise where there was a division between the Czech Republic and Slovakia. Does that create a quasi-precedent? There was no distribution of assets; it was merely a splitting of them.

Professor Takis Tridimas: I cannot see that necessarily working as a precedent. I do not know the specifics of the financial arrangements that were made after the two components separated in Czechoslovakia. As a matter of European Union law, I cannot see how a Member State that decides to leave the European Union can have a claim to get a proportion of the EU's assets. This does not find any legal basis in the EU framework.

Baroness Liddell of Coatdyke: So there is nothing in the Treaties or anything.

Rhodri Thompson: It differs anyway, in that the European Union, as things stand at least, will continue to exist and the United Kingdom will continue to exist as a sovereign country as it always has done. Therefore, the position is not the same as the break-up of Czechoslovakia where you had one state that was broken up into two states.

Q22 **Baroness Liddell of Coatdyke:** You do not think there would be any comeback for the United Kingdom Government—let us use this figure of €20 billion—saying, “We are entitled to one-28th of that”?

Rhodri Thompson: I have some difficulty in seeing how it would work. For example, if the EU owns the Court of Justice—I am not sure whether it does or not—if we were to say that we are entitled to either one-20th or 7% of the Court of Justice and we want to take it in cash, or continue to pay the rent, I am not quite sure how it would work but, at the moment, as Professor Tridimas said, the EU is a freestanding legal entity in its own right in each of the Member States. Therefore, unless there was an issue of contract, for example in relation to the Commission building in London, I would think that it would take its course in the ordinary way as a legal entity.

Q23 **Lord Butler of Brockwell:** We can deal with my question quite briefly, because I am talking about the legal aspects, not the policy aspects. It has been suggested that the UK could, like Norway, have access to the single market in return for making payments to the EU budget. Of course, Norway accepts free movement of people in return for that. That could be a policy condition. Leaving aside the policy, is there any legal barrier to the UK doing a deal by which, in return for budget contributions, it got access to the single market?

Rhodri Thompson: That is a very large question. The single market is bandied around but there is a provision in the Treaty about freedoms. Norway has a number of multilateral arrangements, largely through the EEA, and it has a number of bilateral arrangements. Some of them would certainly be ones that the UK would wish to continue with. On the EU-Norway website, there are 30 or 40 programmes in which Norway participates; I do not know whether the UK would want to participate in all or some of them.

Leaving aside the question of free movement, which is obviously going to be commercially significant as well as politically significant, in that at least in Brussels and Luxembourg it is seen as a restriction on trade even though that is not how it is seen here, there would be a cost in participating in any one of those programmes. Going back to my original remarks, there would also be an issue about who sets the rules for the programme, who interprets those rules and the question of cost. One would certainly expect the EU to start from the position that it would decide all of those things and the Court of Justice would decide how the rules are interpreted. I can anticipate they will be quite considerable political discussions as well as financial ones, but in principle it can be done; however, it is quite a complicated prospect.

Q24 **Earl of Lindsay:** Can I just turn to the European Investment Bank and specifically to the impact of Brexit on our status as a current member and shareholder of the European Investment Bank? As I understand it, we currently have a shareholding or stake that is equivalent of 16% of the bank's capital. We paid up for that stake. We bought those shares. We also contributed to the capital reserves of the bank. Do you envisage that we are likely to be able to remain a shareholder and member of the European Investment Bank post-Brexit? Secondly, if either that is not possible or if we decide not to remain a shareholder, do you anticipate that we, as a paid-up shareholder, would be able to liquidate that shareholding and take the value of that shareholding and any other rights we might have accrued there?

Rhodri Thompson: I see two basic stumbling blocks. The first is Article 308 of the TFEU, which says the members of the European Investment Bank shall be the Member States. On the face of it, if we are no longer a Member State, we are no longer a member of the European Investment Bank. The second is that the task of the European Investment Bank shall be to contribute to the balanced and steady development of the internal market in the interest of the Union. That is the core task to which all of its activities are directed. It would be difficult for the UK to commit to that or for the EU to accept the UK as a participant in that project after the UK has left. It would seem to me that it would need an amendment of the Treaty and that it might be very difficult to persuade the other Member States that they wanted to go down that route in the course of the negotiations. That would be my basic concern about that.

On the second part, at the moment we are one of the four major shareholders, and there was some discussion of that in the previous session. I would assume that if we cease to be a member and a

shareholder, we would be entitled to our money back, though what exactly that would amount to would be, no doubt, an interesting question for accountants and possibly politicians.

Earl of Lindsay: As I understand it, Article 3 of the EIB statute can be amended by unanimity in Council, so it is at least theoretically possible that the requirement to be a Member State in order to remain a member of the bank could be amended so that the UK could remain involved. Secondly, as I understand it, the bank does lend to projects in non-EU countries where they fulfil the EU's external policy objectives. Therefore, the UK could be a beneficiary of the bank's loan programme post-Brexit.

Professor Takis Tridimas: On the first issue, it will be very difficult to have a non-EU Member State remaining a shareholder of the European Investment Bank. It will change the nature of the institution. It was designed by the Treaty to be a regional international financial institution, which is owned by the Member States. You are entirely correct that, in theory, it could be changed, but I would find it very difficult to see why the EU would agree to that. It would almost be easier to establish a new institution with the participation of non-Member States, rather than to water down the European Investment Bank in its current form. It would require an amendment of the Treaty, so it cannot be done under the procedure of Article 50. It would certainly require the unanimity of all Member States and approval by the national parliaments. It would be difficult to envisage this occurring.

The European Investment Bank finances projects that serve the interest of the EU. It has a strong internal market focus but you are entirely correct that it does fund projects outside the EU. It has been particularly active in the so-called Southern Neighbourhood area, i.e. financing projects in countries like Morocco and Tunisia. One could envisage the possibility where the EIB finances, or continues to finance, projects in the United Kingdom. It has been very active in financing, for example, Crossrail, the Channel Tunnel and numerous other projects, in Liverpool and regional UK centres as well as in London. This possibility is not excluded but the amount of money that goes into these projects is predictably much lower than the amount that goes into EU projects proper, as it were. However, yes, under the legal framework, it is possible for the bank to do it.

Lord Skidelsky: You have answered virtually everything that I wanted to ask, but I wanted to make a comment on the financing of investment projects in countries outside the EU. Presumably they would be decided on commercial criteria, as indeed other investments are. The difference would be that if these projects turned out to be loss-making, the European Investment Bank could not call up capital from a non-member. I do not know what its record has been over the years, and whether it has to go back to members to capitalise its investments. My understanding is they have been, on the whole, reasonably successful, in terms of the rate of return, but presumably they could not draw on those non-members for new capital.

Rhodri Thompson: The gist of what we are saying is that the position of the UK—or UK institutions—after withdrawal, on the assumption that we were no longer a member of the bank, would be that we could seek funding for such projects if they were said to contribute to the internal market and the European Union, and transport links with Ireland might be an example, but we would do it, effectively, on a contractual basis. It would just be a matter of what the terms of the arrangement were. We would not have the lender-of-last-resort or shareholder liabilities that we currently have as a member of the bank, I would think.

Lord Skidelsky: That is how it would work, which suggests that we would not get very much money. As you say, the investments in non-members are very, very small.

Professor Takis Tridimas: They are small by comparison to investments in the EU. The European Investment Bank has also financed a number of projects in the EEA countries but these tend to be financed by the bank's own resources. The way the risk is allocated would depend on the specific project, but it would not be possible to call on a non-Member State to finance them. My understanding is that only a small proportion of the subscribed capital of the European Investment Bank has actually been paid up. The United Kingdom has currently paid close to £3 billion; it is a bit less than that, about £2.89 billion. If a country was not a member or a shareholder, it would no longer be liable to being called up.

The Chairman: Thank you very much. You have been extremely patient and you have given us a good amount of time. I suspect that we have as many more questions to ask you. I wonder whether, having reviewed the transcript and looked at your evidence more carefully, we might write to you with further questions and elicit a reply from you. Would that be agreeable?

Rhodri Thompson: That is certainly fine.

The Chairman: Thank you very much. It has really been most valuable to us.