Leaving the EU Digital Single Market: implications for the UK

Miriam González, Head of the International Trade practice at Dechert LLP, provides analysis of UK Prime Minister Theresa May's decision to bring the UK out of the EU Internal Market, in the context of the EU's Digital Single Market. Miriam discusses what will happen if the UK and EU regulatory regimes ultimately diverge, and the complexities involved in trying to create a Free Trade Area agreement with the EU, as the Prime Minister intends.

The British Prime Minister, Theresa May, has decided to withdraw the United Kingdom from the EU Internal Market, whether in whole or as part of a series of internal market-like deals on a sectoral basis. Her decision will have profound consequences on the EU-UK business sector in the years to come, whether in the traditional markets or in the digital one.

While the UK Prime Minister has called for 'frictionless' trade between the UK and the EU, her choice of Brexit means that when Brexit enters into force in two years' time (and with the caveat that the entry into force of Brexit might be delayed for a very limited time in relation to a few specific areas) providers of services and goods in the UK (whether through traditional means or through digital ones) will be subject to two different regulatory models.

On the very day when Brexit will enter into force the UK rules are likely to be largely identical to the EU ones (all courtesy of a complex domestic regulatory process by which the UK will internalise into its domestic legislation all existing regulatory EU *acquis*). But going forward things are far less clear. The UK and EU regulatory models will be similar - or even identical - if the UK decides to simply apply any new EU regulations and directives just like that. Or they may differ if the UK decides not to integrate into the UK regulatory system each new rule enacted by Brussels. It is impossible to know right now what the UK Government will do in each and every sector and subsector. But since the Brexit vote took place under the banner of the UK 'taking back control' and the Prime Minister has indicated numerous times that the UK Parliament will 'decide on British laws,' it is reasonable to assume that the UK will not be happy to simply 'copy and paste' the new rules decided (without any UK input) in Brussels by EU countries.

The consequences of having to comply with two different regulatory books will be felt throughout the overall economy: custom procedures will have to be followed, specifications for goods may be different in the EU and the UK, new licences and authorisations will have to be obtained for the provision of services in some sectors, and such authorisations may be subject to different regulatory conditions. How much or how little this divergence of regulatory models will affect the market is still unknown, as much depends on how much or how little the UK Government decides to copy the EU regulatory model or to depart from it. But what is known is that while the consequences of Brexit and the new dual regulatory system will affect businesses in all sectors, it is likely to be felt particularly acutely in relation to the digital market. This is for three main reasons: because the EU Digital Single Market regulation is still being shaped and therefore there will be regulatory uncertainty on both sides; because in the Digital Single Market regulatory rules are complex; and because tackling such complex regulatory barriers with the instrument of choice of the UK Prime Minister - a free trade agreement - is extremely challenging.

In general terms it is fair to say that the more developed the EU regulatory model, the more similarities between the current EU and UK regulations and therefore less the margin for regulatory divergence after Brexit. The problem is that in relation to the Digital Market there isn't a mature and developed EU regulatory model yet; the EU is still aiming to define many of the key parameters of its regulatory model. Though the EU Digital Market strategy was launched in 2015, discussions on basic issues such as the free flow of data still remain largely open. And many proposals for EU regulations and rules are still being negotiated within the EU. Some of those discussions will lead to concrete EU regulatory initiatives and those initiatives will be put in place in the EU without any regulatory input from the UK. The only options open to the UK Government will be whether to accept those initiatives or not. Accepting them will allow the benefits of the Single Digital Market to be extended to the UK. Not accepting or modifying them will mean that those benefits will be out of reach for them. There is no third way.

Take for example data privacy. The EU General Data Protection Regulation will require all transfers of data to be tested against new standards of opt-in permission rules and it will take effect in 2018. This includes the so-called 'right to be forgotten' or the need to obtain

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consent for holding a wider array of personal data. Regardless of whether the UK decides to go ahead with all aspects of this Regulation after Brexit or not, UK companies will need to comply with the EU standards to be able to trade data from the UK to the EU and use data acquired in the EU. The UK may ask the EU to confirm that its regulatory regime is 'adequate' and, indeed, it should be relatively straightforward to pass such an adequacy test if the UK legislation remains identical to the EU one. But since the Prime Minister has indicated that the UK regulatory regime will be different to the EU one ('British laws adopted by the British Parliament') it will be pointless for the EU to devote resources towards granting adequacy on the basis of the existing UK regulation rather than on the basis of the forthcoming one, which is not yet known.

The issue is even more complex in those areas where EU legislation has not yet been approved (e.g. the implementation of the European Electronic Communications Code, or the Geoblocking Regulation) or those that are still being considered at strategic level (such as the calls for new proposals on the Free Flow of Data). Unless the UK mirrors such legislation within its own jurisdiction in the future, the application of two diverging bodies of regulation will be unavoidable.

The likelihood of diverging regulation between the EU and the UK is to be judged against the many complaints that UK companies and trade bodies have made about the inadequacy of the Digital Market proposals from the EU. They have highlighted numerous times that some proposals are far too burdensome and that they erect barriers rather than eliminating them. Whether they are right or not is a matter of opinion of course, but it is hard to see how against this background the UK would be happy to simply 'copy and paste' the EU regulations without putting in place a different regulatory model themselves.

In a scenario where regulations diverge, the only option to create a resemblance of a Single Digital Market between the EU and the UK will be to conclude a trade agreement covering, amongst other elements, digital trade. But since the Prime Minister has ruled out participation in the Single Market, trade negotiators will struggle to capture in a free trade agreement the myriad of detailed regulatory requirements that the digital market entails.

A good example of such complexity is the EU regulation on the elimination of roaming charges in 2017. The principle of 'Roam like at Home' is meant to apply throughout the Digital Single Market and it will be implemented through a series of consumer protection and safeguard rules. Even if the UK enacted similar rules, how would those impose an obligation on operators based in the UK to extend the no-roaming charge rights to travellers in the EU and the reverse? How would it guarantee that the safeguards for operators against abuse (for those resident or with permanent links to an EU country) will be effectively applied? How will breaches of the system that affect EU citizens travelling to the UK and UK citizens travelling to the EU be policed if there is no independent body to guarantee the correct interpretation of the rules? What consequences would those breaches have? It was all very good to trust national authorities with the enforcement of EU rules when the UK was 'part of a club based on trust.' But since Brexit means such a club does not exist anymore, will both parties be ready to accept that each party polices freely the implementation of rules painfully negotiated between them?

Hoping to deal with these complex issues within a Free Trade Area agreement, as the UK Prime Minister proposes, is like trying to fit every species of animal in the world into Noah's Ark. A miracle was required then, and a miracle would be required now.

Unlike sophisticated Single Market rules, free trade agreements are basic bread and butter instruments, instruments that were originally designed for negotiating straightforward trade liberalisation commitments. As countries started to bypass their liberalisation commitments with discriminatory or restrictive regulation, trade negotiators started stretching free trade agreements to feature regulatory commitments to address the regulatory realities on the ground. At the multilateral World Trade Organisation level, one of the

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first occasions when this was done was in the 1996 Telecoms Agreement that I had the privilege to negotiate. Since then regulatory commitments have been undertaken in other services sectors, notably financial services, and have been adapted to bilateral agreements, especially the most sophisticated ones.

But make no mistake, such agreements deal with regulation in order to prevent regulation becoming an obstacle to trade. For example, in the telecoms sector, it was indicated that allocation and use of frequencies had to be done in a transparent, objective, timely and non-discriminatory manner. This was because discriminatory frequency allocation could be a barrier to trade with similar effects to a law declaring a particular telecoms subsector as non-liberalised. But those regulatory rules in trade agreements do not deal with consumer protection standards, or guarantees, or safeguards, or the harmonised and effective implementation of the rules. Including all those more complex and infinitely more detailed regulatory rules in a free trade agreement is something that has not been done so far. The task for the UK and the EU to fit the detailed and still growing Digital Single Market regulation that is currently being developed in the EU - plus the forthcoming UK regulation that we still do not know about - into a framework as rigid as a bilateral free trade area will be a monumental task.

That complexity explains why some have started to question whether it is worth spending the resources that this negotiation will entail. In order to answer that question, it is worth remembering that EU regulations will apply to UK providers in many cases anyway: consider for example the Geoblocking Regulation that will make online traders unable to refuse to sell goods and services (except for audiovisual and copyright protected content) to consumers regardless of their nationality and place of residence. This legislation would apply to any cross border trade within the EU regardless of the place of location of the business provider (be that the EU or the UK). There are many other similar examples which will force the UK to gravitate naturally to the EU regulatory model. After all, while the UK is an important centre for technology within Europe, 44% of all UK digital exports go to the EU. For those exports to continue, the providers will have to adapt to EU rules, regardless of whether the UK Government takes any action on those rules or not.

One of the attractions of embarking on negotiations will be to guarantee that access to digital talent flows freely between the EU and the UK. But this is a market of highly skilled workers and it is hard to see the interest of either the UK or the EU in imposing restrictions on them, regardless of whether they codify such lack of restrictions in a trade agreement or not. The implementation of the Digital Single Market in the EU is already late. The Commission is incurring delays in relation to many proposals. Negotiating those proposals will take resources and time. Ensuring the market understands the requirements, and that the rules are implemented properly and consistently throughout the Union, will be no minor task. It is legitimate to ask oneself whether devoting resources to a complex negotiation with a reluctant UK makes sense, or whether the EU should focus instead on doing its own homework and ensuring that it emerges from the existing internal discussions as one of the pivotal digital centres in the world. Doing so would allow the EU to maximise the potential created through its size and ensure that all the regulatory energy goes into innovative regulatory solutions that guarantee privacy and consumer protection while being as far as possible 'light-touch.'

The success of the Digital Single Market will depend on whether the EU regulations are a success. If the EU regulatory model in this area is successful it will be in the interest of the UK at a later time to become part of it. At that point it may make sense to embody those joint interests in a bilateral EU-UK Digital Market free trade agreement - but perhaps the time is not yet right.

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