



HOUSE OF LORDS

European Union Committee

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2nd Report of Session 2019–20

# **Brexit: the financial settlement**

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Evidence is published online at <https://www.parliament.uk/hlinquiry-no-deal-financial-obligations> and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence.

## SUMMARY

In November 2018 the UK Government and European Union negotiators reached an agreement on the UK's financial obligations to the EU, which took the form of the financial settlement contained within the Withdrawal Agreement. This established an agreed methodology for calculating the UK's liabilities, which neither side has since challenged. The financial settlement provisions were unchanged in the revised Withdrawal Agreement published on 17 October 2019.

While the financial settlement will fall if the Withdrawal Agreement is not ultimately ratified, this does not mean that the UK will be freed of all financial obligations. Moreover, while it would be difficult to enforce the UK's financial obligations in any international court or tribunal, honouring them is a matter of politics as well as law.

In August 2018, the Rt Hon Dominic Raab MP, then Secretary of State for Exiting the EU, told our Select Committee that "Her Majesty's Government and the United Kingdom always pay their dues". This general principle, which underpins the UK's international standing and reputation, should be the starting-point for any consideration of the financial settlement.

The extensions to the Article 50 period, which have resulted in the UK continuing to make payments as a Member State, have been offset against a reduction in the size of the financial settlement. The Office for Budget Responsibility estimates that the current extension until 31 October 2019 has reduced the financial settlement's value from £37.8 billion to around £32.8 billion.

Any Government seeking to revisit or disown the financial settlement should be conscious of the implications that this course of action would have for broader UK-EU relations. Statements from the EU institutions suggest that they are currently unwilling either to renegotiate the terms of the financial settlement or to start negotiations on a future relationship until this issue is resolved.

# Brexit: the financial settlement

## CHAPTER 1: INTRODUCTION

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1. Questions about the UK's financial obligations to the EU, and the EU's financial obligations to the UK, have returned to prominence in recent months. The issue appeared to have been resolved by the Withdrawal Agreement concluded by the UK and EU negotiators in November 2018, which set out in legally binding terms the methodology for calculating these obligations, but the current Prime Minister has stated on a number of occasions that the UK may withhold some or all of the financial settlement contained within the Withdrawal Agreement.
2. The EU Financial Affairs Sub-Committee conducted an inquiry on this topic in 2017, publishing its report, *Brexit and the EU budget*, in March 2017. Much has changed since then, notably the drafting of the Withdrawal Agreement, the extensions to the Article 50 period and greater information about the possible consequences of failing to reach an agreement. The sub-committee therefore decided to revisit its earlier findings.
3. Chapter 2 considers the change in the value of the financial obligations that result from the Article 50 extensions that have been granted, currently until 31 October 2019. Chapter 3 examines the legal status of those obligations, in particular in light of existing international law. Chapter 4 then discusses the possible consequences of failing to reach an agreement.
4. The EU Financial Affairs Sub-Committee, whose members are listed in Appendix 1, commenced this inquiry in July 2019. We heard evidence from two panels of witnesses in September and considered supplementary written evidence from two of them. We are grateful to all our witnesses.
5. **We make this report to the House for debate.**

## CHAPTER 2: THE VALUE OF THE FINANCIAL SETTLEMENT

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### Background

6. Calculating the UK's financial obligations to the EU, and the EU's financial obligations to the UK, after Brexit has been a complicated process. In our previous report, *Brexit and the EU budget*, published before the negotiations started in March 2017, we identified some of the key components that such a financial settlement might contain.<sup>1</sup> While we noted that the UK might have a legitimate claim to a share of some EU assets, notably those held by the European Investment Bank (EIB), we found that these were smaller than the UK's potential liabilities (as set out in Table 1).
7. In March 2018 the UK and EU agreed a methodology for calculating the settlement, which was ultimately incorporated into the November 2018 Withdrawal Agreement and remained unchanged in the revised Withdrawal Agreement published on 17 October 2019.<sup>2</sup> Under this Agreement, the UK would continue to contribute to the EU's annual budgets in 2019 and 2020 (in other words, for the duration of the proposed transition or implementation period) as if it remained a Member State, pay a share of the outstanding budgetary commitments (*reste à liquider*)<sup>3</sup> as calculated at the end of 2020, and contribute towards other ongoing liabilities such as EU staff pensions. In return, the UK would receive £3.5 billion of repaid capital from the EIB.
8. The Government published a 'reasonable central estimate' of the UK's net liabilities under the agreed financial settlement of between £35 billion and £39 billion, and the Office for Budget Responsibility (OBR) put the figure at £37.8 billion.<sup>4</sup> The greatest annual payments would be made at the outset, through the UK's participation in the EU's annual budgets until the end of 2020: approximately £15.9 billion would be payable over the years 2019 and 2020, £19.6 billion in 2021–28 and £2.3 billion in 2019–64 (see Table 1). The payments in 2019 and 2020 compare with projected Government expenditure for the period 30 March 2019 to 31 December 2020 of approximately £1,450 billion,<sup>5</sup> thus representing around 1% of public expenditure.

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1 European Union Committee, *Brexit and the EU budget* (15th Report, Session 2016–17, HL Paper 125)

2 Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community as endorsed by leaders at a special meeting of the European Council (25 November 2018): [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/759019/25\\_November\\_Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/759019/25_November_Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf) [accessed 10 October 2019]

3 *Reste à liquider* refers to the amount of committed expenditure that remains outstanding at the end of the EU budget period. John Springford, Deputy Director at the Centre for European Reform, told us: "Think of a Polish motorway that has been agreed but has not yet been constructed," Q 14 (John Springford, Centre for European Reform)

4 Office for Budget Responsibility, *Economic and fiscal outlook*, March 2019: [https://cdn.obr.uk/March-2019\\_EFO\\_Web-Accessible.pdf](https://cdn.obr.uk/March-2019_EFO_Web-Accessible.pdf) [accessed 10 October 2019]

5 HM Treasury, *Spending Round 2019* (September 2019): <https://www.gov.uk/government/publications/spending-round-2019-document/spending-round-2019#statistical-annex> [accessed 16 October 2019]

**Table 1: Financial settlement components by time period**

<b>UK participation in EU annual budgets to 2020</b>	<i>Reste à liquider</i>	<b>Other net liabilities*</b>	<b>Total</b>
2019–2020	2021–2028	2019–2064	<b>2019–2064</b>
£15.9 billion	£19.6 billion	£2.3 billion	<b>£37.8 billion</b>

\* The figure is net. UK liabilities include the UK's share of the EU's pension and employee liabilities. In return, the UK is entitled to a share of the EU's investment and budgetary reflows and of the paid-in capital of the European Investment Bank, set at €3.5 billion.

Source: OBR, *Economic and fiscal outlook*, March 2019: <https://obr.uk/efo/economic-fiscal-outlook-march-2019/>

9. The EU, along with the previous Government, have accepted that this settlement reflects the outstanding financial obligations of both sides. The EU's budget commissioner, Günther Oettinger, told the German newspaper *Der Tagesspiegel* on 26 July 2019 that the former UK Prime Minister, Rt Hon Theresa May MP, had “accepted the payment of that amount so we expect that, no matter which government will be our negotiating partner in the future. We expect them to accept that bill”.<sup>6</sup> While the present Government has held out the possibility that payments might be withheld in the event of a ‘no deal’ Brexit, the updated Withdrawal Agreement published on 17 October 2019 made no changes to the terms of the financial settlement.<sup>7</sup> The remainder of this chapter therefore considers the extent of the UK's financial obligations, assuming that the provisions of the Withdrawal Agreement are ratified and put into effect.

### **The uncertainty of the estimates**

10. While the Government has provided an estimate of the financial settlement's value, the National Audit Office (NAO) has said that “the precise value of most components of the settlement is subject to future events and therefore uncertain”. While it considered the Government's estimate to be “reasonable”, it found that “relatively small changes” to the assumptions used could cause the value of the financial settlement to fall outside the £35–£39 billion range. The NAO therefore described the Government's public estimate as “a narrow range of possible outcomes given the degree of uncertainty over the settlement's value”.<sup>8</sup>
11. One of the Government's key assumptions is that the UK will continue to receive EU funding at the same rate as in 2015 and 2016, meaning that it will receive 4.8% of the remaining EU budgetary expenditure in the current budget period and of the balance of outstanding commitments at the end of 2020. The NAO, however, warned in April 2018 that this could change, for example if UK-based beneficiaries decided not to apply for EU funding or if

6 ‘EU says renegeing on Brexit bill would damage UK economy’, *The Guardian* (13 June 2019): <https://www.theguardian.com/politics/2019/jun/13/eu-says-renegeing-on-brexit-bill-would-damage-uk-economy> [accessed 11 October 2019]

7 The key changes to the Withdrawal Agreement related to the Protocol on Ireland/Northern Ireland: <https://www.gov.uk/government/publications/new-withdrawal-agreement-and-political-declaration> [accessed 19 October 2019]

8 National Audit Office, *Exiting the EU: The financial settlement*, 20 April 2018: <https://www.nao.org.uk/wp-content/uploads/2018/04/Exiting-the-EU-The-financial-settlement.pdf> [accessed 10 October 2019]

their funding applications were not approved by the EU at the same rate as previously.<sup>9</sup>

12. The Government considered this risk to be mitigated, because the allocations had already been agreed for the largest programmes and because it had communicated to stakeholders that access to EU funding would be unaffected during a transition period.<sup>10</sup> On the other hand, Jorge Núñez Ferrer, Senior Research Fellow at the Centre for European Policy Studies (CEPS) in Brussels, told us that uncertainty about future funding meant that it was “unavoidable” that EU funding to the UK would decrease.<sup>11</sup> Recent reports have confirmed his assessment, showing that a fall in EU funding has now materialised.<sup>12</sup> The net cost of the financial settlement to the UK is likely to rise as a result.
13. Other key assumptions could also affect the value of the financial settlement that has been agreed. For example, the UK’s economic performance relative to the EU’s Member States will also determine the UK’s budget contributions in 2019 and 2020,<sup>13</sup> and the NAO has described the value of the long-term pension liability as “subject to significant uncertainty”. The financial settlement’s value is also exposed to changes in the exchange rate, as settlement payments will be drawn up and paid in euros.<sup>14</sup>
14. There is also uncertainty about the UK’s payments in the event of an extension to the transition period.<sup>15</sup> While the current Withdrawal Agreement notes that UK would be considered a third country for the purposes of the next EU budget cycle, it would still have to contribute an “appropriate amount” decided by the UK-EU Joint Committee.<sup>16</sup> As Martin Howe QC told us: “If the transition period were to go past December 2020, which of course is also past the end of the current MFF and ORD framework, there would need to be a new negotiation on the basis of the United Kingdom’s contributions in that period.”<sup>17</sup>
15. **The Withdrawal Agreement adopted in November 2018 incorporated the terms of an agreed financial settlement, which remained unchanged in the revised Withdrawal Agreement published on 17 October 2019. If a Withdrawal Agreement incorporating these provisions is ultimately ratified, the terms of the financial settlement contained therein will become legally binding upon both the United Kingdom and the European Union.**

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9 *Ibid.*

10 *Ibid.*

11 [Q 15](#)

12 See for instance, ‘Brexit hits UK science funding and workforce’, *BBC News*, 16 October 2019: <https://www.bbc.co.uk/news/science-environment-50044659> [accessed 16 October 2019]

13 Around 70% of the EU budget is financed from a ‘call rate’ applied to the Gross National Income (GNI) of the EU’s Member States. See European Commission, *Gross National Income-based own resource*: [https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/national-contributions\\_en](https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/national-contributions_en) [accessed 17 October 2019]

14 For its published estimate of the financial settlement, HM Treasury used an exchange rate from the date of the joint report of €1.13 to £1.

15 Article 132 of the [Withdrawal Agreement](#) states that the UK and EU could, before 1 July 2020, agree to adopt “a single decision extending the transition period for up to one or two years”.

16 [Withdrawal Agreement](#), 19 October 2019, Article 132. For a discussion of the Joint Committee that would oversee the implementation of the Withdrawal Agreement, see European Union Committee, [Brexit: the Withdrawal Agreement and Political Declaration](#) (24th Report, Session 2017–19, HL Paper 245), Chapter 2.

17 [Q 3](#)



16. **The Withdrawal Agreement establishes a methodology for calculating payments under the financial settlement, rather than setting a fixed sum. The Government has estimated the financial settlement's value to be £35–39 billion, but there is significant uncertainty involved in reaching this sum. The National Audit Office has said that relatively small changes to the assumptions used could cause the value of the financial settlement to fall outside of this range. It appears that EU funding to the UK has decreased since the referendum, which will increase the net cost of the financial settlement to the UK.**

#### The extensions to the Article 50 period

17. The Government's estimate of the financial settlement's value of between £35 billion and £39 billion was predicated on the UK withdrawing from the EU on 29 March 2019, but the extension to the Article 50 period until 31 October 2019 means that the UK is continuing to contribute to the EU's annual budgets as an EU Member State rather than making payments under the financial settlement. The OBR has estimated that this has reduced the value of the financial settlement by £5 billion, to £32.8 billion, but notes that "while this technically reduces the size of the settlement, it does not change the overall amount that the UK transfers to the EU".<sup>18</sup> In other words, any continuing payments made by the UK as an EU Member State are offset by a commensurate drop in the amount owed under the financial settlement.
18. Further extensions to the Article 50 period would thus continue to reduce the value of the financial settlement. The European Union (Withdrawal) (No. 2) Act 2019 (the so-called 'Benn Act') requires that, unless the House of Commons approves a withdrawal agreement with the EU or approves a statement that the UK is to leave the EU without an agreement, the Prime Minister must seek a further extension to the Article 50 period until 31 January 2020.<sup>19</sup> If granted by the European Council, such an extension could further reduce the size of the financial settlement by around £3 billion, to approximately £29.8 billion.<sup>20</sup>
19. The EU can request up to five months of budget contributions within the first three months of any calendar year, in order to pay for programmes that spend proportionally more earlier in the year.<sup>21</sup> The Government assumed that the EU would do this in its initial estimate of the financial settlement's value; applying the same assumption to the 2020 EU budget would see the value of the financial settlement further reduced to around £25.8 billion following another extension.<sup>22</sup> In each of these hypothetical scenarios the net change in UK transfers to the EU would be negligible: the reduction in the financial settlement would be offset against continuing contributions as a Member State.

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18 Office for Budget Responsibility, *Fiscal risks report*, July 2019: [https://obr.uk/docs/dlm\\_uploads/Fiscalrisksreport2019.pdf](https://obr.uk/docs/dlm_uploads/Fiscalrisksreport2019.pdf) [accessed 15 October 2019]

19 [European Union \(Withdrawal\) \(No. 2\) Act 2019](#)

20 This estimate should be treated with caution. The calculation was made by assuming an even spread of EU funding commitments. While the OBR estimates that the UK's net contribution to the EU in 2018–19 is £12.2 billion (i.e. approximately £1 billion a month), in practice these transfers are not evenly spread throughout year. Office for Budget Responsibility, *Economic and fiscal outlook*, March 2019.

21 According to the NAO, the EU has done this in four of the past eight years and has only requested fewer than four months' worth of contributions on two occasions. In 2019, the EU requested 4.7 months' worth of contributions in the first quarter. National Audit Office, *Exiting the EU: The financial settlement*, 20 April 2018.

22 As with the figure in Paragraph 18, this figure is based on a number of assumptions.

20. **The payments envisaged in the financial settlement for 2019 and 2020 broadly replicate payments that the UK would have made as an EU Member State during this period. The extensions to the Article 50 period, which have resulted in the UK continuing to make payments as a Member State, have thus been offset against a reduction in the size of the financial settlement.**
21. **Assuming a UK departure on 31 October 2019, the Office for Budget Responsibility now estimates the financial settlement's value to be £32.8 billion. An extension until 31 January 2020 would further reduce the financial settlement to around £29.8 billion, or possibly less. While these adjustments do not change the total amount that the UK will transfer to the EU if the Withdrawal Agreement is ratified, they do reduce the amount that could in theory be retained by the UK in the event of 'no deal'.**

## CHAPTER 3: THE LEGAL STATUS OF THE FINANCIAL OBLIGATIONS

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### Background

22. In our previous inquiry we heard different views on the legal status of the UK's financial obligations to the EU, and the EU's financial obligations to the UK, after Brexit. On the basis of the evidence that we received, we concluded: "As a matter of EU law, Article 50 TEU allows the UK to leave the EU without being liable for outstanding financial obligations under the EU budget and related financial instruments, unless a withdrawal agreement is concluded which resolves this issue."<sup>23</sup>
23. The Government took legal advice on the UK's financial obligations to the EU in 2016 and 2017, but has argued that publishing this advice would be damaging to the national interest.<sup>24</sup> This advice preceded the speech given in Florence in September 2017 by the then Prime Minister, Rt Hon Theresa May MP, in which she proposed a transition period following the UK's withdrawal that would last until the end of 2020, thus covering the remainder of the EU's Multiannual Financial Framework (MFF).<sup>25</sup> In November 2018, the former Chancellor of the Exchequer, Rt Hon Philip Hammond MP, in evidence to the House of Commons Treasury Committee, described the negotiated Withdrawal Agreement as follows:
- "We are making good on commitments that have been entered into with the UK's acquiescence during our period of membership of the European Union. These are obligations that we entered into and they are obligations which will be due in any case ... it would not be plausible or credible for the UK to assert that, in the case of no deal, no money at all was payable in respect of these obligations that were entered into during our period of membership."<sup>26</sup>
24. On 3 December 2018, following the publication of the financial settlement contained within the Withdrawal Agreement, the Attorney General, Rt Hon Geoffrey Cox QC MP, took a similar line in addressing the House of Commons: "The view of the Government, and my view, is that we would have obligations to pay a certain amount of money were we to leave the European Union without a deal"—although he noted that this was "a presently unquantifiable sum". He referred to our previous report, stating: "The House of Lords European Union Committee concluded that there would be no obligation under EU law ... but the Committee also concluded that we might have obligations under public international law, and with that I agree."<sup>27</sup>
25. In another House of Commons debate, on 15 January 2019, the Attorney General again referred to our report: "The House of Lords Committee said that there was no obligation in EU law, but that there may well be public

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23 European Union Committee, *Brexit and the EU budget* (15th Report, Session 2016–17, HL Paper 125), para 135

24 National Audit Office, *Exiting the EU: The financial settlement*, 20 April 2018.

25 The Multiannual Financial Framework (MFF) is the EU's seven-year budget plan which broadly sets out the maximum levels of EU spending across different categories. It provides a framework for the annual budgets that are negotiated and adopted each year.

26 Oral evidence taken before the House of Commons Treasury Committee, 5 November 2018 (Session 2017–19) [Q 291](#) (Philip Hammond MP)

27 HC Deb, 3 December 2018, [col 570](#)

international law obligations.”<sup>28</sup> He was correct in this summary: our previous report concluded that individual EU Member States “may seek to bring a case against the UK for the payments of outstanding liabilities under principles of public international law”, though it also cautioned that international law is slow to litigate and hard to enforce. Our report also questioned whether an international court could have jurisdiction over this issue.

### Claims within the financial settlement

26. In September 2019 we took further evidence on the legal status of the UK’s financial obligations to the EU, and the EU’s financial obligations to the UK, from two practising barristers. Martin Howe QC told us that some of the claims put forward by the EU during the course of the negotiations, particularly those concerning the UK’s commitments to the EU budget, were either “weak or extremely weak”. He described the legislation where these budget commitments are made—the MFF Regulation and the Own Resources Decision (ORD)<sup>29</sup>—as “entirely internal commitments within the EU budget process”, which “fall with the treaty” when the UK leaves the EU.<sup>30</sup> He summarised this view in a written submission:

“The fundamental position in the event of a ‘no deal’ exit is that under Art.50(3) TEU, the Treaties shall cease to apply to the UK from the moment of exit. It follows ineluctably that all subordinate legislation and decisions which have effect under the treaties, including in particular the current multiannual financial framework and ‘own resources’ decisions, shall cease to apply to the UK from that moment.”<sup>31</sup>

27. Samuel Wordsworth QC took a different approach, telling us that Article 50 had to be interpreted and applied within the general framework of international law, notably Article 70 of the Vienna Convention on the Law of Treaties.<sup>32</sup> While Article 70(1)(a) of the Vienna Convention states that the termination of a treaty “releases the parties from any obligation further to perform the treaty”, Article 70(1)(b) provides that terminating 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” (see Box 1).

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28 HC Deb, 15 January 2019, [col 1031](#)

29 The Own Resources Decision is negotiated at the same time as the Multiannual Financial Framework and provides the details of how Member States contribute to the EU budget.

30 [Q 1](#)

31 Written evidence from Martin Howe QC ([FOB0001](#))

32 United Nations, Vienna Convention on the Law of the Treaties, May 1969: [http://legal.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf) [accessed 15 October 2019]

### Box 1: Article 70 of the Vienna Convention

#### Article 70. Consequences of the termination of a treaty

1. Unless the treaty otherwise provides or the parties otherwise agree, the termination of a treaty under its provisions or in accordance with the present Convention:
  - (a) Releases the parties from any obligation further to perform the treaty;
  - (b) Does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination.
2. If a State denounces or withdraws from a multilateral treaty, paragraph 1 applies in the relations between that State and each of the other parties to the treaty from the date when such denunciation or withdrawal takes effect.

Source: United Nations, *Vienna Convention on the Law of the Treaties*, May 1969: [http://legal.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf) [accessed 15 October 2019]

28. Our previous report concluded that Article 50 of the Treaty on European Union (TEU) provided its own withdrawal procedures, and that the Vienna Convention was therefore not applicable (“unless the treaty otherwise provides”). Mr Wordsworth, however, argued that “there is nothing in Article 50, including Article 50(3), to replace the default rules, existing as a matter of customary international law”.<sup>33</sup> He told us:

“You have this second part of Article 70 that is expressly preserving the position with respect to such rights and obligations and the legal situation that has been crystallised. It does not matter at all that the obligations in relation to payment under the ORD or the financial regulation are in the form of subordinate legislation. On the plain reading of Article 70(1) (b), an obligation has been created with respect to payment under those instruments, if it is a crystallised obligation.”<sup>34</sup>

29. Mr Wordsworth told us that it was possible to identify such a “crystallised obligation” in the EU budget process, notably when an annual EU budget has been formally adopted: “If it has committed to payment of the 2019 budget and the 2019 budget includes certain lines that go beyond whatever the [withdrawal] date is, that is the obligation the UK has accepted.” He also noted that the UK had certain rights—at least with respect to the rebate and possibly with respect to discrete EU funding commitments—and that the case was less clear for the remainder of 2014–2020 MFF, where it was “much more difficult to identify a specific obligation of payment”.<sup>35</sup>
30. Mr Howe disagreed, arguing that the commitments made to the EU budget “rest on the European Union itself, a body with its own international legal personality”. He described the process for approving the EU budget as an “intra-institutional act”, and argued that approving such a measure within an EU context was “not the same as the UK entering into an international treaty or agreement”. He told us:

“When a Minister of the United Kingdom Government, within the Council of Ministers, votes to approve the budget, it is not an

33 [Q 1](#)

34 [Q 2](#)

35 [Q 1](#)

international act on behalf of and binding the United Kingdom. It is an intrainstitutional act as much as a vote on the budget by a Member of the European Parliament who happens to represent a seat in the United Kingdom is an intrainstitutional act.”<sup>36</sup>

31. The remainder of the UK’s liabilities as agreed in the financial settlement concern the accrued pension deficit for EU staff. In their written evidence, Mr Wordsworth and Sean Aughey noted that the pension scheme was run entirely through the EU’s annual budgets and therefore the same legal principles should apply, adding that a guarantee to fund this also existed in the EU Staff Regulations.<sup>37</sup> While Mr Howe described this as “a more credible and arguable claim” from the EU, he noted that the EU’s pension liabilities were treated on a pay-as-you-go basis and that there was no practice of new Member States being compensated for incurring a share of the existing pension fund deficit.<sup>38</sup> In any event, he could see “no credible argument for the UK being liable for the EU’s pension fund deficit without also being entitled to a corresponding share of the EU’s assets”.<sup>39</sup>
32. One example where the UK could have a claim to EU assets is through its membership in the European Investment Bank (EIB), which is only open to EU Member States. The financial settlement contained within the Withdrawal Agreement provides that the UK would be repaid its €3.5 billion (£3.1 billion) of paid-in capital, but only over a twelve-year period. In our report, *Brexit: the European Investment Bank*, we noted that this figure did not take account of the EIB’s accumulated profits, of which we calculated the UK’s share to be around €7.6 billion.<sup>40</sup> Mr Wordsworth acknowledged that this might be seen as a “rather inequitable situation”, but had “difficulty in seeing that the UK has a right that would filter through to Article 70 of the Vienna Convention to the recovery of that sum”. Mr Howe disagreed, describing it as “a legal claim rather than merely a moral claim”.<sup>41</sup>
33. **Legal experts continue to disagree over the extent to which the UK would have outstanding financial obligations to the EU, or vice versa, in the event of a no deal Brexit. While Article 50 TEU is the correct starting point for a legal analysis of this question, it is silent on how to resolve any outstanding financial obligations in the absence of a Withdrawal Agreement. Article 50 must also be considered in the context of international law, notably Article 70 of the Vienna Convention, which makes provision, under Article 70(1)(b), for pre-existing obligations to survive the termination of a treaty. We note,**

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36 During our previous inquiry, Professor Takis Tridimas and Mr Rhodri Thompson QC told us: “If anything, given that the EU treaties envisage a far more intense form of integration than other international agreements, the limitation on retroactive or immediate effect of termination, provided for by Article 70(1)(b) should apply *a fortiori* to the EU Treaties. Written evidence from Professor Takis Tridimas and Rhodri Thompson QC, *Brexit and the EU budget inquiry* ([EUB0001](#))

37 Article 83 of the EU Staff Regulations ([Regulation No 31 \(EEC\), 11 \(EAEC\)](#)) provides both that benefits paid under the pension scheme shall be charged to the EU budget and that: “Member States shall jointly guarantee payment of such benefits in accordance with the scale laid down for financing such expenditure”. However, Mr Wordsworth and Mr Aughey note that “it is not clear to us how far that guarantee extends, including whether it extends beyond the benefits budgeted for in the current financial year” ([FOB0002](#))

38 [Q 1](#). Martin Howe QC told us that this practice “mak[es] it hard to justify an analogous payment by a departing Member State on exit.” Written evidence Martin Howe QC ([FOB0001](#))

39 Written evidence from Martin Howe QC ([FOB0001](#))

40 See European Union Committee, *Brexit: the European Investment Bank* (25th Report, Session 2017–19, HL Paper 269), paras 53–56

41 [Q 6](#)

**however, that honouring these financial obligations is a matter of politics as well as law.**

### Linking payments to negotiations

34. The Government has suggested that it would seek to link any payments to the EU with other negotiations. In an interview with *The Sunday Times* during his campaign for leadership of the Conservative Party, the Prime Minister said that “the money is going to be retained until such time as we have greater clarity about the way forward”, describing it as “extraordinary” that the previous Government had agreed to the payment before an agreement had been finalised.<sup>42</sup> In his first speech as Prime Minister on 24 July, he said that “in the event of a no deal outcome we will have the extra lubrication of the £39 billion”, having previously described money as a “great lubricant” in getting a good deal.<sup>43</sup>
35. There are three distinct means by which such a linkage could be asserted or established. The first would be for the UK and the EU to agree, by means of an amended Withdrawal Agreement, to link payments to the progress of negotiations on the future relationship. The second would be for the financial settlement provisions of the Withdrawal Agreement to be adopted in their current form, but for the UK subsequently to refuse to honour them except in return for progress in negotiations. The third would arise in the context of a ‘no deal’ outcome, where the financial settlement embodied in the Withdrawal Agreement would fall.
36. Our witnesses agreed that the first of these possible approaches would be permissible. Mr Howe said that he “cannot see any legal issue that would prevent an agreement under which the United Kingdom would make payments subject to conditions such as progress towards an acceptable longterm agreement”.<sup>44</sup> Mr Wordsworth also told us that a linkage could be achieved if the two sides agreed.
37. The second option appears more problematic, as it would put the UK in breach of obligations that it had entered into by ratifying the Agreement. Mr Wordsworth was clear: “If there is a financial obligation and you do not comply with that obligation, i.e. pay the money at the due time that has been specified, there is a breach”. He added that “you could not justify withholding performance under any other principle of international law.”<sup>45</sup> It is worth noting that the Withdrawal Agreement includes detailed provisions on governance and dispute resolution, with the possibility of binding arbitration.<sup>46</sup>
38. As for a ‘no-deal’ scenario, the previous Government had already suggested that the UK could review the payments timetable outlined in the Withdrawal Agreement. Rt Hon Dominic Raab MP, then Secretary of State for Exiting the EU, told the EU Select Committee in August 2018: “I do not think that

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42 ‘Boris Johnson Brexit interview: That £39bn is ours’, *The Sunday Times*, (9 June 2019): <https://www.thetimes.co.uk/article/boris-johnson-brexit-interview-that-39bn-is-ours-n0p7gds8c> [accessed 11 October 2019]

43 ‘New UK PM Johnson’s arrival speech in Downing Street’, *Reuters*, (24 July 2019): <https://www.reuters.com/article/britain-eu-leader/text-new-uk-pm-johnsons-arrival-speech-in-downing-street-idUSL8N24P6DK> [accessed 11 October 2019]

44 Q 4

45 *Ibid.*

46 See European Union Committee, *Brexit: the Withdrawal Agreement and Political Declaration* (24th Report, Session 2017–19, HL Paper 245), paras 39–70

it would be safe for either side to assume that the financial settlement as agreed as part of the Withdrawal Agreement would then be paid in precisely the same shape, with the same speed or at the same rate if there was no deal.” He added: “The timing of payments is actually rather important on the EU side—I think that we overlook it on our side—because of the way money is distributed.”<sup>47</sup>

39. Our witnesses again focused on the need for the two sides to agree—either by means of the Withdrawal Agreement or, in the event of ‘no deal’, by means of what Mr Wordsworth called “a much smaller agreement that simply deals with the financial obligations”. If no such agreement were possible, it would “come down to a question of the parties’ rights and obligations under international law”.<sup>48</sup> Mr Wordsworth acknowledged that attempting to enforce the UK’s financial obligations at the International Court of Justice (ICJ) would in itself lead to delays. Claims in front of the ICJ were “lengthy proceedings”, and “in a case such as this, there would unquestionably be objections to jurisdiction and admissibility”. Overall, he believed that seeking to resolve this through the ICJ, even were such a claim possible, could take “a period of three, four or possibly more years”.<sup>49</sup>
40. **The legality of linking the payments of any financial obligations with progress in other negotiations depends on the legal status of the financial obligations themselves. The EU and UK could, within an amended Withdrawal Agreement, agree to link the payments with negotiations on a future relationship.**
41. **If a Withdrawal Agreement containing provisions on the financial settlement is ratified in close to its current form, and if the UK were then unilaterally to withhold or delay payments, such action would be contrary to the terms of that Agreement and subject to the enforcement provisions it contains.**
42. **In the event of a ‘no deal’ Brexit there would be more scope for the UK to review the scale and timing of any payments, though this could have implications for future negotiations and the UK’s wider reputation.**

#### **The question of enforceability**

43. In addition to considering the possible value and status of any outstanding financial obligations, our previous report referred to the potential problems of enforcing any legal obligations after Brexit. While individual EU Member States might seek to bring a case against the UK for the payment of outstanding liabilities under principles of public international law, we noted that “international law is slow to litigate and hard to enforce”. Moreover, we found it “questionable whether an international court or tribunal could have jurisdiction over this issue”.<sup>50</sup>
44. This is in part because the Treaty on the Functioning of the European Union (TFEU) prohibits EU Member States from submitting the legal

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47 Oral evidence taken before the House of Lords European Union Committee, 29 August 2018 (Session 2017–19), [Q 7](#) (Dominic Raab MP)

48 [Q 5](#)

49 [Q 11](#)

50 European Union Committee, *Brexit and the EU budget* (15th Report, Session 2016–17, HL Paper 125), para 136



interpretation of the EU Treaties to a court other than the Court of Justice of the European Union (CJEU).<sup>51</sup> Mr Wordsworth told us that this rule “would put a Member State in very real difficulties so far as concerns seeking to bring a claim subsequent to UK withdrawal.” He also told us that “there would be an issue as to whether the CJEU could have jurisdiction over a former member state”.<sup>52</sup>

45. Even if these difficulties could be overcome, it is unlikely that such a case could be brought before the ICJ. Mr Howe told us that the EU, “because it is not a state, is not subject to the compulsory jurisdiction of the International Court of Justice”.<sup>53</sup> Mr Wordsworth agreed, noting that “the jurisdiction of the ICJ is limited to states, so you would have to find a member state that wished to bring a claim”. This would raise in turn the issue of standing, in that a Member State seeking to bring a claim would not be a party to the Withdrawal Agreement:

“It is a well-established principle in ICJ jurisprudence that the court cannot rule on an issue if it inevitably is going to have to decide on the legal rights and obligations of a party not before it, if that is a necessary step in its analysis. In this case, you can see that having a very real resonance, because, even if a claim is brought by member state X against the United Kingdom, in order to find liability you may well have to make findings in relation to acts of the European Union, and the European Union would not be a party before the court.”<sup>54</sup>

Mr Wordsworth further noted that even if a Member State could establish its standing, any claim it made would have to be “very carefully confined”, addressing only the damage incurred by the Member State itself—it would not cover all the sums provided for in the financial settlement.<sup>55</sup>

46. Mr Wordsworth underlined, however, that “just because a breach of obligation is not accompanied by a compulsory jurisdictional provision, it does not mean it is somehow less of a serious breach of international law”.<sup>56</sup> Mr Howe agreed: “Even if there are either difficulties or impossibilities in enforcing or adjudicating whatever the substantive obligations are, there may well be arguments for the United Kingdom, as a generally lawabiding country in the scheme of international law, agreeing to some form of neutral and acceptable adjudication.”<sup>57</sup>
47. **Our witnesses agreed that there would be difficulties in enforcing any legal claims made in relation to the UK or EU’s financial obligations after a ‘no deal’ Brexit. This is in part because, as we noted in our previous report, it is “questionable whether an international court or tribunal could have jurisdiction”, not least because of the exclusive jurisdiction of the CJEU over matters of EU law.**

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51 Article 344 of the Treaty on the Functioning of the European Union states: “Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein.” Article 344, Treaty on the Functioning of the European Union, [OJ C 326](#) (consolidated version of 26 October 2012).

52 [Q 5](#)

53 [Q 7](#)

54 *Ibid.*

55 [Q 8](#)

56 [Q 7](#)

57 [Q 1](#)

48. **The difficulties in enforcing any possible financial obligations do not mean that there might not be a breach of international law if the UK were to withhold payments. We note the arguments for the UK in this scenario, as a nation committed to the rule of law, seeking a form of neutral and acceptable adjudication, such as arbitration, to settle the issue.**

## CHAPTER 4: THE CONSEQUENCES OF FAILING TO HONOUR THE FINANCIAL SETTLEMENT

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### Background

49. There has been some speculation as to what would happen if the UK and the EU failed to reach an agreement on their outstanding financial obligations—or if the settlement already contained in the Withdrawal Agreement were to fall as a result of failure to resolve other issues. In our previous report, *Brexit and the EU budget*, we concluded that “the political and economic consequences of the UK leaving the EU without responding to claims under the EU budget are likely to be profound”. We also noted that “if the UK wants a preferential trading relationship with EU, including a transitional arrangement, the EU partners may well demand a financial contribution post-Brexit”.<sup>58</sup>
50. On 29 April 2017, the European Council adopted its guidelines for the Brexit negotiations with the UK. This set out a phased approach to the negotiations, starting with a number of key withdrawal issues before moving onto discussions about the future relationship. Withdrawal issues included the need to agree a “single financial settlement” to ensure that the EU and UK “both respect the obligations resulting from the whole period of the UK membership in the Union”.<sup>59</sup> The EU remains clear that UK agreement to the financial settlement is a precondition for the commencement of negotiations on future EU-UK relations, whether or not a Withdrawal Agreement is concluded. For instance, the European Parliament’s Resolution of 18 September 2019 states that “in the case of a ‘no-deal exit’, the UK’s financial and other obligations will still exist; [and] affirms that in such a case it will refuse to give consent to any agreement or agreements between the EU and the UK unless and until the UK honours its commitments”.<sup>60</sup>

### Souring relations with the EU

51. As we noted above, the Prime Minister has said that the financial settlement will be “retained” until there is greater clarity about the future relationship with the EU (see Paragraph 34). Warwick Lightfoot, Head of Economic and Social Policy at Policy Exchange, told us that the UK refusing to pay its financial obligations could be “very awkward” for the EU institutions. He said that this was because the EU cannot borrow money to run a deficit, but warned that putting the EU in such a situation “will cause a bitter taste”. He recommended that the UK pay its outstanding financial obligations to the EU and, if anything, err “on the generous side”, because “the danger of irritations with our former partners and continuing neighbours is quite high”.<sup>61</sup> Martin Howe QC also highlighted the consequences of non-payment, noting that, if the UK declined to enter into a binding agreement on the financial settlement, “refusing to agree a longterm relationship is something the European Union could well consider”.<sup>62</sup>

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58 European Union Committee, *Brexit and the EU budget* (15th Report, Session 2016–17, HL Paper 125), para 137

59 Press release, *European Council (Art. 50) guidelines for Brexit negotiations*, European Council, 29 April 2017: <https://www.consilium.europa.eu/en/press/press-releases/2017/04/29/euco-brexit-guidelines/> [accessed 17 October 2019]

60 European Parliament resolution of 18 September 2019 on the state of play of the UK’s withdrawal from the European Union (2019/2817(RSP))

61 [Q 12](#)

62 [Q 10](#)

52. Jorge Núñez Ferrer, Senior Research Fellow at the Centre for European Policy Studies (CEPS) in Brussels, agreed that “you will have reactions from the EU if you do not pay”. While he described the financial settlement as “quite trivial as an amount in the picture of everything”, covering the shortfall resulting from the UK’s non-payment would nonetheless be “very difficult domestically” on the EU side. Nevertheless, he did not think that the UK would gain any advantage by refusing to pay:

“I do not think it gives any negotiation power to withhold this money and say, ‘Oh, we’re going to negotiate piece by piece’, because then the other side will react by saying, ‘Okay, then we implement these contingency measures’. The EU can cover it. They have a reason to do it. It is unpleasant, but they will feel that the problem came from [the UK].”<sup>63</sup>

53. John Springford, Deputy Director of the Centre for European Reform (CER), told us that the EU would be unwilling to renegotiate specific aspects of the financial settlement. While it could take mitigating steps in the event of ‘no deal’—notably through an emergency trade deal—he said that “signing up to the provisions of the withdrawal agreement will be the demand”.<sup>64</sup> Indeed, in a Communication on 10 April 2019, the European Commission said that reaching an agreement on citizens’ rights, the Irish border and the financial settlement was a “precondition for discussions on the way forward with the United Kingdom”.<sup>65</sup>
54. **Failure by the UK Government in a ‘no deal’ scenario to honour the financial settlement contained in the Withdrawal Agreement would be received negatively by the EU, and statements by the EU institutions suggest that they are currently unwilling either to renegotiate its terms or to start negotiations on a future relationship until this issue is resolved. Any Government seeking to revisit or disown the financial settlement should be conscious of the implications that this would have for broader UK-EU relations as well as for the UK itself.**

#### Possible reputational damage

55. Our previous report warned that the failure to reach an agreement on the outstanding financial obligations could carry “a wider reputational risk if the UK is perceived as having avoided its responsibilities”.<sup>66</sup> Rt Hon Philip Hammond MP, then Chancellor of the Exchequer, told the House of Commons Treasury Committee in November 2018 that, if the UK were not to fulfil its financial obligations, “we would effectively rule ourselves out of being regarded as reliable partners in future international deals of any kind, including trade deals. That would not be something that I would recommend at all.”<sup>67</sup>

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63 [Q 13](#)

64 [Q 12](#)

65 Communication from the Commission to the European Parliament and the Council, *Addressing the impact of a withdrawal of the United Kingdom from the Union without an agreement: the Union’s coordinated approach*, COM(2019) 195 final: [https://ec.europa.eu/info/sites/info/files/file\\_import/com2019\\_195\\_final\\_en\\_0.pdf](https://ec.europa.eu/info/sites/info/files/file_import/com2019_195_final_en_0.pdf) [accessed 18 October 2019]

66 European Union Committee, *Brexit and the EU budget* (15th Report, Session 2016–17, HL Paper 125), para 203

67 Oral evidence taken before the House of Commons Treasury Committee, 5 November 2018 (Session 2017–19), [Q 291](#) (Philip Hammond MP)

56. Samuel Wordsworth QC told us that the UK had “a high reputation in the world of international law, and that reputation would be damaged if there was a perception that the UK was failing to comply with treaty obligations”.<sup>68</sup> Martin Howe QC agreed, arguing that agreeing to some form of neutral and acceptable adjudication with the EU would enable the UK to “demonstrat[e] that it is willing to obey international law rather than take advantage of an absence of a jurisdictional route which leads to a legal remedy”.<sup>69</sup> The then Secretary of State for Exiting the EU, Rt Hon Dominic Raab MP, in evidence to our Select Committee in August 2018, confirmed that “Her Majesty’s Government and the United Kingdom always pay their dues”.<sup>70</sup>
57. The UK’s credit rating is a key component of its wider international reputation, and Mr Lightfoot suggested that any UK failure to honour its financial obligations would “be of interest to credit rating agencies and bond markets”.<sup>71</sup> We note, however, that recent reports suggest that the major credit rating agencies would not regard non-payment as a sovereign default.<sup>72</sup>
58. **We welcome the confirmation by the former Secretary of State for Exiting the EU, now Foreign Secretary, that “Her Majesty’s Government and the United Kingdom always pay their dues”. Failure by the UK Government to honour its financial obligations, however calculated, would have consequences for the UK’s international standing and reputation.**

### Disruption for recipients of EU funding

59. The Government has said that it would guarantee certain EU funding in a ‘no deal’ scenario and has already committed to maintaining EU programmes after Brexit<sup>73</sup>—including farm support, structural funds and science and education programmes. The EU has agreed to maintain funding for the PEACE IV Programme to provide support for peace in Northern Ireland and Ireland, as well as ongoing Erasmus+ learning mobility activities involving the UK.<sup>74</sup>
60. There remain some questions about how these guarantees will function in practice. In particular, there is uncertainty over the fate of research funding agreed under the Horizon 2020 programme, which in many cases involves teams of researchers from more than one Member State. Our Home Affairs Sub-Committee concluded in its February 2019 report, *Brexit: the*

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68 [Q 10](#)

69 Written evidence from Martin Howe QC ([FOB0001](#))

70 Oral evidence taken before the House of Lords European Union Committee, 29 August 2018 (Session 2017–19), [Q 7](#) (Dominic Raab MP)

71 [Q 12](#)

72 ‘Legal hazards but no default seen if Britain doesn’t pay Brexit bill’, *Reuters*, (10 June 2019): <https://uk.reuters.com/article/us-britain-ratings-brexit/legal-hazards-but-no-default-seen-if-britain-doesnt-pay-brexit-bill-idUKKCN1TB1BI> [accessed 16 October 2019]

73 The Government has said that it will guarantee the full MFF allocation of structural and investment funds until the end of 2023, the payment of awards where UK organisations have made successful bids to the European Commission, and the current level of agricultural funding under the Common Agriculture Policy (CAP) Pillar 1 until the end of 2020. See HM Treasury, *The government’s guarantee for EU-funded programmes if there’s no Brexit deal*, (8 August 2019): <https://www.gov.uk/government/publications/the-governments-guarantee-for-eu-funded-programmes-if-theres-no-brexit-deal/the-governments-guarantee-for-eu-funded-programmes-if-theres-no-brexit-deal> [accessed 17 October 2019]

74 Communication from the Commission to the European Parliament and the Council, *Addressing the impact of a withdrawal of the United Kingdom from the Union without an agreement: the Union’s coordinated approach*, [COM\(2019\) 195 final](#)

*Erasmus and Horizon programmes*, that the Government “should, as a matter of urgency, provide further information on how it intends the underwrite guarantee to operate in practice, including who will disburse the funding and what terms and conditions will apply to beneficiaries”.<sup>75</sup> On 30 July 2019, Universities UK published a ‘no deal’ briefing saying that the full details of how the underwrite guarantee would work in practice “must be published and publicised by the Government”.<sup>76</sup> Mr Springford made similar points:

“They say the payment of awards where UK organisations have successfully bid directly to the European Commission on a competitive basis, while we remain in the EU, for the lifetime of the project, will be guaranteed. But the question is this: okay, if you have been involved in a collaborative project under Horizon, you may receive some money, but are you going to be shut out of that project as a UK researcher? How is that going to work?”<sup>77</sup>

61. Failure to honour the UK’s financial obligations would also have an impact on the UK’s longer-term participation in EU programmes like Horizon 2020 and its successor, Horizon Europe. The former Prime Minister, Rt Hon Theresa May MP, expressed her Government’s desire to “take part in those specific policies and programmes which are greatly to the UK and the EU’s joint advantage, such as those that promote science, education and culture—and those that promote our mutual security”.<sup>78</sup> But, as Mr Springford told us, it would be “impossible for the UK to be part of Horizon 2020 if it went to ‘no deal’ and there was no subsequent agreement covering the provisions of the withdrawal agreement”. He noted that, following the Swiss referendum on limiting EU migration, the EU immediately suspended two-thirds of Switzerland’s participation in the Horizon 2020 programme: “It seems very likely that, in the event of no deal with the UK, the EU would react in a very similar way.”<sup>79</sup>
62. Replacing EU funding for agriculture or regional development may raise different issues. Mr Lightfoot noted that “the great bulk of payments to farming businesses are made through UK entities and the devolved Administrations in Scotland, Wales and Northern Ireland”.<sup>80</sup> Replacing structural funds, which support regional development, could also raise issues of devolved and reserved competence, which fall outside the scope of this report.
63. **The Government has guaranteed certain EU funding for UK organisations in the event of ‘no deal’. However, there remain unanswered questions about how this guarantee will function in practice. We remain concerned that could be significant short-term**

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75 European Union Committee, *Brexit: the Erasmus and Horizon programmes* (28th Report, Session 2017–19, HL Paper 283), para 91

76 Universities UK, *No-deal briefing*, 30 July 2019: <https://www.universitiesuk.ac.uk/policy-and-analysis/reports/Documents/2019/no-deal-briefing.pdf> [accessed 17 October 2019]

77 **Q 18.** The Government’s technical notice on *Horizon 2020 funding if there’s no Brexit deal* notes that, in cases where UK participants lead a consortium and distribute funds to other participants, these consortia may not comply with EU Member State participation thresholds after the UK becomes a third country. Our previous report, *Brexit: the Erasmus and Horizon programmes*, therefore noted that the Government’s underwrite guarantee “is subject to the UK reaching an agreement with the EU on the continued eligibility of UK participants”.

78 Written Answer 2 November 2017, [HL2367](#)

79 [Q 17](#)

80 [Q 19](#)

**disruption to programmes, including Horizon 2020, as well as a threat to continued UK participation in the longer term.**

## SUMMARY OF CONCLUSIONS

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1. The Withdrawal Agreement adopted in November 2018 incorporated the terms of an agreed financial settlement, which remained unchanged in the revised Withdrawal Agreement published on 17 October 2019. If a Withdrawal Agreement incorporating these provisions is ultimately ratified, the terms of the financial settlement contained therein will become legally binding upon both the United Kingdom and the European Union. (Paragraph 15)
2. The Withdrawal Agreement establishes a methodology for calculating payments under the financial settlement, rather than setting a fixed sum. The Government has estimated the financial settlement's value to be £35–39 billion, but there is significant uncertainty involved in reaching this sum. The National Audit Office has said that relatively small changes to the assumptions used could cause the value of the financial settlement to fall outside of this range. It appears that EU funding to the UK has decreased since the referendum, which will increase the net cost of the financial settlement to the UK. (Paragraph 16)
3. The payments envisaged in the financial settlement for 2019 and 2020 broadly replicate payments that the UK would have made as an EU Member State during this period. The extensions to the Article 50 period, which have resulted in the UK continuing to make payments as a Member State, have thus been offset against a reduction in the size of the financial settlement. (Paragraph 20)
4. Assuming a UK departure on 31 October 2019, the Office for Budget Responsibility now estimates the financial settlement's value to be £32.8 billion. An extension until 31 January 2020 would further reduce the financial settlement to around £29.8 billion, or possibly less. While these adjustments do not change the total amount that the UK will transfer to the EU if the Withdrawal Agreement is ratified, they do reduce the amount that could in theory be retained by the UK in the event of 'no deal'. (Paragraph 21)
5. Legal experts continue to disagree over the extent to which the UK would have outstanding financial obligations to the EU, or vice versa, in the event of a no deal Brexit. While Article 50 TEU is the correct starting point for a legal analysis of this question, it is silent on how to resolve any outstanding financial obligations in the absence of a Withdrawal Agreement. Article 50 must also be considered in the context of international law, notably Article 70 of the Vienna Convention, which makes provision, under Article 70(1)(b), for pre-existing obligations to survive the termination of a treaty. We note, however, that honouring these financial obligations is a matter of politics as well as law. (Paragraph 33)
6. The legality of linking the payments of any financial obligations with progress in other negotiations depends on the legal status of the financial obligations themselves. The EU and UK could, within an amended Withdrawal Agreement, agree to link the payments with negotiations on a future relationship. (Paragraph 40)
7. If a Withdrawal Agreement containing provisions on the financial settlement is ratified in close to its current form, and if the UK were then unilaterally to withhold or delay payments, such action would be contrary to the terms of that Agreement and subject to the enforcement provisions it contains. (Paragraph 41)



8. In the event of a ‘no deal’ Brexit there would be more scope for the UK to review the scale and timing of any payments, though this could have implications for future negotiations and the UK’s wider reputation. (Paragraph 42)
9. Our witnesses agreed that there would be difficulties in enforcing any legal claims made in relation to the UK or EU’s financial obligations after a ‘no deal’ Brexit. This is in part because, as we noted in our previous report, it is “questionable whether an international court or tribunal could have jurisdiction”, not least because of the exclusive jurisdiction of the CJEU over matters of EU law. (Paragraph 47)
10. The difficulties in enforcing any possible financial obligations do not mean that there might not be a breach of international law if the UK were to withhold payments. We note the arguments for the UK in this scenario, as a nation committed to the rule of law, seeking a form of neutral and acceptable adjudication, such as arbitration, to settle the issue. (Paragraph 48)
11. Failure by the UK Government in a ‘no deal’ scenario to honour the financial settlement contained in the Withdrawal Agreement would be received negatively by the EU, and statements by the EU institutions suggest that they are currently unwilling either to renegotiate its terms or to start negotiations on a future relationship until this issue is resolved. Any Government seeking to revisit or disown the financial settlement should be conscious of the implications that this would have for broader UK-EU relations as well as for the UK itself. (Paragraph 54)
12. We welcome the confirmation by the former Secretary of State for Exiting the EU, now Foreign Secretary, that “Her Majesty’s Government and the United Kingdom always pay their dues”. Failure by the UK Government to honour its financial obligations, however calculated, would have consequences for the UK’s international standing and reputation. (Paragraph 58)
13. The Government has guaranteed certain EU funding for UK organisations in the event of ‘no deal’. However, there remain unanswered questions about how this guarantee will function in practice. We remain concerned that could be significant short-term disruption to programmes, including Horizon 2020, as well as a threat to continued UK participation in the longer term. (Paragraph 63)

## APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

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### Members

Lord Bruce of Bennachie  
Lord Cavendish of Furness  
Baroness Couttie  
Lord Desai  
Lord Giddens  
Baroness Liddell of Coatdyke  
Baroness Neville-Rolfe  
Lord Sharkey (Chairman)  
Lord Thomas of Cwmgiedd  
Viscount Trenchard  
Lord Turnbull  
Lord Vaux of Harrowden

### Declarations of interest

Lord Bruce of Bennachie  
*No relevant interests to declare*

Lord Cavendish of Furness  
*Director, Vitagrass Farms Ltd*

Baroness Couttie  
*No relevant interests to declare*

Lord Desai  
*No relevant interests to declare*

Lord Giddens  
*No relevant interests to declare*

Baroness Liddell of Coatdyke  
*Member, Advisory Committee, Price Waterhouse Coopers*

Baroness Neville-Rolfe  
*Former Commercial Secretary (Minister of State), HM Treasury (2016–2017)*  
*Governor, London Business School*

Lord Sharkey  
*Member of Council, University College London*

Lord Thomas of Cwmgiedd  
*Chairman, Financial Markets Law Committee*  
*Vice President, the European Law Institute*  
*Chancellor, Aberystwyth University*  
*Door tenant as arbitrator at Essex Court Chambers*

Viscount Trenchard  
*Trustee, Fonthill Estate*

Lord Turnbull  
*No relevant interests to declare*

Lord Vaux of Harrowden  
*Receipt of Common Agricultural Policy (CAP) payments as a farmer in Scotland*

The following Members of the European Union Select Committee attended the meeting at which the report was approved:

Baroness Couttie  
 Baroness Donaghy  
 Lord Faulkner of Worcester  
 Baroness Hamwee  
 Lord Jay of Ewelme  
 Lord Kerr of Kinlochard  
 The Earl of Kinnoull  
 Lord Lamont of Lerwick  
 Lord Morris of Aberavon  
 Baroness Neville-Rolfe  
 Lord Ricketts  
 Lord Sharkey  
 Lord Teverson  
 Lord Wood of Anfield

During consideration of the report the following Members declared an interest:

Lord Lamont of Lerwick  
*Director, Jupiter European Opportunities Trust*  
*Director, Compagnie Internationale de Participations Bancaires et Financieres (CIPAF)*  
*Director, Chelverton UK Dividend Trust*  
*Adviser, Halkin Investments*  
*Adviser, Official Monetary and Financial Institutions Forum (OMFIF)*  
*Adviser, Meinhardt Engineering Group, Singapore*  
*Adviser, Stanhope Capital LLP*

A full list of Members' interests can be found in the Register of Lords Interests:  
<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

## APPENDIX 2: LIST OF WITNESSES

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Evidence is published online at: <https://www.parliament.uk/hlinquiry-no-deal-financial-obligations> and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence and in alphabetical order. Those witnesses marked with \*\* gave both oral evidence and written evidence. Those marked with \* gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

### Oral evidence in chronological order

- |    |  |                          |
|----|--|--------------------------|
| ** | Martin Howe QC, 8 New Square   | <a href="#">QQ 1-11</a>  |
| ** | Samuel Wordsworth QC, Essex Court Chambers   | <a href="#">QQ 1-11</a>  |
| *  | Dr Jorge Núñez Ferrer, Associate Senior Research Fellow, Centre for European Policy Studies (CEPS) | <a href="#">QQ 12-19</a> |
| *  | Warwick Lightfoot, Head of Economic and Social Policy, Policy Exchange                             | <a href="#">QQ 12-19</a> |
| *  | John Springford, Deputy Director, Centre for European Reform (CER)                                 | <a href="#">QQ 12-19</a> |

### Alphabetical list of all witnesses

- |    |   |                         |
|----|---|-------------------------|
|    | Sean Aughey, Barrister, 11 KBW  | <a href="#">FOB0002</a> |
| *  | Dr Jorge Núñez Ferrer, Associate Senior Research Fellow, Centre for European Policy Studies (CEPS) ( <a href="#">QQ 12-19</a> ) |                         |
| ** | Martin Howe QC, 8 New Square ( <a href="#">QQ 1-11</a> )  | <a href="#">FOB0001</a> |
| *  | Warwick Lightfoot, Head of Economic and Social Policy, Policy Exchange ( <a href="#">QQ 12-19</a> )                             |                         |
| *  | John Springford, Deputy Director, Centre for European Reform (CER) ( <a href="#">QQ 12-19</a> )                                 |                         |
| ** | Samuel Wordsworth QC, Essex Court Chambers ( <a href="#">QQ 1-11</a> )  | <a href="#">FOB0002</a> |

## APPENDIX 3: CALL FOR EVIDENCE

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The House of Lords EU Financial Affairs Sub-Committee, chaired by Lord Sharkey, has launched an inquiry into the UK's financial obligations to the EU in a 'no deal' scenario. This will build on its previous report, *Brexit and the EU budget*, published in March 2017. The Committee invites interested individuals and organisations to submit evidence to this inquiry.

Written evidence is sought by 28 August 2019. Public hearings are expected to take place in September and the Committee aims to report to the House in October.

### Background

Based on a range of evidence received, our previous report concluded that Article 50 allows the UK to leave the EU “without being liable for outstanding financial obligations under the EU budget and related financial instruments, unless a withdrawal agreement is concluded which resolves this issue.” However, it also warned that the political and economic consequences of doing so would be “profound” and noted that the EU may well demand a financial contribution before agreeing a preferential trading relationship, as well as a transition period.

The Government recognises that the UK has obligations to the EU, and the EU obligations to the UK, that will survive the UK's withdrawal—and that these would need to be resolved in the event of a 'no deal' Brexit. In our ongoing correspondence with the Government, the Chief Secretary to the Treasury has told us that the UK will seek a negotiated settlement with the EU if the draft Withdrawal Agreement is not ratified. However, if a negotiated settlement cannot be reached, this would then be settled “through the courts, in the context of obligations contestable under both EU and international law.”

The EU has made clear its view that the UK honouring the financial commitments that it made as a Member State will be a precondition for any future negotiations. In April, the European Commission published a Brexit Communication which said that addressing the UK's financial obligations, together with the issues of citizens' rights and the Northern Irish border, would be “a precondition for discussions on the way forward.”

Giving the increased possibility of a 'no deal' Brexit, the Committee has decided to revisit the issue of the UK's financial obligations to the EU, focusing in particular on the possible consequences of the UK deciding not to pay. This could involve considering the enforceability of the UK's financial obligations to the EU, the likely political response from the EU, and the implications for UK organisations that currently receive EU funding.

### The inquiry

The Committee seeks evidence on the following questions in particular:

1. What are the different scenarios under a 'no deal' Brexit and how could these affect the UK's financial obligations to the EU?
2. What is the status of the UK's financial obligations to the EU, and the EU's financial obligations to the UK, in the event of a 'no deal' Brexit?
3. How do the UK's financial obligations to the EU in a 'no deal' scenario compare to the financial settlement contained within the draft Withdrawal Agreement?

4. How have the Article 50 extensions affected the value of the UK's financial obligations to the EU? How could any further extensions affect this?
5. If no agreement is reached with the EU, how would the UK's financial obligations be legally enforced? Under which court's jurisdiction could such a case be considered?
6. What is the EU's position on the UK's financial obligations, particularly its participation in the remainder of the 2014-2020 Multiannual Financial Framework (MFF)?
7. What would the political consequences be of the UK and EU failing to reach an agreement on their mutual financial obligations?
8. How would the EU's funding commitments be affected if the UK decides not to pay a financial settlement?
9. How would UK organisations currently receiving EU funding be affected in a 'no deal' scenario? Which areas, if any, would not be covered by the guarantee initially announced by the Government in December 2018?
10. If the UK chooses to participate for the remainder of the current MFF, to what extent could EU funding to the UK decrease during this period? How should this be addressed?

You need not address all of these questions.