Working Translation / Original: German

The EU / UK Trade and Cooperation Agreement (TCA) – The VCI's Assessment ("Living Document")

Overview / Key Messages

- From the viewpoint of the chemical-pharmaceutical industry, the TCA is better than a "hard Brexit," but it brings considerable worsening compared with the UK's membership of the internal market
- On the positive side, there will be no tariffs and quotas in trade in goods and chemicals, provided the respective origin criteria are fulfilled. On the other hand, there are individual product-specific rules of origin that can hamper the efforts of the chemical industry that are supported by EU industrial policy.
- The TCA is a free trade agreement and, therefore, does not exempt from regulatory barriers that have to be complied with in trade, nor does it bring any facilitation in customs clearance that now becomes necessary.
- The rules on cooperation in the implementation and further development of the chemicals legislation are insufficient. Supplementary agreements are desirable, particularly on data sharing.
- For the pharmaceutical industry, the mutual recognition of production certificates is positive, while the lack of mutual recognition for batch release is deplorable
- It is positive that both sides are committed to ambitious climate, environmental and other sustainability goals.
- It is too early to assess what effect the new provisions on the "level playing field" will have in practice.
- It is positive that the UK can remain part of the EU research programmes. Unfortunately, the UK will no longer participate in Erasmus+.
- We hope that further rules will be agreed fast for the areas that are still unregulated (personal data, financial services).

General appraisal: as good as possible

The EU/UK Trade and Cooperation Agreement (TCA) is a very comprehensive agreement and regulates many areas. It goes beyond the EU's previous free trade agreements (FTAs). However, some fields are not part of the agreement or have not yet been definitely regulated, e.g. foreign and security policy, financial services or personal data flows.

The United Kingdom is one of the major trading partners outside the EU of the German chemical-pharmaceutical industry.

The industry's exports across the Channel amounted to just under 10 billion euros in 2019. This is roughly equivalent to the volume of exports to China or half of exports to the United States. Imports from UK totalled 6.9 billion euros.

The TCA is better than the imminent threat of a hard Brexit. But from the chemical industry's perspective, it is by its very nature a significant deterioration compared to the UK's former EU membership. Since closer ties had not been realistic for quite some time, the agreement on Christmas Eve - even "in the final hour"- was good news. The bottom line is this: There are many positive points, but not all of our wishes came true. Thus, supplementary agreements would be desirable.

One positive aspect compared to a hard Brexit is that there will be no tariffs or quotas on industrial goods in the future - this is the core of any free trade agreement. For chemicals, there are also good and flexible rules of origin that make most of the EU-British chemical trade duty-free.

However, there are also areas where the chemical industry would have expected more: for example, some rules of origin in areas of industrial policy interest are more flexible than desirable. And for us, this is particularly serious: The UK is establishing its own chemicals legislation, so from now on there will be two separate regimes. In this context, far-reaching agreements on data sharing for the registration of chemicals would have been important for the chemical industry in order to reduce duplication of work and costs.

It is good that – following ratification – reliable planning becomes possible at long last. This is hoped to revive German-British chemical trade. Therefore, the agreement should be ratified quickly.

It would also be desirable for the agreement to lay the foundation for closer cooperation. In the short term, above all, with regard to the open aspects of the agreement (for example in the future cooperation of the chemicals agencies), but also in the long term across all regulatory areas – inter alia, to prevent regulations from drifting apart.

Fast ratification, bring about legal certainty, intensify cooperation

After intensive negotiations, the EU and the British government reached agreement on the TCA on Christmas Eve. Since 1 January 2021, the agreement has been provisionally applied thanks to a tour de force of the institutions. Ratification has been completed in the UK.

Final ratification is still pending in the EU. The European Commission and the Council's legal service are taking the view that the agreement can be concluded as "EU only". For the EU, ratification of the agreement thus still requires referral to and approval by the EP (Art. 218 (6) TFEU) and final adoption of the decision to conclude the

agreement by the Council (unanimously in accordance with Art. 218 (8) TFEU, possibly by written procedure).

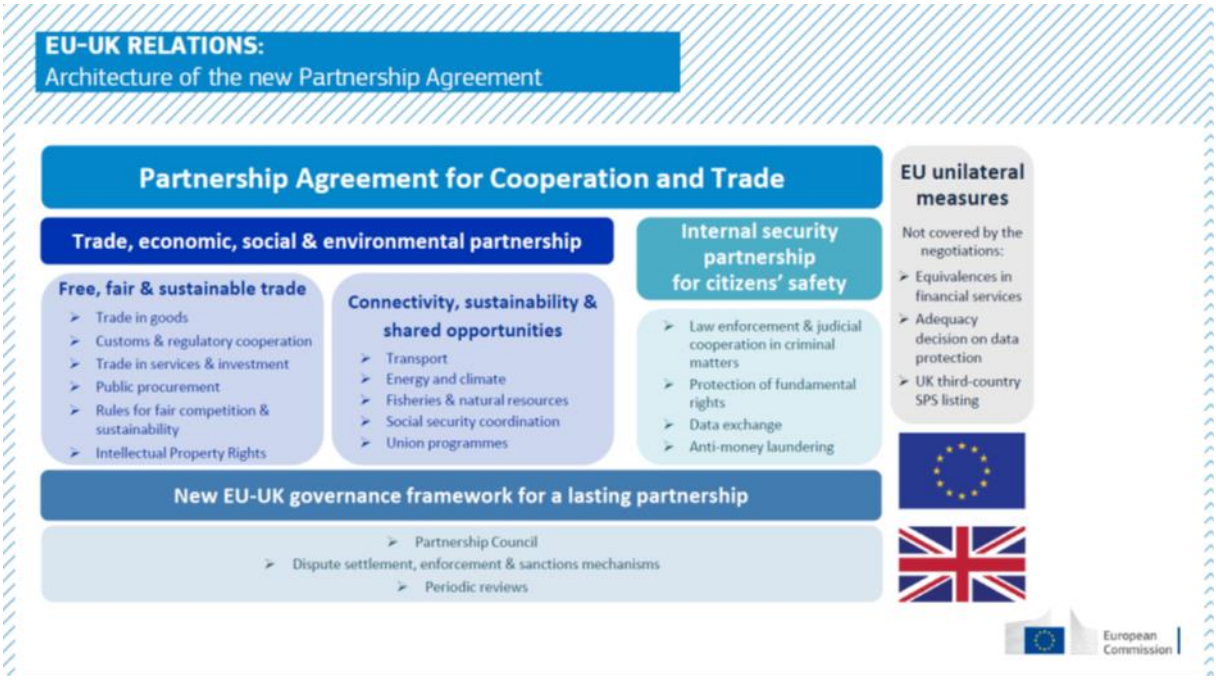
The provisional application initially applies for 2 months and ends on 28 February 2021 (*meanwhile: extension to end of April*), or

- on a date determined by the Partnership Council, or
- with entry into force of the agreement (= after completion of ratification procedures),whichever is the earliest (Art. FINPROV.11, p. 470).

The text of the agreement is available in all 24 official languages of the EU. However, by 30 April 2021, all language versions of the agreement will undergo final revision.

Structure:

The comprehensive agreement includes, inter alia, rules for cooperation in the areas of trade, transport, and fisheries (including provisions to ensure fair competition), and an overarching governance framework (including dispute settlement, enforcement, and sanctions mechanisms).



Part 6 of the TCA regulates a horizontal dispute settlement mechanism that applies to most areas of the agreement (Art. INST.9 et seq., p. 442 et seq.). According to this mechanism, in the event of a dispute, the contracting parties will first attempt to resolve the dispute amicably by way of consultations. If this is unsuccessful, the request can be made to establish an arbitration tribunal. The arbitration tribunal submits its decision to the contracting parties, which will be binding for them. If a contracting party does not comply with a decision of the arbitration tribunal or does not take the necessary implementation measures, the complaining contracting party can temporarily suspend

obligations under the agreement, possibly also across sectors. Suspension of obligations must be reasonable (if necessary, subject to review by the arbitration tribunal).

At this stage, partnership councils are established to accompany the implementation of the agreement.

VCI comments on the individual provisions:

Ultimately, an assessment of the TCA stands or falls with the benchmark. Compared with the UK's membership in the EU, there are additional burdens – while there are advantages over a hard Brexit. In the following analysis, the respective advantages of the different perspectives vary.

Customs and customs procedures

The following is positive and at the core of a free trade agreement: There will be **no tariffs or quotas** in bilateral trade in the future – this also holds true for chemical products, provided the product-specific rules of origin are met.

However, the **processes** at the border will become **more complicated** - this is normal in the context of a free trade agreement compared with EU membership, but causes considerable additional bureaucracy and delays. This is because, as a matter of principle, the EU-UK agreement does not exempt deliveries from bans and restrictions or other non-tariff trade barriers that must be complied with during import or export. Every regulatory barrier must be complied with despite the agreement. Moreover, full customs clearance must now be carried out; unfortunately, the agreement does not provide for any facilitation directly applicable by companies here.

As the agreement was reached so late, the time to adapt business processes (e.g. for customs declarations, issuing supplier's declarations and the changeover to the new list conditions regarding rules of origin) was extremely short. Fortunately, there was no chaos at the border at the beginning of January and the **customs systems seem to be working**. Nevertheless, many practical questions remain open:

For example, there was some uncertainty as to whether the **REX system** would apply. Unlike in other agreements, there is nothing on this in Articles ORIG.18, ORIG.18a and ORIG.19. Footnote 2 of Annex ORIG-4 builds a bridge to Article 68 UCC-IA.[1]

Meanwhile, it has become clear that EU exporters should use the REX system. Since an EORI will probably suffice for GB exporters, there is unequal treatment (analogous to the agreements with Canada and Japan). Companies that are faced with customs

[1] "Where the Union has a preferential arrangement which requires an exporter to complete a document on origin in accordance with the relevant Union legislation, such a document may be completed only by an exporter who is registered for that purpose by the customs authorities of a Member State."

processes for the first time due to Brexit were not able to implement the agreement immediately in January, because the issuing of a **REX number** (main customs office) usually takes several weeks. Furthermore, we are more and more observing that some customs authorities in the EU are attaching inadmissible conditions to the issuing of a REX number and to the handling of the REX status, thus increasing the bureaucratic burden for companies.

Import value-added tax

The agreement reduces customs duties, but - compared to EU membership - not import VAT or potentially applicable excise duties. In addition, exemption thresholds cease to exist. Consequently, bureaucratic hurdles and additional fiscal burdens arise. Depending on the delivery conditions and responsibility, this can also mean for the chemical industry in Germany that (e,g, in the case of DDP deliveries) higher costs occur for the sale. This can either minimise the EBIT of the seller or - if passed on to the customer - have effects on competitiveness. Moreover, there can be costs for additional processing by external service providers. In total, such extra costs can be quite significant and impact pricing.

Rules of Origin (RoO)

Chemicals: Flexibility as the basis for high utilisation rates

For chemical products (HS codes 28 to 39), flexible rules of origin have been agreed in the TCA. These will make most of the EU-UK chemical trade duty-free.

On the individual elements of the RoO

It is very helpful that a **retroactive claim for preferential tariff treatment** (ORIG. 18a) is possible, as the implementation of the rules for obtaining tariff preferences under the agreement will take some time in the companies.

Unfortunately, there was **no** agreement on **diagonal cumulation**. At least, however, not only pure bilateral cumulation but also limited full cumulation between the EU and the UK is now possible (ORIG.4). Another point of criticism is that there is no transitional arrangement for EU or UK goods that were already in the other country before 31 December and are intended for "re-export" to the EU under a different jurisdiction. Furthermore, the agreement does **not** provide the possibility for the UK to join the regional agreement and to thus participate in **cumulation** in the Pan-EUR-MED zone. This means that the negotiating partners did not followed one of the main demands of German industry.

It is positive that **accounting segregation** (ORIG.14) is made possible for certain finished products which are classified, inter alia, in chapters 10, 15, 27, 28 and 29 or in headings 3201, 3207, and 3901 to 3914 of the HS. This could be interesting for some

chemical companies. Unfortunately, the new rules do not apply to all chemical and pharmaceutical products and not to trading goods. The German chemical industry had hoped for much more flexibility here to make better use of the agreement – even more so as Germany and other Member States must be ready to reconsider relevant requirements for allowing accounting segregation.

No **draw-back prohibition** was adopted (ORIG.17), so that preferential originating goods can also result from inward processing. Instead, Article ORIG.17 contains a review clause that allows introducing a draw-back prohibition at a later time.

Flexibility is provided by the **10% value tolerance** (ORIG. 6) for all products in chapters 27 - 40. It is welcome that the negotiating parties have used the value method for the general tolerance and have dispensed with the weight tolerance here.

The planned differentiation and unequal treatment of **transport/protective packaging** on the one hand and **sales packaging** on the other is unnecessary (ORIG. 9, ORIG. 10). Unfortunately, the latter is to be taken into account only in the case of value rules within the framework of preference determination, otherwise transport/protective packaging is to be disregarded. For companies, this differentiation makes it difficult to use the agreement, as the software solutions deployed for preference determination cannot deal with this for technical reasons.

Lubricants, greases, compounding materials, solvents, catalysts and other inputs that are used in production and not incorporated in the final product are deemed **"neutral elements"** (ORIG. 13) and can be sensibly left out of the origin determination - as is already regulated in a similar manner in other EU free trade agreements.

Here, too, the importer's knowledge can be used as the basis to claim preferential tariff treatments (ORIG. 18) - comparable to the EU-Japan EPA. The chemical and pharmaceutical industry notes that the usability is limited anyway and only applies within groups of companies, if at all. From our viewpoint, the principle of the importer's knowledge as a simplification should be treated with caution, as the number of possible use cases is currently very low and this involves a high level of risk.

Unlike in the EU-Japan EPA, indicating the origin criterion or the processing ruleswith a respective code on the **declaration of origin** (ORIG. 19 in conjunction with Annex ORIG-4) is not necessary. The chemical-pharmaceutical industry expressly welcomes that this requirement has been left out. The elimination of this major obstacle to implementation should also be pursued rapidly in the EU-Japan EPA.

The provisions on **requests for verification** (ORIG. 24-26) are essentially based on the rules of the EPA with Japan. The VCI deplores that – despite cross-sectoral criticism and rejection of the new approach enshrined in the EPA – the negotiating parties deliberately uphold it. This approach will hamper the trade liberalizing effect of the trade agreement, as it is difficult to reconcile with the protection of commercial business information. The provisions on verification are in urgent need of adjustment. Sensitive company information must not be passed on to third parties outside the EU - this is the only way to safeguard the protection of know-how and innovation in the chemical-pharmaceutical industry.

Electromobility: Uncertainty in planning remains

For parts of the chemical industry as a supplier, the **rules of origin of the electromobility value chain** were important. The agreements provide for a “change of tariff heading” (CTH) with restrictions (cathode material) for position 85.07 and alternatively a value rule that offers increasing protection for EU manufacturers in three stages until the end of 2026. Here, the chemical industry would have wished for a higher level of protection based on a better consideration of the special value-added structure of a lithium-ion battery. The negotiation result is problematic for parts of the chemical industry, e.g. for anode material; equal treatment of all core components such as active materials would have been desirable. However, the automotive industry wanted very flexible rules, so the EU had to find a compromise for the negotiations.

Moreover, the intended **review process** reduces planning security for the chemical industry’s investment projects, which are desirable under the industrial policy, after four years at the earliest; in particular, due to the lack of clearly defined criteria. From the VCI*s position, the review must not result in more flexibility which would run counter to the industrial policy goals of the EU. Instead, a level of protection should be established that is appropriate for a sustainable building of European capacities. The rules and criteria to be applied for the review process have to be coordinated and defined at an early stage, i.e. promptly, in order to provide all market players with a reliable basis for the derived long-term corporate decisions (issue: protection of legitimate expectations).

There is still a need for clarification regarding the interpretation of some aspects of the rules of origin, especially regarding the CTH exemptions for cathode materials.

Limited cooperation on chemicals legislation

Basically, it is positive that there is a **chemicals annex** to the TCA as a framework for regulatory cooperation, e.g. on GHS/CLP.

But for the chemical industry, the rules made in the agreement are **overly limited**. This is because the UK is building its own chemicals legislation. Consequently, there are two systems – an EU and a UK system. For the chemical industry, far-reaching agreements on **data sharing** would have been important in this context, particularly for the registration of chemicals in order to avoid duplication of work and costs. Additional costs of 1 billion pounds are expected. This affects British and EU companies. Therefore, it would be desirable for the agreement to become the starting point for closer cooperation - especially with regard to the handling of the agreement in future **cooperation between the chemicals agencies** ECHA and HSE.

Especially against the backdrop of the EU chemicals strategy, regulatory divergence threatens in the long term. On the EU market, this does not pose any immediate risks to consumers or competitiveness, as the approval of chemicals for the EU internal market is based on the principle of "no data no market". However, diverging chemical standards would be reflected in different registration and authorisation processes in the

EU and UK, together with additional costs and bureaucracy as well as different costs for raw materials and inputs. Furthermore, higher EU standards might put EU producers at a competitive disadvantage in the UK and in third markets.

Medicines and medical devices: light and shadow

The agreement on a basic **mutual recognition** of official documents on the inspection of **production plants** is positive. This is an important first step, but hopefully others will follow soon.

Unfortunately, there is no agreement on the mutual recognition of **batch release**. This makes cross-border trade in medicines more difficult, because now the release for finished medicines and active substances imported from the UK must also be carried out in the EU by a "qualified person" - and vice versa.

Every year, 1 billion packs of medicines are traded between the UK and the EU27.

To avoid drug shortages in the UK, the British side is unilaterally allowing imports of medicines authorised in the EU until mid-2021.

As regards medical devices, it has not yet been possible to establish mutual recognition of conformity assessments.

Further issues

In its assessment of horizontal issues, the VCI largely follows the Federation of German Industries (BDI) and the Confederation of German Employers' Associations (BDA).

Level playing field, regulatory divergence and punitive tariffs

To ensure a "level playing field" (LPF) for open and fair competition and sustainable development, the agreement provides for comprehensive provisions (Art 1.1 et seq., p. 214 et seq.). These cover competition policy, subsidy control, state-owned enterprises, taxation, labour and social standards, environment and climate, and other instruments for trade and sustainable development.

In the field of **subsidy control**, both parties are required to establish or maintain an independent authority or body that plays an appropriate role in their subsidy control system and to ensure access to their national courts. In addition, each party must have an effective mechanism to demand back unlawful subsidies. The competence of the **arbitration tribunal** within dispute settlement is provided for in certain cases. Furthermore, each party has the possibility, under certain conditions, to take **unilateral remedial measures** if, for example, it considers that a subsidy has a significant adverse effect on trade or investment between the parties.

In the field of **environment and climate**, there is a **clause on "non-regression from levels of protection"**. In the event of disputes between the parties, certain forms of dispute settlement are provided for.

As regards **taxation**, reference is made to international standards for certain areas. Here, too, a lowering of standards is to be prevented by a "standstill clause". This field is not subject to the dispute settlement mechanism.

This is new: To the extent that future significant differences between the parties – as regards labour, social affairs, environment, climate protection or subsidy control – result in major impacts on trade and investment between the parties, either party can take suitable unilateral **rebalancing measures** to remedy the situation, subject to certain procedures (Article 9.4, p. 254 et seq.).

While the intention to avoid regression or excessive divergences in standards is welcome in principle, the possibility of unilateral countermeasures cannot yet be conclusively assessed.

Public procurement

From the perspective of the pharmaceutical industry, it would have been desirable if NHS tenders had not been excluded from the overall liberal access rules.

Research and Innovation

Basically, the partnership agreement provides for a continued participation of British actors from research and innovation (i.e. also companies) in the respective EU programmes. This is generally seen in a positive light. For German companies, the following aspects are of special importance:

- **Horizon 2020:** Participants or institutions from the UK remain eligible for participation and funding until the end of Horizon 2020 (31 December 2020) and until the end of the duration of the individual H2020 projects (until mid-2022). This applies to both collaborative and individual funding measures.
- **Horizon Europe (HEU):** The partnership agreement provides for the continued participation of British research and innovation partners (including companies) in Horizon Europe (HEU). This is fundamentally positive, as existing innovation partnerships between the EU and the UK can also be consolidated in future innovation projects. In future, the UK will be given the status of an **associated third country** and will have to pay a participation fee for taking part in EU research projects. Details still need to be worked out. In principle, the agreement provides for participation "under fair and appropriate conditions and, where appropriate, in the form of access to certain services provided under Union programmes". However, UK institutions will not be eligible for funding for measures of the future European Innovation Council (EIC) under HEU.
- Student exchange (ERASMUS +): The UK has decided not to participate in the new generation of the student exchange programme Erasmus+. However, measures of the current Erasmus programme can continue to be funded until the end of the project period. For example, projects to increase student mobility can be supported until the end of the project period (until 31 March 2023). This is deplorable, because

the funding of higher education partnerships needs to be put on a new footing. The UK government has announced its intention to establish a global exchange model that includes Europe. The responsibility for education partnerships with third countries basically lies with the EU Member States. For Germany, this means that a possible new legal framework would have to take into account the competences of the German federal states (Bundesländer). Therefore, reshaping is likely to be complex and time-consuming.

Intellectual property rights

Standard rules largely apply for intellectual property rights. One point of criticism is in Article IP.5 - Exhaustion: This title does not affect the freedom of the contracting parties to determine whether and under what conditions the exhaustion of IP rights applies. Article IP.5 leaves it to the discretion of the EU and GB to develop **principles of exhaustion**. This is problematic, as the exhaustion principles may differ in the future. Efforts should be made to ensure that exhaustion applies in the EU and UK when a product is placed on the market anywhere in this economic area, i.e. a sale in the UK market gives rise to exhaustion in the EEA and vice versa. By the way, the comments on exhaustion apply to all IP rights.

We would suggest that in designing the exhaustion rules, the EU and the UK agree that placing on the market in one of the two parties gives rise to exhaustion. If that is not possible, there should at least be a uniform rule – this means that GB should not refer, for example, to the global exhaustion approach, i.e. if placed on the GB market, it is deemed exhausted worldwide.

Furthermore, the enforcement of unregistered designs seems to be somewhat limited (no preparatory act covered).

Data flows

The TCA provisions in the section on "Digital trade" are welcome in principle. The declared aim is to facilitate digital trade. It is positive that the parties undertake to ensure the cross-border flow of data. Restrictions on the data flow through, for example, **data localisation provisions** are **inadmissible** (Article DIGIT 6).
No customs duties are charged on electronic transfer. Article DI-GIT.8 clarifies that this is considered services. Transfer or access to source codes must not be demanded (Article DIGIT.12).

Regarding the transfer of **personal data**, the EU and the UK have agreed on a transitional period of 4 months, which can be extended to 6 months. The aim is to reach an adequacy decision in the meaning of Article 45 GDPR by then (Article FINPROV.10A(4)(a)). A mutual determination of an adequate level of data protection would significantly facilitate the exchange of data for companies. Now it is up to the European Commission to rapidly finalise the adequacy decision within the deadline of

1 July 2021 at the latest, so that open legal questions can be clarified in companies. It is important for businesses to keep an eye on further developments.

The agreement also includes an article on open data of public/governmental bodies (Article DIGIT.15). Both parties commit to a user-friendly and workable design for making such data accessible.

The EU and the UK have also agreed on thematic cooperation in the field of cyber security (Article CYB.1 et seq.). There will be a regular dialogue to exchange information on international security, security of emerging technologies, internet governance, cyber security, cyber defence and cyber crime. The CERT-EU and the national UK computer emergency response team should cooperate on a voluntary basis. However, a mandatory exchange of information, for example, would have been welcome here. Furthermore, the EU and the UK endeavour to cooperate in relevant international bodies and forums.

Taxation

The TCA also includes sections on tax law. Essentially:

- **Good governance clause (taxation standards)**, p. 236 et seq.: Commitment to the principles of good governance in the field of taxation and the commitment to follow OECD standards on tax transparency, exchange of information and fair tax competition.[2] The parties also reaffirm their support for the OECD's action plan to combat base erosion and profit shifting (BEPS).
- **Sales tax / value-added tax;** p. 1192 et seq.: The agreement contains a protocol on the cooperation of administrative authorities and combating fraud in the field of value-added tax. Here, concrete measures are an exchange of information / mutual administrative assistance.[3]

Other relevant tax issues, such as the impact on transfer prices (requiring review), are not covered by the agreement. Thus, answering such questions remains open for the time being.

Climate and energy

As for other goods, trade in energy goods across the internal market border is less efficient than within the internal market. As a net importer, the corresponding risk is

[2] In particular, the exchange of information, whether upon request, spontaneously or automatically, concerning financial accounts, cross-border tax rulings, country-by-country reports between tax administrations, and potential cross-border tax planning arrangements (DAC VI).

[3] Example: Standard form for requests for information, spontaneous exchange of information and feedback between the EU MS and the UK in the context of cooperation in combating VAT fraud, p. 1202 et seq.

mainly on the UK side. Both parties want high ambition in climate policy but wish to pursue this in their own ways.