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Free Movement of Capital in the EU Internal Market and possible consequences after Brexit

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Index

INTRODUCTION **5**

CHAPTER ONE *7*

Free Movement of Capital: the fourth fundamental freedom of the EU Single Market *7*

1. Preliminary notes about the Single Market and Four Fundamental Freedoms **7**

1.1 A brief historical overview of the Single Market 7

1.2 The functioning of the Market 9

1.3 The four fundamental freedoms 10

2. EU Law approach with circulation of capital and payments **11**

2.1 The long *journey* before the definitive enforcement of the fourth fundamental freedom 11

2.2 The different situation of payments 15

3. Article 63 TFEU and the consequent legal regime **16**

3.1 The decisive role of the European Court of Justice jurisprudence about free movement of capital 17

3.2 Article 63 of the Treaty on the Functioning of the European Union 19

3.3 Can a horizontal effect perspective be adopted with Free Movement of Capital? 23

4. Derogations to Free Movement of Capital **25**

4.1 Articles 64 and 66 TFEU: derogations between Member State and ‘third countries’ only 25

4.2 The different regime of Article 65 TFEU 27

CHAPTER TWO *30*

Other EU law implications of capital circulation among the European Union 30

1.Introductive Overview **30**

2. The project of a Capital Markets Union for the EU **31**

2.1 The Context 32

2.2 The Project 34

2.3 Consequences and impact on Member States 37

3. Free movement of capital and the potential overlap with other fundamental freedoms **39**

3.1 Free movement of capital and freedom of establishment 39

3.2 Free movement of capital and freedom to provide services 44

4.The free Movement of Capital and the fight against Terrorism **47**

4.1 The functioning of economic restriction and in particular "*smart sanctions"* 47

4.2 Articles 75 and 215 TFEU: legal regime and related controversial issues 51

CHAPTER THREE *56*

The UK's decision to Leave the European Union: from the history of the Euroscepticism to the activation of Article 50 procedure *56*

1. Background history and characteristics of the EU-UK relationship **56**

1.1 The *rocky* steps towards the admission to the European Economic Community 57

1.2 Euroscepticism: nature, reasons and juridical implications. 62

2. Article 50 of the Treaty on the European Union: how to withdraw from the European Union **67**

2.1 The nature and rationale of Article 50 TEU 67

2.2 Article 50 in practice: the steps followed by UK and EU Institutions 68

2.3 The negotiations with the European Council 71

2.4 Effects and functional implications of the Withdrawing Procedure 73

2.5 The discussed issue of Revocability 75

3. Status of the Withdrawal Process and essential developments **77**

3.1 The position of the UK's government 77
3.2 The position of the European Union 83

CHAPTER FOUR *87*

Brexit: juridical problems and economic consequences in the perspective of Free Movement of Capital *87*

1. The Withdrawal Agreement and possible future scenarios 87
1.1 The Agreement on the withdrawal of the United Kingdom from the European Union 89
1.2 The correlated Political Declaration... 92
1.3 The question about the future legal relationship between UK and EU ... 94
1.4 The example of already existing models 95
1.5 The hypothesis of a *No-Deal* scenario 98

2. Consequences of Brexit for the Free Movement of Capital 100
2.1 The traditional central position of the United Kingdom in European financial markets and the consequent impact of Brexit on capitals and investments allocation 102
2.2 Brexit's impact on Financial Services: some considerations on the regulatory aspects 105

3. Brexit's impact on the Capital Markets Union project 110

CONCLUSION *114*

BIBLIOGRAPHY *120*

INTRODUCTION

The liberalization of capital movements and payments transactions is vital to the correct functioning of the Internal Market of the European Union.
The aim of this liberalization is to foster the efficiency and integration of European financial markets, consequently allowing European citizens and enterprises to carry out many different economic transactions.
The aim of this work then, is trying to analyze how the Internal Market dynamics will be affected by an important and unexpected phenomenon which is definitely drawing the attention of the European Union and the rest of the World: the Brexit.
More to the point, attention will be put on the interconnections and consequences which could arise from the contrast between the integration policies carried out by the institutions of the European Union and the process started by the United Kingdom to withdraw from the Union.
In particular, this work will analyze the outcomes of the above mentioned relationship (or contrast) in the specific perspective of the fourth fundamental freedom which structures the EU Internal Market: the free movement of capital.
The first chapter of this thesis indeed, is dedicated to an examination of the provisions in the Treaty on the Functioning of the European Union which set out a legal regime of full liberalization of capital movements and payments transactions; this analysis is also backed up by a historical description of the evolution of this set of provisions and the consequent legal framework, came by complementary of the other three fundamental freedom to definitively liberalized.
Moreover, in the second chapter, the discourse will put focus on the practical implication of the free flowing of capital within the boundaries of the Internal Market European Union. The discussion will shift from the *formal* understanding of the legal framework provided by the Treaty, to the *practical* initiatives and harmonization processes carried out by the institutions of the Union: an example that will be presented is the idea of a Capital Markets Union for the European Union, a project which aims to the integration of different national capital markets in order to offer to European companies and enterprises a method of investment alternative to bank loans.
In addition to that, the second chapter will consider the power (explicitly conferred by the Treaty on the Functioning of the European Union) the EU institutions can

exercise to impede and block investments performed by individuals and organizations considered capable of undermining the safety of the Union.
Furthermore, this work intends to describe the functioning of the rules of European Union law – especially through the analysis of the implementation of Article 50 TUE – which allowed the United Kingdom to trigger the withdrawal process, along with an overview of the cultural and political reasons which are behind the Brexit and date back to the second half of the Twentieth Century.
Having taken into account the reasons and the history of the Euroscepticism, the fourth and last chapter proposes a study of the different legal models capable of being chose by the United Kingdom and the European Union to regulate their future relationship. This discussion the, will be furthermore accompanied by a hypothesis of the economic consequences of the Brexit process in the field of free movement of capital, and more precisely as long as the specific sectors of Foreign Direct Investment and the regulation of Financial services are concerned.
In this regard, it is to be mentioned that the examination of the above cited consequences of Brexit, is based on a precise starting point: the key-role of the United Kingdom in the European financial market. The majority of worldwide and Union-wide financial operators has indeed decided to locate its European headquarter in London. This thesis will therefore present how the United Kingdom's withdrawal from the EU could affect these consolidated dynamics, giving space also to the possible detriments the Brexit is capable of causing to the harmonization process carried out by the European Union in the field of financial services.
Eventually, it should be underlined that the analysis of the legal consequences will go, by force, hand in hand with an economic and political discussion of the whole situation. In fact, consideration must be given to the fact that the entire Brexit process and the connected studies result to be strongly affected by the political uncertainty, which at the present time characterize the position of the United Kingdom.
As a closing remark then, it appears worth to mention that this thesis is the result of a period of research performed in the months of October and November at the London School of Economics, with a view to get in touch more closely with the atmosphere of such a complex phenomenon in the place where it started.

CHAPTER ONE

Free Movement of Capital: the fourth fundamental freedom of the EU Single Market

1. Preliminary notes about the Single Market and Four Fundamental Freedoms

As the analysis of this thesis is going to focus on one of the four fundamental freedoms of the Single Market[1] of the European Union, it should be made clear how the Single Market works and which are its main characteristics.
This discussion then, results essential in order to better understand the magnitude of an exceptional phenomenon such as the decision of the United Kingdom to withdraw from the European Union. It will be further analyzed the importance of the Single Market, focusing on its history and its functioning, as the possibility for the UK to benefit from its features is one of the most crucial issues in Brexit's negotiations. Moreover, as the objective of this work is to understand the consequences of the British secession from the EU on the rules that govern the flow of capital within the Union, the relevant provisions about Free Movement of Capital will be examined and determined as well.

1.1 A brief historical overview of the Single Market

The project of a common market shall be brought back to the 1957 when the six members of the European Economic Community (EEC) gave birth to a customs

[1] "*The original Treaty of Rome used the term common market. The Single European Act of 1986 inserted the term internal market, which coexisted with common market in the language of the Treaty. In the political discussions, the term single market was often preferred. The Lisbon Treaty, which came into force in 2009, replaced all references to the common market with internal market. The Court has tended to use all three concepts interchangeably. However, legal scholars have insisted that the common market and the internal market are different concepts.*",
J.Snell, *The internal market and EMU: from common market to economic union* for the UACES 44th Annual Conference (Cork, 2014).

union for the free movement of goods, in that way moving the first steps towards the creation of a common market [2].

Furthermore, it is the European Court of Justice (ECJ) that is considered to have played a decisive role in the development of the Internal Market: Cassis de Dijon case law and the principle of mutual recognition for the free movement of goods appeared as a key element in this evolving plan [3].

A second decisive move coming up to the latest structure of the Single Market shall be reconducted to 1985, when the UK member of the Delors Commission [4] Arthur Cockfield, produced a White Paper directed to the European Council suggesting to accomplish the project of a common space with no barriers among the Member States. This white paper had a crucial importance because it was the scheme for the drafting of the Single European Act (SEA) [5].

The latter was signed in 1986 and it is considered as the first consistent revision of the Treaty of Rome, the act that gave birth to the European Economic Community. The Single European Act, among other important achievements as the codification of European Political Cooperation, set out the aim of adopting the necessary measures for the correct implementation of the Internal Market until the 31 of December 1992. This project conceived the idea of a space characterized by no barriers and the core of which had to be the respect of the Four Fundamental Freedoms. Indeed, Art. 8a (later Art. 7a) EEC explicitly stated: "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provision of this Treaty".

Then, in order to let the common market develop as planned, a new Art. 100a EC gave powers to the EEC to adopt the necessary measures for the approximation of

[2] K.Mortelmans, *The common market, the internal market and the single market, what's in a market?* (Kluwer Law International, 1998), pp.101-108.

[3] N.Reich, A.Nordhausen Scholes, J.Scholes, *Understanding EU Internal Market Law* (Intersetia, 2015), pp.5-6.

[4] The Delors Commission was the administration of Jacques Delors, the eighth President of the European Commission. Delors presided over the European Commission for three terms (though the last one lasted for around a year).

[5] The Single European Act was the first major revision of the 1957 Treaty of Rome. The Act set the European Community an objective of establishing a single market by 31 December 1992, and other objectives. It was signed at Luxembourg on 17 February 1986. It came into effect on 1 July 1987, under the Delors Commission.

rules set out by the Member States concerning the establishment or functioning of the internal market.
The Single Market was finally launched the 1st of January 1993, but this would not have been considered sufficient to its definitive implementation without the several efforts from institutions and authorities of the Community and the Member States to apply and enforce the related EU law, especially in accordance with the objectives set out in Article 2 EEC[6].

1.2 The functioning of the Market

A fundamental scope of the common market is, undoubtedly, to guarantee the "openness" of the market to encourage economic initiative and the efficiency of competition.
According to Norbert Reich, this objective can be achieved in two ways: *"Firstly, by the free movement of goods, persons, services, and capital, secondly, by approximation of legislation and by a system where competition is not distorted"*[7].
The essential source of law to be mentioned in this context is the Article 26 of the TFEU, widely recognized as an "umbrella provision"; it is a general provision which delineates the essential elements of the Common Internal Market.
While the first paragraph generally enucleates the aim of the creation of a single market for the European Union through measures in accordance with Treaties' provisions, and the third attributes to the Council the power to determine guidelines to ensure a balanced progress in all sector concerned, it is the second paragraph that clearly explains what the Common Internal Market is.
In the majority of cases, principles which direct Union mechanisms need to be developed into legal rules, usually by means of Court practice or secondary law. This means that, as mentioned before, it is essential for the correct functioning of the Market that Member States and the European Union institutions work closely

[6] Article 2 of the Treaty establishing the European Economic Community:
"It shall be the aim of the Community, by establishing a Common Market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States."
[7] N.Reich, A.Nordhausen Scholes, J.Scholes, *Understanding EU Internal Market Law* (Intersetia, 2015).

together. To let this co-operation function in the correct way, Member States should adopt national rules which permits the appropriate implementation of EU law and does not contradict its principles.

1.3 The four fundamental freedoms

The second paragraph of Article 26 TFEU states: "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured in accordance with the provisions of the Treaties."

From this section of the document, it results distinctly how the four fundamental freedoms do constitute the essential core of the internal market. Therefore it is significant to specify that each freedom has its dedicated section of the TFEU, in which the main rules and principles are enshrined. In this context then, it results essential to recall the role of Article 114 TFEU, whose principal scope is to permit the harmonization of Member States' rules introducing Union-wide rules, as for example product standards and many others[8]. Furthermore, it is worth to point out that, in the perspective of harmonization, the European Court of Justice has strongly contributed with its jurisprudence related to Article 114 TFEU[9].

Moreover, by the time each freedom has achieved a different level of development: the sector of goods, for example, is widely recognized to be the most advanced because of the early attention paid to it [10].

Looking at the considerable case law about this topic, it is easy to identify some characteristics of these fundamental freedoms.

They had been conceived with the economic intent of addressing market failures, with the aim to prohibit and consequently eliminate both direct and indirect discriminations, and more in general, any kind of restriction applied by a Member

[8] "*Save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.",*Article 114 TFEU, para.1.

[9] In this sense see Case C-376/98 *Tobacco Directive,* Case C-380/04 *Tobacco Advertising II,* Case C-58/08 *Vodafone*.

[10] P.Oliver and W.Roth, *The internal market and the four freedoms* (Kluwer Law International, 2004).

State. Obviously, this description is the result of a long process which is still evolving thanks to ECJ's efforts.
The fundamental freedoms have to be intended as fundamental rights and they are characterized by "direct vertical effect" against the Member States, and in specific circumstances, by "horizontal effect" as well[11].
Nevertheless, in general, it is possible for a Member State to adopt restrictions (or, better-said, justifications) when explicitly provided by EU laws and Treaties.
Even though each fundamental freedom maintains its own "sovereignty", they shall be considered as a unique and inseparable feature of the Common Internal Market.

2. EU Law approach with circulation of capital and payments

2.1 The long *journey* before the definitive enforcement of the fourth fundamental freedom

The Free Movement of Capital is the fourth of the fundamental freedoms and therefore constitutes a cornerstone European Union law.
As the aim of this thesis is to analyze the importance of capital liberalization throughout the Union, it is crucial to recall that the correct enforcement of this freedom is to be seen as a prerequisite for the optimal functioning of the other three freedoms and, more in general, for the correct activity of the whole Internal Market.
The rationale underpinning capital circulation's provisions is that capital should be left free to flow where it could be optimally invested, enabling entrepreneurs to locate production where it is most efficient or guaranteeing that cross-border financial transactions are free from any national interference [12].
As just said, the Free Movement of Capital holds up the constitution of a Common Market and a Monetary Union, which are two of the aims enshrined in Article 2 of the EEC Treaty. Nevertheless, such rules and principles about capital circulation

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[11] For the "direct effect of EU Law" and the "supremacy of EU Law" see respectively Case 26/62 *Van Gend en Loos* and Case 6/64 *Costa v. Enel;* for the "vertical direct effect" in free movement of goods see Case 8/74 *Dassonville*, Case 120/78 *Cassis de Dijon,* Joined Cases C-267/91 and C-268/91 Keck and Mithouard; for the "horizontal effect" see Case 265/95 *Commission v. France (Spanish Strawberries)*.
[12] S.Hindelang, *The free movement of capital and foreign direct investments* (Oxford University Press, 2009)

within the territory of the EU have undergone a long and challenging itinerary before their definitive implementation.
The legal framework which regulate the field of interest of this thesis is provided by the fourth chapter of the Treaty on the Functioning of the European Union, more precisely by Articles from 63 to 66. However, these provisions outline a legal regime that is significantly different from the one set out by the EEC Treaty: the first developments shall be traced back to the Maastricht Treaty, which has the merit to have put the free movement of capital on an equal footing of the other freedoms deeply modifying the original text and apparatus of the EEC Treaty.
The corpus of the EEC Treaty in fact, was characterized by a number of articles about capital circulation that were not as *developed* as the ones about goods, persons or services: those were much more advanced in terms of scope and nature.
In particular, according to Article 67 EEC, Member States should progressively abolish as between themselves restrictions on the movement of capital only *"to the extent necessary for the proper functioning of the Common Market*". This specification was absent in the provisions related to other freedoms and was originally intended to put Article 67 EEC in connection with Article 69 of the same Treaty, which was empowering the Council to adopt directives that appeared to be necessary in the course of the transitional stage before the definitive implementation of the Common Market.
That peculiar clause contained in Article 67 EEC is crucial to be considered because it was implicitly (at least initially, then in explicit terms as well) setting out a legal regime according to which all the rules about fundamental freedoms were directly effective, except for the capital circulation's one.
According to Catherine Barnard, the liberalization of capital movements took longer because this field was much more closely linked to the stability of economic and monetary policy of the Member States than the other three freedoms[13]. That is therefore the reason for those less imperative terms used in the text of Article 67 EEC.
In the context of the previous legal framework, Article 69 EEC was empowering the Council to issue the directives necessary for the progressive implementation of

[13] C.Barnard, *The substantive law of the EU, the four freedoms* (Oxford University Press, 2011), p.519.

the provisions of Article 67; this provision then, revealed to be an indispensable one in the perspective of the liberalization of free movement of capital.

Indeed, the Council played an indispensable role by issuing three directives aimed to rule the matter: two first directive, which had been promulgated in 1960[14] and 1963[15], divided capital movements in four lists (indicated with the letters A,B,C and D) annexed to the directives and established a different regime per each list.

Considering capital movements included in the first two lists Member States were prohibited to adopt restrictions, providing for an unconditional liberalization; the third list conceded the imposition of types of constraint when the free movement of capital could have caused an obstruction to the fulfilment of national economic policy objectives; list D did not provide any obligation to fulfil the liberalization of capital circulation.

The two mentioned directives have been very important as first step towards the definitive development of free movement of capital, even though their usefulness shall be more properly seen in connection with the third directive issued by the Council: Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty[16], entered into force on the date of notification, the 7th of July 1988.

This directive gained the successful result to take the previous legal framework to the next level, providing for the unconditioned liberalization of all capital movements between the Member States, anticipating the actual legislation and overcoming the partial liberalization set out by the two previous directives.

Article 1(1) of the Council Directive 88/361/EEC provided that *"Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I."*

This time, any kind of clause that could have the effect to restrict the capacity of the provision is undoubtedly absent: capital movements are unconditionally freed for the first time.

[14] First Directive for the implementation of Art.67 of the Treaty ([1959-62] OJ Spec. Ed. 49).

[15] Second Council Directive 63/21/EEC ([1963-4] OJ. Spec. Ed. 5).

[16] Third Council Directive 88/361 for the implementation of Art.67 of the Treaty ([1988] OJ L178/5).

Nevertheless, the Directive did not establish a legal regime limited only to the EU dimension, but provided also for a rule that showed the attention for the Member States' perspective. In fact, Article 4 stated that the provisions of the Directive should be *"without prejudice to the right of Member States to take all the requisite measures to prevent infringements of their laws and regulations…",* in this way setting up a first example of *justification* in the field of capital circulation.
A decisive role in this context shall be assigned to the *nomenclature* annexed to the Council Directive. "Annex I" was created with the aim of facilitating the application of the Directive and classifying different types of capital movements depending on the economic nature of the assets concerned; it introduced for example the notion of Direct Investments[17].
Even though there was no mention of the potential connection with other sections of the Treaty, and though it had been explicitly stated in the text of the document that the list presented was not an exhaustive one, it should be reported that this instrument achieved great importance: actually, the European Court of Justice and more in general EU law had been using the so called *nomenclature* still after the entry into force of the Maastricht Treaty and the subsequent repealing of the Directive 88/361.
In order to conclude the analysis about the previous legal framework and its development, a last mention should be made to the approach to "third countries"[18]. Article 67 EEC was indeed referred only to movements of capital performed between the Member States of the European Union.
It was Article 70 of the same Treaty that provided that the Commission should propose to the Council measures for *"the progressive co-ordination of the exchange policies of Member States in respect of the movement of capital between those States and third countries"* in order to achieve *"the highest possible degree of liberalisation";* in other words, the Council had been given the power to promote, via measures to be adopted by unanimous vote, the co-ordination of different national rules concerning capital operations with "non Member States".

[17] *"The establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings"* and *"The participation in new or existing undertaking with a view to establishing or maintaining lasting economic links"*, Annex I to Directive 88/361 for the implementation of Art.67 of the Treaty.
[18] It is a general definition to indicate countries that do not form part of the European Union.

Though, it is to be said that apart from the provision in Council Directive 88/361 of Article 7 (1)[19], which could be seen as an *encouragement* to Member States in order to reduce differences in the treatment of operation regarding capital coming from or going towards third countries, considerable changes were not be made.

2.2 The different situation of payments

The principle of free movement of capital is today enshrined in Article 63 of the TFEU. Nevertheless, this provision deals not only with capital circulation, but also with payments.

The distinction between the areas of capital and payments can be associated with the important ECJ judgement about the early case of *Lambert*[20] in 1988.

There, it was stated by the Court that while Article 106 EEC covered current payments, i.e., the transfers of foreign exchange which constitute the consideration within the context of an underlying transaction, Article 67 EEC covered movements of capital, i.e., financial operations essentially concerned with the investment of funds, rather than remuneration for a service[21].

The case at issue was really meaningful also because it clarified what type of measures adopted by the Member States could be considered not as a restriction to the liberalisation of payments; in particular, national provisions dealing solely with the way a payment should be performed were considered as legitimate and in line with Article 106 EEC.

In order to continue the study of the previous system about payment as well, it should be recalled that Article 106 EEC, in its first paragraph, stated that:

"Each Member State undertakes to authorise, in the currency of the Member State in which the creditor or beneficiary resides, any payments connected with the movement of goods, services or capital, and any transfers of capital and earnings, to the extent that the movement of goods, services, capital and persons between Member States has been liberalised pursuant to this Treaty".

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[19] *"In their treatment of transfers in respect of movements of capital to or from third countries, the Member States shall endeavour to attain the same degree of liberalization as that which applies to operations with residents of other Member States, subject to the other provisions of this Directive."*

[20] Case 308/86 *Ministère public v. Lambert* [1988] ECR 4369.

[21] Case 308/86 *Lambert* [1988] ECR 4369, para. 10.

Therefore, considering that the freedom to provide goods and services throughout the Union had been completely liberalised for a long time, interested subjects had been guaranteed the right to pretend that Member States would not have tried to impede the performing of the related payments.
In relation to this context, another crucial aspect that must be recalled is that EU provisions about payments had been considered directly effective much more time before this happened with capital; in particular, the ECJ found it out in its early judgement *Luisi and Carbone*[22].
Moreover, in another judgement the European Court of Justice suggested that the free movement of payments, at the time still considered autonomous from free movement of capital, was perhaps the most important provision in the EEC Treaty for the purpose of attaining a common market[23].
Nevertheless, the distinction between payments and capital has been largely reduced by the Maastricht Treaty, which brought together both the provisions on capital, vastly amended to reproduce the contents of Directive 88/361 EEC, and those on payments; the first paragraph of Article 63 TFEU is about capital while the second one is about payments.

3. Article 63 TFEU and the consequent legal regime

Article 63 of the Treaty on the Functioning of the European Union is without any doubts one of the most important provisions of the Treaty, because it deals with the circulation of capital not only among Member States, but also with countries outside the European Union. However, relying upon the fact that it concerns issues which are more related to the legal framework of the States, institutions of the EU demonstrated to be more cautious with the enforcement of Article 63 TFEU, previously Article 67 EEC. This approach has clearly slowed down the development of the fourth fundamental freedom of the European Union Internal Market, the Free Movement of Capital.

[22] Joined Cases 286/82 and 26/83 *Luisi* and *Carbone* [1984] ECR 377.
[23] Case 7/78 *R.v.Thompson* [1978] ECR 2247, para. 22.

3.1 The decisive role of the European Court of Justice jurisprudence about free movement of capital

The jurisprudence of the European Court of Justice (ECJ) of the European Union has traditionally played a crucial role for the enforcement and development of EU law; that is the case of the free movement of capital as well.

It has already been said that the peculiar clause enshrined in Article 67 EEC was *implicitly* setting out a legal regime according to which all the rules about fundamental freedoms were directly effective, except for the capital circulation's one. This implicit conclusion was readily confirmed by the ECJ: it therefore excluded the nature of directly effective provisions of Article 67 EEC and following articles in one of its most relevant cases.

This conclusion shall be traced back to the *Casati*[24] judgement of 1981. The Case involved Mr. Casati, an Italian citizen and resident in Germany who, at the act of expatriating, wanted to re-export the currency previously imported in Italy; the relevant fact was that the currency was imported in violation of Italian administrative rules, because it had not been declared when Mr. Casati crossed the border, and according to these rules it could not be re-exported.

Therefore, the Court was asked to decide if the Treaty was guaranteeing a specific right to Mr. Casati that could impede the application of national sanctions.

Eventually, in that peculiar context, the ECJ stated that the even though it was to be considered as one of the fundamental freedoms of the Community, the complete freedom of movement of capital could undermine the economic policy of Member States and cause inequalities in the balance of payment[25].

"For those reasons, Art. 67(1) differs from the provisions on the free movement of goods, persons and services in the sense that there is an obligation to liberalize capital movements 'only to the extent necessary to ensure the proper functioning of the common market'".

The situation that followed the *Casati* judgement though, made it clear that the auspicated liberalization of capital movements at the end of the transitional period

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[24] Case 203/80 *Casati* [1981] ECR 2595.

[25] *Casati,* n.11, para. 8-9.

could not be achieved relying solely upon Article 67 EEC, and that is why Article 69 EEC resulted to be of such importance.
At the present time, the state of play is totally different because free movement of capital rules are peacefully considered to have direct effect: individuals can invoke these rules before their national judge and determine the inapplicability of the national provisions contrary to them.
This achievement has been made possible thanks to two other judgements of the European Court of Justice: the cases at issue are *Bordessa*[26] and *Sanz de Lera*[27].
In the former judgement the Court decided on the legitimacy of a specific requirement for authorization for the (physical) transfer of banknotes from a Member State to another one in relation to Articles 1 and 4 of the Council Directive 88/361.
It was finally determined by the ECJ that the requirement to abolish all restrictions on movement of capital was *"precise, unconditional and did not require a specific implementing measure"*[28]. The fact that Member States could rely upon Article 4 of the Directive was not enough to prevent Article 1 of the same legal source from having direct effect; national courts would have to make inapplicable national rules in contrast with those EU law provisions.
In *Sanz de Lera* the Court of Justice had to face an identical situation: the case was indeed about national legislations requiring specific preventive authorization for the import or export of foreign currencies.
The reasoning of the Court was the same as the one in *Bordessa*: the requirement at issue was having the effect to subject to the discretion of a national administration the effective functioning of the free movement of capital.
The national requirements could not be justified because they could have made the idea of free movement of capital vain.
Eventually, after the liberalization of the free movement of goods, persons and services, and after all the burdensome and challenging steps made by the European Union institutions, with the entry into force of the Treaty of Maastricht all restrictions on capital movements and payments across the Union borders were

[26] Cases C-358/93 and C416/94 *Criminal Proceedings against Bordessa and Others* [1995] ECR I-361.
[27] Joined Cases C-163/94, C-165-94 and C-250/94 *Sanz de Lera* [1995] ECR I-4821.
[28] *Bordessa*, cit., para 33.

prohibited. This achievement then, with Maastricht Treaty has been enshrined in Article 63 of the Treaty on the Functioning of the European Union.

3.2 Article 63 of the Treaty on the Functioning of the European Union

"1. Within the framework of the provision set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
2. Within the framework of the provision set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited."
This is the text of Article 63 TFEU and it deals, differently from the past, with capital circulation and payments at the same time, providing for the abolition of all sorts of restriction to their free circulation.
Nevertheless, that Treaty provision does not determine a clear definition neither for capital movements nor for payments; that is why Directive 88/361 and its annexed *nomenclature* revealed to be so important and were used so many times by the Court of Justice in its judgement, even though the Directive and the Annex had been repealed with the entry into force of Maastricht Treaty.
Another decisive contribution in defining situations to which Article 63 could apply, has to be recognized to the ECJ.
Firstly, it shall be recalled that it had considered payments as "transfers of currencies which constitute a consideration in the perspective of an underlying business", and capital movements as "financial operations essentially linked to investments without being the compensation for a specific supply"[29].
Secondly, the jurisprudence of the European Court of Justice comprised in the scope of Article 63 TFEU both the *direct investments* and the *portfolio investments*, defining them respectively as "*form of participation in an undertaking through the holding of shares which confers the possibility of participating effectively in its management and control (direct investments)"*, and *"the acquisition of shares on the capital market solely with the intention of making a financial investment without*

[29] L.Daniele, *Diritto del mercato unico europeo: cittadinanza, liberta' di circolazione, concorrenza, aiuti di stato* (Giuffré, 2012).

any intention to influence the management and control of the undertaking (portfolio investment)"[30].

Another issue that seems to be relevant in this context of definitions and is worth it to be mentioned, is that the Court of Justice rarely added the requirement of the "economic activity" nature in relation to capital movements, as if the economic nature of the activity had to be implicitly assumed with capital circulation (as it was happening with goods and differently from persons)[31].

Going on with the analysis of the legal regime set out by Article 63 TFEU, it is crucial to focus on the *territorial scope* as well: it must be said that the field of application of that provision affects *intra-State* movements and movements with third countries; in general, it is easy to understand the aim of *intra-State* movements, because they concern two Member States of the EU. Instead, the reasons behind the inclusion of third countries in the general provision enshrined in Article 63 TFEU are peculiar: it is said that a first reason is that free movement of capital between Member States would undermine capital controls towards third countries as investors would enter or exit the EU via the most liberal jurisdiction to access the target State. A second reason alleged is that the liberalization of capital circulation with third countries could have the effect to boost the use and power of the single currency; in the end, the free circulation of capital with third countries promotes and can help to achieve the *open market economy* objective expressed in Article 119 TFEU[32].

Once having described the field of application of Article 63 TFEU, it is to examine which kind of national measures are considered to be in violation of the Treaty. It should be recalled that in Article 67 EEC it was possible to find a reference to *restrictions* and *discriminations*, while with the entry into force of Maastricht Treaty the reference about the latter has been dropped out: Article 63 TFEU mentions indeed the abolition of *restrictions* only. Nevertheless, none of the two terms had never been defined, and what constitutes and constituted a violation of the free movement of capital was left to the Court of Justice decision on a *case by case* basis.

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[30] Case C-182/08 *Glaxo Welcome* [2009] ECR I-8591, para. 40.

[31] C.Barnard, *The substantive law of the EU, the four freedoms* , cit., p.523.

[32] J.Snell, 'Free movement of capital: Evolution as a non-linear process' in P.Craig and G. de Bùrca (eds.), *The evolution of EU Law* (Oxford: OUP,2011).

Initially, the ECJ faced situations that could be traced back to the area of *discrimination measures*: to be considered as such, a specific measure should have treated a capital operation in a less favourable way on the basis that it was presenting a *transnational* element, asking for example for the fulfilment of a peculiar requirement. At the same time, obviously, the same operation performed inside the Member State at issue should be subject to a less burdensome or more favourable regime.

Even though Article 63 TFEU makes no references about the nature of the discrimination, it is peacefully admitted that the norm aims to prohibit both directly and indirectly discriminatory national measures, working in the same way as the other three freedoms. Moreover, it is also deemed that the prohibition enshrined in the above mentioned EU law provision shall be equally applied to non-discriminatory measures capable of impeding the access to the market.

As long as *direct discrimination* is concerned, the Court had stated in two judgements (*Konle*[33] and *Albore*[34]) that it could be justified only relying upon express derogations[35].

On the other hand, *indirect discrimination* measures and *non-discriminatory* national rules are not prohibited as such, but only if they cannot be objectively justified by general interest purposes[36]. This approach of the Court is capable of being found in the judgment *Commission v. UK*[37], in which the Court stated that although the national rules examined were not distinguishing between residents and non-residents of a Member State, the provisions at issue were having the effect of deterring investors from other Member States from making investment, consequently hindering the internal market.

The approach adopted by the ECJ in *Commission v. UK* resulted to be useful not only for "non-discriminatory rules cases", but also with "restrictions cases"[38].

In most cases, a discrimination approach started to be difficult to apply to capital movement. That is why, principally after the entry into force of the single European

[33] Case C-302/97 *Konle* [1999] ECR I-3099, para. 24.
[34] Case C-423/98 *Albore* [2000] ECR I-5965, para. 17.
[35] The legal regime about expressed derogations is enshrined in *Article 65 TFEU.*
[36] L.Daniele, *Diritto del mercato unico europeo: cittadinanza, liberta' di circolazione, concorrenza, aiuti di stato* (Giuffré, 2012).
[37] Case C-98/01 *Commission v. UK* [2003] ECR I-4641.
[38] C.Barnard, *The substantive law of the EU, the four freedoms,* cit., pp.531-532.

currency[39] (when it became difficult for the ECJ to find national measures *discriminating* on the grounds of nationality), the "restriction-based approach" started to be preferred by the ECJ rather than the "discrimination" one[40].

To outline the differences with "discrimination cases", in "*restrictions cases*" the Member State's rule had the effect of hindering the market having gone beyond any kind of nationality issue.

In the judgement of the leading case *Commission v. Portugal* the Court affirmed: *"Even though the rules in issue may not give rise to unequal treatment, they are liable to impede the acquisition of shares in the undertakings concerned and to dissuade investors in other Member States from investing in the capita of those undertakings. They are therefore liable, as a result, to render the free movement of capital illusory."*[41]

In the same judgement though, the Court admitted that the free movement of capital could be restricted on the basis of a national rule only in that provision could be justified on the grounds of Article 65 TFEU or imperative reasons of public interest; in addition to this, the national rule should be proportionate to its scope.

Moreover, it is worth it to mention the discussion risen in this context about the possibility to apply the *Keck principle* to the field of application of Article 63 TFEU. Thanks to the principle extrapolated in the famous *Keck* case [42], the Court considered legitimate the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements on the condition that this measure should apply to all relevant traders operating within the national territory and, secondly, that they affect in the same manner the marketing of domestic products and of those from other Member States.

Instead, in *Commission v. Spain* the ECJ explicitly stated that such a principle conceived for the correct functioning of free movement of goods could not be applied to capital: *" although the relevant restrictions on investment operations apply without distinction to both residents and non-residents, it must none the less be held that they affect the position of a person acquiring a shareholding as such*

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[39] The Euro, officially the currency of 19 of 28 EU Member States, was introduced to world financial markets in 1998 replacing the former European Currency Unit (ECU). Nevertheless, it was only by the 1st of January 2002 that physical Euro banknotes and coins entered into circulation.

[40] C.Barnard, *The substantive law of the EU, the four freedoms*, cit., pp.531-532.

[41] Case C-367/98 *Commission v. Portugal* [2002] ECR I-4731, para. 45.

[42] Joined Cases C-267/91, C-268/91 *Keck and Mithouard* [1993] ECR I-06097.

and are thus liable to deter investors from other Member States from making such investments and, consequently, affect access to the market".[43]

3.3 Can a horizontal effect perspective be adopted with Free Movement of Capital?

In the previous paragraphs it has been stated that the first legal framework about free movement of capital did not provide for the direct effect of its rules; in particular Article 67 TEC was not characterized by that essential characteristic.
The situation has changed with the entry into force of Article 63 TFEU with Maastricht Treaty, and the consequent repealing of previous rules about capital circulation. As put forward above, the European Court of Justice's contribution has been crucial to determine the direct effect and the right of citizens to invoke the rule at issue: in addition to the cases already examined, it appears worth it to report what the Court stated about the direct effect of free movement of capital in another judgement, *Skatteverket v. A*: *"Artcile 63 lays down a clear and unconditional prohibition for which no implementing measure is needed and which confers rights on individual which they can rely on before the courts"*[44]; then it continues specifying that Article 63 TFEU and following are capable of render inapplicable national rules which are in violation of them.
The extract from that ECJ's judgement clearly summarises what the "direct effect" consist of, and more precisely, what the direct *vertical* effect consists in.
Therefore, given that EU citizens have the right to rely upon rules on free movement of capital in cases of Member States adopting laws inconsistent with them (as it has been just said, the *vertical direct effect*), it seems indispensable to dedicate few words outlining the doubtful situation about the existence of a *horizontal direct effect* in the field of free movement of capital.
Firstly, it is crucial to clarify that when the horizontal effect is at stake, the discussion is about the possibility for EU citizens to enjoy their rights protected by Treaty rules against a violation caused not by Member States' acts, still by acts of privates.

[43] Case C-463/00 *Commission v. Spain* [2003] ECR I-4581.
[44] Case C-101/05 *Skatteverket v.A* [2007] ECR I-11531, para 21.

Before starting the analysis about the potential horizontal dimension of the provisions in the field of free movement of capital , it should be clarified that the existence of such a pricinple has not yet been recognized by the European Court of Justice and other EU institution; neither for free movement of capital, nor for the other fundamental freedoms.

Nevertheless, the other three freedoms seem to be more evolved about this issue: for example, *Viking*[45] and *Laval*[46] are two fundamental judgement in which the Court has recognized the applicability of such a horizontal effect in relation to the field of application of the freedoms of establishment and services.

Moreover, there are scholars which are convinced that others examples of horizontal direct effect's recognition can be found in judgements about free movement of persons as, for example, *Angonese* case; there the Court found that *"the prohibition of discrimination on ground of nationality laid down in Article 48 (currently Article 45 TFEU) of the Treaty must be regarded as applying to private persons as well."*[47].

Then, as long as free movement of capital is concerned, it is to say that the issue of the horizontal effect has never been faced explicitly; this, according to scholars as professor Vladimir Savkovic[48], due to the fact that free movement of capital deals and offers protection to natural and legal persons of third countries as well: this aspect though, makes it harder for the Court to develop relevant case law on that matter.

Nevertheless, the jurisprudence of the Court of Justice has demonstrated to be decisive again: in the words of professor Savkovic the group of cases widely known as *"golden shares cases"* has the merit to have put the free movement of capital closer to other fundamental freedoms.

It is to be mentioned then, that it results still unlikely to imagine the recognition of such a principle in a near future. Nevertheless, it is meaningful to point out that in the above mentioned cases the European Court of Justice has stated that non only

[45] Case C-438/05 *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line SBP and OÜ Viking Line EEsti* [2008] ECR I-10779.

[46] Case C-341/05 *Laval un Partneri Ltd vt Svenska Byggnadsarbetarefbsrbundet and Others* [2008] ECR I-11767.

[47] Case C-281/98 *Roman Angonese v Cassa di Risparmio di Bolzano SpA* [2000] ECR I-04139, para. 36.

[48] V.Savkovic, *The fundamental freedoms of the single market on the path towards horizontal direct effect: the free movement of capital* (Judicial Tribune, Volume 7, 2017).

instruments of primary or secondary legislation can represent a restrictive measure, but also articles of associations of companies and firms under certain conditions. This development is an important step forward as it demonstrates an extensive tendency of the ECJ, which, in order to prevent the fundamental EU law principles from being violated, started to considered rules coming out not only from national institution, but also from private enterprise.
It would not be seen as the explicit establishment of the horizontal direct effect principle, but it certainly constitutes an important step towards that direction.

4. Derogations to Free Movement of Capital

Once it has been described the functioning of the legal regime set out by Article 63 TFEU, given that it is characterized by direct vertical effect, it should be analysed another relevant peculiarity of the fourth fundamental freedom here at issue.
In fact, Article 63 TFEU is followed by Articles 64, 65 and 66 TFEU, each of them providing for different possibilities of derogation to the prohibition set out by the main provision already examined.
Among them, the justifications enshrined in Articles 64 and 66 offer a more limited field of application, as it will be better explained below.
On the contrary, Article 65 TFEU and its four paragraphs has the role of the *principal* provision about derogations in the field of free movement of capital.
Furthermore, given that it is widely considered that exceptions to the application of this freedom are not limited only to the ones explicitly included by the EU legislator in the Treaty, a mention will be made to the contribution that can be traced back to the European Court of Justice jurisprudence.

4.1 Articles 64 and 66 TFEU: derogations between Member State and 'third countries' only

As anticipated above, the freedom that protects capital circulation within EU Member States and between them and third countries is actually more limited than it appears at a first read of Article 63 TFEU.

In particular, just the relationship with third countries is subject to a narrower regime: Articles 64 and 66 TFEU in fact, present the peculiarity to be dealing only with the interrelation between EU Member States and non-Member States.
That is also why it has been specified before that these rules are characterized by a more limited field of application; they do not consider intra-EU exchanges.
Following the order dictated by the Treaty, Article 64 TFEU will be considered as first.
The latter is structured in three paragraphs, all of them providing for a potential restriction of the free movement of capital.
"The provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries…"; it then continues describing a group of few economic operations from which payments are implicitly excluded[49]. This first potential restriction is called the *"grandfather clause"* and it is considered to be the most important of the three included in Article 64 TFEU because of its practical and concrete implications[50].
The other two provisions attribute to EU institutions, more precisely the Council and the European Parliament, the power to adopt measures having the effect to restrict the free circulation of capital with third countries.
In particular, the second paragraph allow the European Parliament and the Council, *"whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of the Treaties"*, to act in accordance and with the ordinary legislative procedure in the context of the economic operations yet listed in paragraph one.
According to Article 64 (3) TFEU instead, it is the Council that may unanimously adopt measures which constitute a step backwards in Union law as long as free movement of capital to and from third countries is concerned, following the special legislative procedure and after having consulted the European Parliament.

[49] Art.64 (1) applies to any restriction, of those which already exited in 1993, which involves *"direct investment- including real estate- establishment, the provision of financial services or the admission of securities to capital markets"*.
[50] C.Barnard, *The substantive law of the EU, the four freedoms,* cit., p.524.

As already stated above, these two latter types of restriction resulted to be less important than the one enshrined in Paragraph 1 from a practical point of view, so much that examples of the measures are still absent.
Moreover, the restriction set out by Article 66 TFEU shall be considered a potential restriction as well as those of Article 64 TFEU; it nevertheless presents many differences in relation to the subjects involved, the scope and consequently the field of application.
Firstly, it is to be noted that the rule at stake gives the power to adopt restrictions affecting the free movement of capital with third countries to the Council on a proposal from the Commission and after consulting the European Central Bank; the EU Parliament is not even mentioned.
This peculiarity about the choice of the subjects involved is strictly linked with the scope of the Article 66 TFEU: the measures the Council has the power to adopt should be directed to face situations of *"serious difficulties for the operation of economic and monetary union"* caused or likely to be caused by capital movements to or from non-EU States.
Then, it is clear that Article 66 TFEU has a specific scope and field of application: it concerns the balance of payments; though, given that EU institutions can rely upon it only *"in exceptional circumstances"*, at the present time there are no decisions of the European Court of Justice in which the Court relied upon that legal basis.

4.2 The different regime of Article 65 TFEU

Article 65 TFEU is considered to be the most important provision about possible derogations of the free movement of capital[51].
This view is based on the fact that the above mentioned Treaty's rule is characterized by a broader field of application.
Therefore, on the one hand the European Union legislator has provided for Articles 64 and 66 TFEU which deals with capital movements specifically towards or from third countries; on the other hand, the article examined in this paragraph considers

[51] L.Daniele, *Diritto del mercato unico europeo: cittadinanza, liberta' di circolazione, concorrenza, aiuti di stato* (Giuffré, 2012).

restrictions to free movement of capital capable of being applied not only with situations between a Member State and a third country, but with *internal* situations (two Member States and no third countries considered) as well.

Paragraph 1 is the main core of Article 65 TFEU, considering in an explicit way the circumstances which justify a restriction of the fourth fundamental freedom; the other three paragraphs complete the whole legal regime set out by the norm.

Going more in depth, Article 65 (1) TFEU is divided in two parts: the first one, "*part a)"*, which is widely recognized as a *specific derogation*, and a second part *"b)"* which is considered as a *general* exception.

The former part of Article 65 (1) TFEU relates to tax provisions distinguishing between resident and non-resident taxpayers or the place where their capital is invested and consequently allows Member States to apply them.

In this context it is worth mentioning two important cases the Court of Justice has dealt with, in which the breadth of the rule has been outlined. In *Verkooijen*[52] and in *Manninen*[53] the Court extrapolated in a more precise way the criteria which arise from the *part a)* of Article 65 (1) TFEU: first of all it should be assessed if the national tax rule at stake creates a regime which really distinguishes between resident and non-resident taxpayers. If the two situations are not objectively comparable in the light of the national provision, the measure established should be considered as lawful; on the contrary, if the situation examined by the court are not objectively comparable, the measure could be justified only on grounds of *general interest* and *proportionality*.

This interpretation applied by the ECJ is widely considered as similar to the one adopted with *indirect discrimination* measures and *non-discriminatory* national rules[54].

Part b) of the first paragraph or Article 65 TFEU enshrines a more general legal regime for derogations in the field of free movement of capital. It fact, it considers measures intended to ensure effective fiscal supervision and to combat tax evasion, in addition to *"measures which are justified on grounds of public policy or public security"*. Again, the ECJ jurisprudence resulted to be decisive in order to clarify the criteria its correct enforcement and applicability: for example, the Court has

[52] Case C-35/98 *Verkooijen* [2000] ECR I-4071.
[53] Case C-319/02 *Manninen* [2004] ECR I-7477.
[54] Already examined *supra,* para 3.2.

made clearer in its case law that derogations should be interpreted strictly and in accordance with other Treaty's provisions that refer to the same notions[55]; moreover, the ECJ had specified that derogations should not be misapplied so as to serve purely economic policies and that those are subject to the principle of proportionality. In addition to this, it should be recalled what stated by the Court in the already mentioned case *Commission v. Portugal* about Article 65 (1) TFEU. In that judgement it has been stated that *"the general financial interests of a Member State cannot constitute adequate justification"*, pointing out that economic grounds cannot be used as mean to remove obstacles provided for by the Treaty.

In order to complete the description of the legal regime set out by Article 65 TFEU, paragraph 3 should be mentioned too.

The third paragraph is strictly related to the first one, and it states that *"The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63"*; it is important to add that this provision has been created by the EU legislator taking into account the second sentence of Article 36 TFEU on goods[56] to which it is equivalent, in the wording but also in the aim. This is a decisive example of the progresses that have been made in the field of free movement of capital.

It can be concluded though, that the Internal Market fundamental freedom examined in this chapter has always been considered the fourth one not only because of the late enforcement, but also due to the different and *less liberal* approach of European Union Institutions. However, having regard to the essential goals achieved in this field until now, and considering the increasingly crucial role given to a capital circulation free from barriers within the Union, it can be said that the legal regime set out in the TFEU for the free movement of capital is reducing the gap with the other three freedoms in terms of development and relevance.

[55] Case C-54/99 *Eglise de Scientologie* [2000] ECR I-1335, paras. 17-18.

[56] *"Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."*

CHAPTER TWO

Other EU law implications of capital circulation among the European Union

1.Introductive Overview

In the course of the previous chapter, it has been analyzed the importance of the Internal Market of the European Union and, consequently, the role of the free movement of capital. As already considered, this fundamental freedom has undergone a long process through its implementation and enforcement, which have been concluded some time after the definitive enforcement of the other three fundamental freedoms concerning goods, persons, services and establishment.
Nevertheless, it has been already noted that the delay which characterized the enforcement of this freedom is in part due to the various and diverse implications connected to the liberalization of the flowing of capital and payments within the boundaries of the European Union, but also due to the external relations [57].
That is exactly the point of this chapter: concentrating the focus of the analysis on the practical implications that derive from the free circulation of capital among the Member States of the European Union and among those countries and non-EU states. This aspect results of great importance in particular at the present time, with the highly likely withdrawal of the United Kingdom from the European Union. In fact, the UK is an essential contributor of the EU budget and a crucial player in economic relationships with non-EU States which want to start investing and trading with the European Union. The Brexit then, will cause a sharp decline of EU financial resource, and this will consequently have an impact on all the practical implications, projects of EU institutions and Union policies that will be examined hereafter.
Therefore, attention will be put on the central role of the circulation of capital at the present time, to the extent that the European Commission considered appropriate to devise the specific project of creating a union of integrated capital markets able to

[57] C.Barnard, *The substantive law of the EU, the four freedoms* (Oxford University Press, 2011), Pg.518-522.

boost and strengthen the whole economy of the EU: it is the Capital Markets Union project.
Then, it has been considered noteworthy the description of how the flow capital within the Union borders is capable of being used by the Council, and more in general by the EU Institutions, in order to achieve important goals of the European Union. The second paragraph is indeed dedicated to the restrictions that the EU Institutions are empowered to adopt and that have been imposed in the field of capital movements and financial operations; the above mentioned restrictions then, are intended to be applied to capital movements performed within the territory of the Union in the perspective of combating terrorism and fighting associated organizations.
A final reasoning instead, is devoted to the examination of the relationship between the free movement of capital and the other fundamental freedom, with a particular attention to the connection with the freedom of establishment.
In fact, the boundaries which exist in the delimitation of the two freedoms of capital movement and establishment, can be considered less stringent in comparison with the others; differences, similarities and contact points will be discussed in order to provide for a clear depiction of all the relevant implications connected with free movement of capital.
To conclude, but also to present the topic with different words, the aim of this chapter is to describe the functioning of the free movement of capital by giving space not only to the static aspects related to the study of the legal framework, but also to pay attention to the dynamic dimension of this fundamental freedom which is in close interaction with numerous and different EU policies.

2. The project of a Capital Markets Union for the EU

In the previous chapter it has been affirmed that one of the main objectives of the European Union, as also enshrined in Article 63 of the Treaty on the Functioning of the European Union, is to let the capital flow freely throughout the Union and among the Member States. Thus, in order to achieve this ambitious result, the various European capital markets should be harmonized with the aim to reach a level of full integration, in order to be able to produce economic growth. Therefore,

the integration of capital markets in the European Union is since a long time seen as a key element of EU policies, because it is considered by the Institutions as crucial for the sustainable development of European economy.
Then, it is important to underline that the project here under examination is not a single legislative proposal, but it consist of a series of initiatives that will be launched and will develop in the years to come till 2019 by the EU Institutions, in particular the EU Commission.

2.1 The Context

As long as the project of a Capital Markets Union (CMU) is concerned, it should be recalled that the creation of a true single market exclusively in the perspective of capital is a cornerstone of the project *"An Investment Plan for Europe"*, an idea announced in November 2014 by the then candidate for Commission President Jean-Claude Juncker. This plan, also called *Juncker Plan*, presents the three main objectives of removing obstacles to investment, providing visibility and technical assistance to investment projects and allowing a smarter use of financial resources. The CMU project is therefore strictly linked with all the above mentioned objectives, and the Green Paper *"Building a Capital Markets Union"* was indeed published by the Commission in February 2015, just few months after the Investment Plan. The Commission launched then a period of consultation on the content of the Green Paper in order to create an Action Plan setting out the main pillars and a specific itinerary towards the establishment of the Capital Markets Union by 2019.
Even though this proposal of the Commission presents elements and characteristics which could be considered innovative having regard to the actual situation of the European economy, it is to be mentioned that the idea of reconstructing the European financial system is far from new.
A first report entitled *"The Development of a European Capital Market"*[58] was produced in 1966 and it was aimed to demonstrate the importance of capital market integration, showing the conditions of effective use of economic policy instruments

[58] *The Development of a European Capital Market*, Report by a group of expert appointed by the EEC Commission, Brussels, November 1966.

on an integrated European financial market and how to achieve an integrated capital market with the consequent benefits of developing such a regime.

Another step towards the rethinking of the European financial system was moved in 1999, when the idea to reconstruct the system at issue emerged as a key element of the *"Financial Services Action Plan"*[59].

At that time, this plan was being considered as strictly related with the third stage of the building process of the Economic and Monetary Union (EMU), the EU Institutions believing that the benefits of having one currency would be less effective than expected without a concrete integration of different Member States' financial markets[60].

This peculiar issue has been considered also in the document *"Five Presidents Report"* of June 2015, when the Commission described the Capital Markets Union as a necessary complement to the Banking Union and, consequently, to the Economic and Monetary Union as well; a clear example of this broad plan is the intention of the Commission to adopt the term Capital Market *Union*, which explicitly recalls the above mentioned other two *Unions* (the Banking Union and the EMU).

With the aim of a better understanding of the extent of the project which is being analysed in this chapter, it results crucial to mention what the Commission stated in one of its documents of 2015: the Capital Markets Union was considered *"as a new frontier of Europe's single market' with the aim of reducing fragmentation in financial markets, diversifying financing sources, strengthening cross- border capital flows and improving access to finance for businesses, particularly Small and Medium Enterprises (SMEs)'"*.

In fact, the CMU project was published in order to create a debate at the EU level regarding the difficulties and possible solutions in order to achieve the goal of developing and strengthening capital markets, and furthermore to make it possible to reduce the cost of capital, particularly for small and medium enterprises.

All these objectives appeared to be more necessary than ever after the global financial crisis of 2007, when European capital markets showed a critical decline

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[59] *Implementing the framework for financial markets: Action Plan*, Communication from the Commission COM (1999) 232 final, Brussels, May 1999.

[60] M.A. Janicka, *Capital Market Union – Perspectives on Changes in the Financial System Model in the European Union* (Acta Universitatis Lodziensis, Folia Oeconomica n.333(1)/2018), p.197.

and started to become immediately more fragmented than in previous recent years. The impact of the international crisis was devastating and cause a massive loss in terms of liquidity, as the European Central Bank was unable to apply its monetary policy in an effective way, provoking at the same time a decrease of the cross-border loaning in the European Union.
The great difficulty demonstrated by EU Member States in facing and overcoming the negative consequences of the global crisis, in addition to the absence of signs of growth dynamics in the economy of the Union, stimulated the Commission to think and promote this Capital Markets Union project. The latter is seen as a cornerstone of the process towards the rebuilding of a balance in the economy of the European Union.

2.2 The Project

As previously stated, the CMU is not the result of a single legislative project, but it consists of a series of different but strictly related initiative which have the aim to create a single, integrated and well-structured European market for capital which is able to encompass all 28 Member States.
The core and main aspect on which the whole project of the Capital Markets Union is structured, is the development of capital markets as a financing source alternative to bank lending, usually the principal source of financing chosen by enterprises located in the European Union; this results particularly true for Small and Medium Enterprises (SMEs), which can be considered as the main addressee of the program. According to EU Institutions reports, today, European businesses are heavily reliant on banks and this makes the whole economy vulnerable to a tightening of bank lending. Thanks to this Union of capital markets indeed, the access to finance for companies, in particular for SMEs, could be facilitated to the detriment of the traditional bank funding.
To achieve such a result though, it is crucial to look at other models outside the EU and learn from those experiences, and this is exactly what the Commission has done.
In this perspective, the US model should be considered as the perfect example: in fact, it is largely believed that the success of the American economy is in major part

due to its financing via the capital market[61].

EU public and private equity markets were approximatively half the size of those in the US in 2016[62], being this figure a clear example of the more accentuated reliability of the European finance on a bank-based system.

Nevertheless, according to the words of the EU Commissioner Jonathan Hill, *"stronger capital markets would not replace banks as a source of financing, but the Capital Markets Union will help grow the overall pot so that everyone benefits and businesses, particularly SMEs, can find more sources of funding. It's about giving choice to companies on where and how they want to get financing. This should also make Europe more attractive to inward investment, and spread risk more effectively than in the past."*

In order to allow the correct enforcement and implementation of the Capital Markets Union and consequently to elaborate the solutions which could fit most, the Commission and the other EU institutions shall consider properly the actual financial situation of the European Union.

At the time in fact, reports and several analyses of the Institutions have shown many different and peculiar aspects which in the perspective of the CMU project are seen as elements to challenge. The tendency to rely on bank lending as the main source of financing has been already mentioned, but there are many other obstacles to markets integration such as: the significant differences in financing conditions between EU Member States; the differing rules and market practices in relation to financial instruments; the lack of investors which are ambitious to go beyond their national borders when investing and, to conclude, the important figure that many Small and Medium Enterprises throughout the Union have limited access to finance[63].

As an answer to this obstacles, the Commission has described the Capital Markets Union as a project which would bring substantial benefits to the whole European Union, thanks to the more efficient allocation of capital and the deepening of the financial markets.

To reach the goal of increasing the benefits that the capital market generates in the

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[61] Ibid.

[62] L.Quaglia, D.Hwarth and M.Liebe, *The political economy of European Capital Markets Union* (Journal of Common Market Studies, 2016), p.186.

[63] Website of the European Council: https://www.consilium.europa.eu/en/policies/capital-markets-union/

economy, paying particular attention to the sustainability of the economic growth and the creation of new jobs, the Commission has set out many specific objectives to be accomplished by 2019.

A first step is the one towards the development of a more diversified financial system complementing bank financing with deep and developed capital markets, thus reducing the now established fragmentation of that sector; then, as previously anticipated, a crucial aspect is the improvement of the access to finance for small companies, usually non-financial firms which have less economic power but which still constitute a significant part of the entire group of monetary operator in the European Internal Market. Strictly related is the idea to *unlock* the capital around the European Union which is considered to be *frozen*, putting it to work for the economy in order to give to investors more investment options and at a lower cost. Moreover, the last but not less important objective is the broader if considered in its scope: The Capital Market Union project considers as a main aim the facilitation of the movement of capital throughout the Union, *"establishing a genuine single capital market in the EU where investors are able to invest their funds without hindrance across borders"*[64]. Nevertheless, even if these goals can be considered as feasible in theory, it is crucial to bear in mind that it could be different in practice. In fact, what reported above is to be collocated in a long-term reaching perspective and the path towards their accomplishment is full of obstacles. That is why the EU Institutions have set out short-term goals as well: these indeed, deal in particular with the simplification and reduction of the number of procedures, the creation on high and common standards among Member States, and the related preparation of uniform criteria in the financial sector and, more precisely in the field of credit risk and capital markets financing.

Due to the peculiar nature of the Capital Markets Union project, whose enforcement will be the result of a large number of different legislative layers, Member States are being called on to act and envisage a heavy burden of work in terms of the laws which are and will soon be necessary to the implementation of the CMU. About this topic in fact, few scholars are worried about the likely risk of an over-regulation phenomenon which could slow down the process and, even worse, generate

[64] Website of the Commission of the European Union: https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_en

additional costs for intermediary and issuers[65].

2.3 Consequences and impact on Member States

The Commission designed the Capital Markets Union to attract in particular EU and euro area periphery countries, which had been harder hit by the global financial crisis of 2007[66]. Nevertheless, the response of Member States in relation to the CMU project demonstrated to be different from what imagined and planned by the Institutions of the European Union.

In this section, it is important to recall a figure related to the responses that Member States presented to the Commission immediately after the presentation of the plan to give birth to such a system of integrated capital markets: Member States provided for more than 400 written responses to consultation about CMU, and this large amount of answers has been of great help in pointing out the impact this project could have had on different countries in the European Union.

Considering periphery countries, more precisely those of Southern and Eastern Europe, those have been usually considered to be in a weaker position than Northern Europe countries when acting and operating in the financial sector.

Because of the vulnerable position of those countries, many scholars think that the Capital Markets Union would not be seen as an opportunity to gain more economic power, while the more developed Member States will be those who will achieve more positive results[67]. For example, according to Professor Iulian Panait, "*the Capital Markets Union cannot operate effectively as long as southern European markets are underdeveloped as compared to Western markets. Its beneficial effects would manifest most clearly, both at national and European level only in the context of accession to the Monetary Union and of achievement of a higher degree of convergence. Otherwise, the economic and financial shocks will be felt more intensely than in the case of non-participation in such a union. Contrary to the objectives and expectations, the Capital Markets Union could generate advantages for investments precisely in developed countries, rather than in the countries at the*

[65] I.Panait, *Towards the Capital Market Union* (Hyperion Economic Journal, Bucarest, 2015), p.40.
[66] W.G. Ringe, *Capital Markets Union for Europe: A Commitment to the Single Market of 28* (Law and Financial Markets Review, Vol. 9, No.1, 2015), pp.5-7.
[67] L.Quaglia, D.Hwarth and M.Liebe, *The political economy of European Capital Markets Union* (Journal of Common Market Studies, 2016), p. 194.

periphery of the European economy."[68].

Moreover, a positive response to this Capital Markets Union project has been given by the United Kingdom, and this fact is particularly important for the analysis uphold in this thesis.

The UK indeed, demonstrated conceivably to have the most to benefit from the enforcement of this project, as the financial liberalization and integration of capital markets throughout the European Union would create an abundant advantage, considered the breadth and the still high developed level of their capital markets.

However, even if the same economic benefit could be still appreciated in relation to other Northern Europe Member States (e.g. The Netherlands, Sweden, Denmark and Belgium as well), few scholars used to think, mostly during the years before the Brexit vote, that the Capital Markets Union should be considered in part as an effort to repair and strengthen the (economic) relationships between the European Union and the United Kingdom[69].

Nonetheless, these doctrinal opinions should not shift the focus from the significant results that could be achieved in terms of capital circulation among Member States and, more in general, throughout the whole Europe.

At least in principle indeed, EU Institutions are persuaded that if the CMU project will be followed by a thorough and accurate implementation through national and Union-level instruments and regulations, all European Union countries would be able to benefit from the economic advantages deriving from a Capital Markets Union.

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[68] I.Panait, *Towards the Capital Market Union* (Hyperion Economic Journal, Bucarest, 2015), p.40.

[69] W.G.Ringe, *Capital Markets Union for Europe - A Political Message to the UK* (Oxford Legal Studies Research, Paper No.26, 2015).

3. Free movement of capital and the potential overlap with other fundamental freedoms

3.1 Free movement of capital and freedom of establishment

"Freedom to move certain types of capital is, in practice, a precondition for the effective exercise of other freedoms guaranteed by the Treaty, in particular the right of establishment.": this statement was made by the European Court of Justice in *Casati*[70], a decisive judgement about the free movement of capital which has already been analysed in the previous chapter.

With this statement though, the ECJ indicated far in advance the issue of the potential overlap between the free movement of capital and the other freedoms, being this matter particularly meaningful in relation to the legal framework provided by the Treaties for the freedom of establishment.

These two fundamental principles of the European Union embody the role of the backbone of the internal market in the area of cross-border investment and cross-border entrepreneurship.

Furthermore, because of the similarities which characterized the field of application of both, the risk that the two legislative framework can overlay is easily conceivable. Of particular interest indeed, are the Treaty's provisions which allow Member States to put limitations to the exercise of those rights, and an issue which particularly plays a prominent role is their application in regard to third-country situations, as the scope of Art. 63, para. 1 TFEU reaches beyond the territory of the European Union, while Art. 49 TFEU only applies in internal situations.

Nevertheless, the depicted scenario of overlapping legislations can be traced back only to recent times, because as it has been already stated in the first chapter of this thesis, the complete liberalization and the consequent direct effect of the free movement of capital have been completed relatively late in the day (in comparison with the establishment and the other freedoms).[71] What just affirmed is also

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[70] Case 203/80 *Casati* [1981] ECR 2595.

[71] 'Those wanting to make use of the free movement of capital were ultimately prevented from bringing restrictive or discriminating measures founded in primary law before the European Court of Justice until 31.12.1993. One result of this was that there were only a few judgments up until the 1990s that concerned themselves with the elements peculiar to capital movement, whereas the freedom of establishment was able to gain broad attention (and a broad field of application).'.

important to understand better the approach of the European Court of Justice on the matter, in particular in relation to the judgements that will be examined below.

To start the discussion it is important to recall that direct investment forms a subcategory of the notion of 'capital movement' within the meaning of Art 63 TFEU. The economic activity of direct investment does not, however, constitute only 'capital movement', but can also qualify as establishment for the purpose of Art 49 TFEU[72].

The major part of the discussion about the relationship between these two fundamental freedoms then, is focused on understanding which Treaty disposition should apply, if Article 63 TFEU for capital or Article 49 TFEU for establishment, when Member States adopt domestic legislations which could potentially be in contrast with such a legal framework.

According to the developments in the interpretation of Art 49 TFEU, the freedom extends equally to the purchase of shares in an 'already existing' undertaking or a cross-border merger[73]. However, Not every share purchase, though, is covered by Art 49 TFEU, but only those that form the basis for a prospective entrepreneurial activity, but it is crucial to understand if there is a threshold above which one can still assume that the investor is in a position to act as entrepreneur. In the field of freedom of establishment then, it has been developed the so called *definite influence test*, which looks at the degree of influence the acquisition of a certain number of shares could attribute to the stockholder[74]. In this context, professor Steffen Hindelang affirmed that *"If one now wants to compare the test just outlined with respect to identifying an establishment with the one developed for the identification of direct investment with respect to holdings mentioned in Annex I, Heading I.2 of the EC Capital Movements Directive ('effective participation test'), then one notices that the notions of establishment and direct investment are perceived by this study as overlapping to a very great extent.33 The 'effective participation test'*

W. Schön, *Free Movement of Capital and Freedom of Establishment* (T.M.C. Asser Press, 2016), p.231.

[72] S. Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (Oxford University Press, 2009), p.81.

[73] For purchase of shares see Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)*, para 77; for cross-border mergers see Case C-411/03 *SEVIC Systems AG*, para 19.

[74] In this sense, The ECJ held that it is for the national Courts to determine whether the holder can exercise the necessary degree of influence, see Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue*, para 30.

requires essentially the same threshold as the Court's 'definite influence test'."[75]. Nevertheless, it is important to mention that Advocate General Geelhoed in *Test Claimants in the FII Group Litigation,*36 which puts forward the thesis that the threshold for the detection of direct investment within the *effective participation test* is clearly lower than in the *decisive influence test,* as he termed it, in the context of identifying establishment. On the other hand, his colleague Advocate General Alber in *Baars*[76] explicitly referred to the distinction between direct investment and 'portfolio investment' as mentioned in Annex I to the EC Capital Movements Directive for the purpose of identifying establishment.

To use the words of Professor Hindelang then, the Court's understanding of the doctrinal relationship of the freedom of establishment and free movement of capital, in both intra-Community and third country contexts, can hardly be described as a prime example of clarity. In fact, in an intra-Community context, the Court had tried to avoid taking up an unambiguous stance. Concerning the relationship of the two freedoms in a third country context, for a long time there was no decision that explicitly touched upon this issue. Therefore, he identification of a distinctive criteria is an issue which can be considered under ongoing development.

Going more in depth in the relationship within the two freedoms at stake in this paragraph, it is crucial to recall that the applicability of the principles deriving from the freedom of establishment are granted only to Member States, while Article 63 TFEU explicitly widen its applicability to third countries' nationals.[77]

Therefore, the freedom of a Member State to impose restrictions on direct investments from third countries substantially depends on whether the restricted operations fall within the chapter of establishment, or the chapter on capital movement; in the latter case the measures capable of creating a limitation will have to be justified under Article 65 TFEU.[78]

As a solution to the problem can be given only relying on the various decisions of the Court of Justice of the European Union, it is noteworthy to remind that at a first stage (notably between 1990s and 2000s), the ECJ demonstrated to have a

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[75] S. Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law,* cit., p.85.

[76] Case C-251/98 (Opinion of AG Alber) *C Baars v Inspecteur der Belastingen Particulieren/ Ondernemingen Gorinchem*, para 33, endnote 17.

[77] Ibid, p.232

[78] F. Benyon, *Direct investment, national champions and EU treaty freedoms: from Maastricht to Lisbon* (Hart, 2010), p. 73.

preference for the application of Article 49 where possible; this is mostly due to the fact that, as it has been anticipated above, the liberalization of capital movement was not completed. Once it was given complete enforcement to that fundamental freedom, the Court also adopted for a period Article 49 and Article 63 TFEU together.[79]

A decisive judgement which demonstrates this practice of the European Court of Justice is the one which decided the case *Commission v. Spain*[80] in 2008, where the Commission proposed an infringement action against Spain concerning restrictions on investments in the energy sector.

In the case at issue, the Spain had been accused of having violated Article 63 TFEU, but the Spanish authorities were contesting that in the case at stake only Article 49 TFEU could find application: in fact, the domestic legislation accused of the violation was providing for a specific requirement for consent for an acquisition over the threshold of 10 per cent, in this way regarding only those potential buyers that would like to exercise a certain influence in a Spanish company. This, according to Spain, would have cause the application of the sole provision about freedom of establishment, namely Article 49 TFEU.

In other words, Spain was claiming that the restrictive domestic measure consisting in a requirement for consent over a certain threshold of shares, could be related only to the willingness of exercising entrepreneurial activity; thus, the fundamental principles deriving from the free movement of capital were not at stake.

The Court instead, stating that it was necessary to consider the object of the relevant national legislation, considered the Spanish domestic provisions in violation of both Articles 49 and 63 TFEU. It was considered to be uncertain that the rules considered would have in every case enabled the purchaser of those shares to have *a certain influence* therein.[81]

A similar scenario with a similar decision of the court can be found in the case *Commission v. Italy (pharmacists)*[82], while in another judgment concerning Italy

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[79] C.Barnard, *The substantive law of the EU, the four freedoms* (Oxford University Press, 2011), p.527.

[80] Case C-207/07 *Commission v. Spain* (ECJ, 17 July 2008).

[81] F. Benyon, *Direct investment, national champions and EU Treaty freedoms: from Maastricht to Lisbon* (Hart, 2010), p. 75.

[82] Case C-531/06 *Commission v. Italy (pharmacists)* [2009] ECR I-4103.

the Court went into more detail about the application of both Articles 49 and 63 TFEU[83].

According to the judgement of the above mentioned case, the European Court of Justice found out that *"national legislation not intended to apply to those shareholdings which enable the holder to have a 'definite influence on a company's activities' but which applies irrespective of the size of the holding, may fall under both Article 49 and 63 TFEU."* ; on the contrary, veto powers on management decisions were considered as falling under Article 49 TFEU only[84].

Recently though, the ECJ moved the focus of its analysis more on Article 63 TFEU, and in this context it is to be collocated the recent judgement *Kronos*[85]. The Court there considered possible to widen the access to the internal market for companies from other countries having their centre of management in the territory of the European Union. Moreover, in the specific case there was a US company based in Germany which claimed the qualification as discriminatory of a domestic provision about the taxation of its *foreign-source* dividends. The judgement of the Court permitted the US corporation based in Germany to rely on Article 63 TFEU, thus considering the domestic provision as discriminatory. From the judgement in *Kronos* it can therefore be assumed that a person who is a citizen of another country, is likewise granted the rights deriving from the free movement of capital within the territory of the European Union.

Nevertheless, many scholars suggest to be cautious in the reading of what stated by the Court, because of the risks of misinterpretation: for example, professor Wolfgang Schön considers that *"the more generous wording of the personal protection afforded by the free movement of capital should not be used to close an apparent gap in the range of persons covered by the freedom of establishment. Above all, it must be a prerequisite in each case that, in order for these non-EU companies and firms to exercise all fundamental freedoms, they are recognized as legal entities in their chosen European state of residence."*.[86]

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[83] Case C-326/07 *Commission v. Italy* (ECJ, 26 March 2009) (2010) 47 CMLR 245.

[84] F. Benyon, *Direct investment, national champions and EU treaty freedoms: from Maastricht to Lisbon* (Hart, 2010), p. 75.

[85] Case C-47/12 *Kronos International v. Finanzamt Leverkusen* EU:C:2014:2200.

[86] W. Schön, *Free Movement of Capital and Freedom of Establishment* (T.M.C. Asser Press, 2016), p. 233.

After having considered the case law relevant and pertinent to the discussion about the relationship between the free movement of capital and the freedom of establishment, it can be said that an *aprioristic* approach does not seem to be applicable by the European Court of Justice. It demonstrated thus to be necessary an examination on a case by case basis, also because, to quote a reasoning of the Court itself in one of its judgement, the judicial applicability of one or the other fundamental freedoms is materially dependent on whether and to what extent the economic commitment of the market citizen finds expression in an activity or investment[87].

3.2 Free movement of capital and freedom to provide services

In order to better analyze the various interconnections between the free movement of capital and other fundamental freedoms, it appears necessary to consider the relationship of the freedom object of this thesis and the freedom to provide services, as provided for by Articles 56 TFEU and followings.

It is worth it to mention that a flow of cases similar to the one about freedom of establishment in relation with free movement of capital, has characterized the jurisprudence about services.

A specific link between the two freedoms at stake has been recognized in Article 58 para. 2 TFEU, which provides that the liberalization of banking and insurance services connected with movement of capital is to be achieved *in step with* the liberalization of movement of capital[88].

This link though, shall be read as keeping the two freedoms connected but autonomous, as it is not possible to find a hierarchy principle regulating the relationships between them.

An important case, in which the European Court of Justice had to rule about the issue at stake here, is the quite recent *Fidium Finanz*[89] case, that involved also key findings as long as financial activities of third countries are concerned.

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[87] Ibid, p.240.

[88] C.Barnard, *The substantive law of the EU, the four freedoms* (Oxford University Press, 2011), p. 527.

[89] Case C-452/04 *Fidium Finanz* [2006] ECR I-9521.

The litigation dealt with a Member State's requirement for a third country finance company to get a permission to perform loan activity in the field of financial services. The third country company was a Swiss one, and it was claiming the German provisions requiring the above mentioned authorization were to be considered discriminatory.
The Court then, had to decide whether the Swiss company could rely on Article 63 TFEU, that confers rights to third countries, or on Article 56 TFEU, which gives protection only to Member States.
Firstly, the ECJ stressed the reasoning that although closely linked, the two provisions considered shall be read as separated rules, regulating different situation each with its own field of application[90].
Furthermore, the Court decided to make a clarification about the possible existence of a hierarchy principle governing the application of Article 63 TFEU instead of Article 56 TFEU. In doing so, the ECJ on the one hand explicitly stated that the principle enshrined in Article 57 TFEU, whereby *"Services shall be services for the purposes of the Treaty insofar as they are not governed by the provisions relating to freedom of movement of goods, capital and persons…"*, did not constitute a hierarchy principle but it was simply related to the definition, in order to ensure that all economic activity fell within the scope of the fundamental freedoms[91]; on the other hand then, the Court clarified that a hierarchy principle was not capable of being found in Article 58 para. 2 TFEU, as its significance was only to specify that freedom to provide services and free movement of capital may progress at different rates[92].
Such a conclusion demonstrates an approach which really differs from the one the Court came up with in 1995 in *Gebhard* case, when it was explicitly recognized that the provisions of the chapter on services were subordinate to those on the right of establishment[93].
Eventually, the judgement of *Fidium Finanz* was decide by the Court in favour of Article 56 TFEU, stating that the consequent reduction of cross-border financial

[90] Ibid, para. 28.
[91] Ibid, para. 32.
[92] Ibid, para. 33.
[93] Case C-55/94 *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, para. 22.

traffic was *"merely an unavoidable consequence of the restriction on the freedom to provide services"*.

By contrast, in another case concerning holdings in investment funds in the Cayman Islands, the Court found that since the issue was about investments in a product rather than the entrepreneurial activity of offering the investments for sale, the purpose of the national rule contested was relating *"at least principally to capital movements"*[94].

In conclusion, from the described case law of the European Court of Justice it is possible to consider a specific outcome: notwithstanding the close link which characterizes the field of application of the free movement of capital, the freedom to provide services and the freedom of establishment, the rules and the provisions governing each field of application remain autonomous and not subject to a given principle of hierarchy. As stated above, the decision of the Court to let one legislation prevail on the other in the past was due to the different level of development of the considered disciplines; at the time instead, having regard of the copious case law produced by the ECJ on these topics, it is preferred to consider the relationship between the concerned freedoms as a situation of parallelism instead of one of hierarchy[95].

In order to introduce the topic that will be discussed in the next paragraph, it should be recalled that all those investments and economic operations (be they expressions of the freedom of establishment or of the free movement of capital) are likely to be blocked and funds are likely to be freezed by EU institutions, if the above mentioned investments and operations resulted to be linked with persons or organizations which are considered harmful for the safety of the Union and the rest of the World. In other words, the Institutions of the European Union are empowered to block the investment of capital within the Union from persons or organizations when these are considered dangerous according to specific criteria.

[94] Case C-560/13 *Finanzamt-Ulm v. Wagner-Raith* EU:C:2015:347.

[95] F. Benyon, *Direct investment, national champions and EU treaty freedoms: from Maastricht to Lisbon* (Hart, 2010), p. 77.

4.The free Movement of Capital and the fight against Terrorism

One of the main objective of this thesis is to outline a complete and clear state of play of the rules and principles which regulate the free movement of capital not only among the Member States of the European Union, but also throughout the whole Europe. Furthermore, it appears necessary to look at the EU law legal framework which allows the capital to flow freely within the Union, in relation to the rules and regulations which empower EU Institutions to put a limit to the free circulation of capital. In particular, the rules that will be examined in this paragraph are conceived in order to fight and interfere with States, organizations or individuals considered involved in terroristic operations. It is the case of mechanisms legally provided by the Treaties which, in the perspective of safeguarding the common security of the European Union, have the effect of put a limit to the freedom of movement of capital in the Internal Market, exclusively when the parties involved and the specific potential harmful circumstances so require. As already mentioned, the Brexit will cause a significant decline of EU financial resource, having an impact on all the practical implications, projects of EU institutions and Union policies. The here considered mechanisms for the safeguarding of the security of the Union are capable of being touched by the withdrawal of the UK from the EU as well, as the United Kingdom actually plays a key role in the European landscape in terms of capital allocation[96].

4.1 The functioning of economic restriction and in particular "smart sanctions"

Since the European Union's early constitution, the practice of imposing sanctions to put a limit to the economic power of a given actor because of its dangerous relationships with terroristic or other types of rights violating organisations, is widely recognized to be well-established within the various European Union instruments. About this peculiar issue, it is necessary to outline the legal framework which the EU may be called to act in: considering mostly the counter-terrorist

[96] T.Buccellato and others, *Brexit, La posizione di Confindustria* (Centro Studi Confindustria, Luglio 2017).

finance, but also the Anti-Money-Laundering policy for example, both states and non-states operators act in different ways and at multiple levels of governance. This overlaying legislative framework is characterized by the strict co-operation of the European Union with a large numbers of bodies which have been involved in counter-terrorist finance during the years, as the World Bank, the Interpol, the Financial Action Task Force, the Council of Europe and many others.[97]

The most pertinent relationship though, is without any doubts the one which had been consolidated between the European Union and the United Nations: this relationship has accurately been described by the experts and scholars as *symbiotic*, because of the great effort constantly demonstrated by the EU in aiming to meet and also outpace the resolutions elaborated by Council of the above mentioned organization.[98]

This tendency of the European Union to adapt in relation to United Nation's standards can be traced back as early as the second part of the Twentieth Century, when the Institutions of the EU, at that time still the European Economic Community, were imposing embargoes against the apartheid regimes in Southern Rhodesia (1966) and South Africa (1977). Then, it was however uncertain whether the EEC had or not the power to elaborate and consequently impose those economic penalties, but they had been embraced in both cases after having followed a UN Council's resolution[99]. As already mentioned, the Institutions of the EU are still very focused on being in line with the various standards of the United Nations, as recent cases with Libya, Eritrea, Afghanistan, Yemen and others demonstrate[100].

Following this practice, the European Union has also imposed autonomous sanctions against countries that were violating fundamental rights, as Iran, the USSR or Argentina.

It has been long disputed if the EU had the power to adopt those economic sanctions, but this practice has been mostly criticized during the years because of the claimed capability to create collateral damages to innocent people.

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[97] CJ Shaw, *Worldwide War on Terrorist Finance* (Journal of International Banking Law and Regulation 469, 2007).

[98] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.84.

[99] Zagel, Gudrun, *Article 215 TFEU on Restrictive Measures* (Smith& Herzog on the Law of the European Union, Researchgate, 2015), p.4.

[100] Ibid, p.5.

As this system of penalties was considered to hurt the population of targeted states rather than the government accused of oppressing those populations, starting from the 1990s, the United Nations decided to shift towards a different model of sanctions: the so called *"smart sanctions"*. This instrument aims at punishing not the entire State, but only the belligerent and guilty actors, that might be governments, organizations or individuals as well. Even though these UN resolutions are only binding under international law, it is the idea behind the mechanism that should be considered as revolutionary according to many scholars[101]. The European Union lost no time in following this practice.

The Member States decided to fulfil the obligation coming from the United Nation through the European Union, even if those resolutions were not directly binding the EU. Common positions in the field of Common Foreign and Security Policy had been adopted in order to implement the resolutions of the UN Council, which had the implementation of smart sanctions as counter-terrorist means as their main objective.

More in general, EU action may be divided in two categories: the first category encompasses the practice to prevent the flow of capital to or from suspected terrorist or suspected associates with terroristic organizations; the second one instead, is the action to freeze the assets of the suspected actors.

The decision of the Member States to align themselves to UN Council resolutions through the better equipment of the European Union structure might be explained relying upon the fact that, on the one hand a "Community approach" facilitates the coherence of external operations, and on the other hand the concurrent adoption and implementation of those resolutions on the behalf of the whole Union is capable of enhancing the effects of restrictive measures and helps avoiding loopholes and inequality in the application of that sanctioning system[102].

Today, the power of the European Union to impose restrictive economic measures directly against non-State entities is confirmed and enshrined in Articles 75 and 215 of the Treaty on Functioning of the European Union, introduced by the Lisbon Treaty in order to replace the previous legislative framework.

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[101] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.116, and G.L.Simons, *The Scourging of Iraq: Sanctions Law and Natural Justice* (Macmillan, 1996).

[102] Council Regulation 877/82/EEC of 16 April 1982, suspending imports of all products originating in Argentina, OJ 1982 L 102/1, Preamble, 3rd recital.

At this point of the discussion, it is crucial to remember that the development of the legal regime about economic restrictive measures and *smart sanctions* has been considered as one of the most challenging, in particular in the perspective of EU constitutional Law. Discussion arose about both the strongly invasive character of freezing found sanctions, and the correct legal basis which the EU should have relied on[103].

Considering this issue, it is noteworthy that before the Lisbon Treaty the European Union had chosen Articles 60, 301 and 308 EC as a legal basis for the adoption of regulations necessary to implement UN resolutions[104].

According to Article 301 EC, the Council was given the power to adopt the necessary measures to interrupt or reduce economic relationships with third countries in the light of the Common and Foreign Security Policy, acting by a qualified majority and on a proposal from the Commission.

The same legislative procedure was provided for Article 60 EC, which was giving the Council the power to act, in the same cases envisaged in Article 301 EC, in order to take the necessary measures specifically about capital and payments movements.

Both articles were only covering the enforcement and application of economic penalties directed to third countries, and Article 60 EC was considered to be a sort of *lex specialis* of Article 301 EC: more precisely, economic embargoes had been imposed using Article 301 EC as a legal basis, while if restrictions of capital transfers and payments were involved, Article 60 EC had been use as an *additional* legal basis. The practice of freezing funds was indeed considered as based on both articles read in conjunction.

Article 308 EC instead, was empowering the Council to act in order to achieve the Community's goals when the Treaty did not provide for the necessary powers, doing so extending the legal basis for the application of the legal regime of economic sanctions[105].

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[103] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), pp.125-128.

[104] It is essential here to recall that before the legal regime settled by the entry into force of the Lisbon Treaty, *smart sanctions* were not yet considered. For the EU Institutions then, it was only possible to apply general economic restrictions (e.g. embargoes).

[105] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.126.

At the time, these articles do not exist anymore because they have been modified by the Lisbon Treaty: moreover, after the implementation of the above mentioned Treaty, the legal basis provided for economic sanctions should be identified in the discipline set out by Articles 75 and 215 of the TFEU.

4.2 Articles 75 and 215 TFEU: legal regime and related controversial issues

It has been already analyzed that the provisions in force before the Lisbon Treaty were interpreted as capable of being read together and as a unique legal basis: depending on the situation, Article 60 EC was the *lex specialis* to Article 301 EC and both provisions should have been read in conjunction with Article 308 EC.
Unfortunately, the above mentioned Treaty resulted to have made the situation more complicated, as at the time the present legal framework offers two plausible legal bases for the adoption of economic sanctions.
In fact, on the one hand the in the updated version of the TFEU it is possible to find Article 215, which provides for the adoption of *restrictive measures* in general, according also with the name of the Title IV in which it is collocated.
According to the structure and the content, the above mentioned provision is composed of three paragraphs: the first one empowers the Council to adopt the necessary measures to interrupt or cause the reduction of, not only economic, but also financial, relations with one or more third countries; the second paragraph provides for the possibility of the Council to impose restrictive measures on natural or legal persons, and groups or non-State entities (this is the case of the already mentioned *smart sanctions*)[106]; the third paragraph simply states that all the measures allowed by the article itself, shall include the necessary provisions on legal safeguards.
Having regard of what just considered, Article 215 TFEU seems clearly to many scholars the successor of ex-Articles 60 and 301 TEC merged together. In fact, if the text and the content recall without any doubt ex-Article 301 EC, it is noteworthy to recall the inclusion in that provision, after the entry into force of the Lisbon Treaty, of the competence and the power to restrict *financial relations* as well.

[106] This is the case of the *Kadi* judgement of the European Court of Justice, which will be examined below.

Before the introduction of Article 215 TFEU indeed, restrictions on capital transfers and payments (financial restrictions) were based specifically on ex-Article 60 EC in addition to ex-Article 301 EC.[107]

While analysing Article 215 TFEU, it would appear disrespectful for the discussion not to mention an important judgement of the European Court of Justice about the subjects at stake: it is the notorious *Kadi Case*[108].

Kadi and Al Barakaat is considered to be the most important judgment ever delivered by the ECJ on the relationship between EC and international law and one of its most important judgments on fundamental rights[109].

For the purposes of this paragraph though, the issues related to fundamental rights will not be discussed; what matters to this analysis indeed, is that thanks to the above mentioned judgement, when replacing the old provisions, Article 215 TFEU has been *equipped* by the Lisbon Treaty with a second paragraph which makes explicitly reference to individuals and non-State entities, contrary to the past. Considering the legal regime in force at the time of the *Kadi* case, specific aspects of targeted sanctions, in particular the protection of fundamental rights of addressees as well as their right to legal protection had still to be clarified.

In that judgement indeed, the ECJ held that, in light of considerations of effectiveness and humanitarian concerns, Articles 60 and 301 EC should be interpreted as enabling the EC institutions to impose sanctions not only against entities or persons who physically control part of the territory of a third country and those who effectively control its government apparatus but also 'against persons and entities associated with them and who or which provided them with financial support.[110]

The recalled judgement of the European Court of justice is therefore of great importance, also because after that the Lisbon Treaty brought about a major revision of the previous legal framework, introducing Article 215 TFEU reflecting the case-law and practice developed to overcome the legal and factual difficulties that had

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[107] Zagel, Gudrun, *"Article 215 TFEU on Restrictive Measures"* (Smith& Herzog on the Law of the European Union, Researchgate, 2015), p.19.

[108] Joined Cases C-402/05 P and C-415/05 P *Yassin Abdullah Kadi and Al Barakaat International Foundation v. Council of the European Union and Commission of the European Communities* [2008] ECR I-6351.

[109] P.Takis Tridimas, *EU Law, International Law and Economic Sanctions Against Terrorism: The Judiciary in Distress?* (Penn State Law eLibrary, Journal Articles, 2009), p.661.

[110] Ibid, p.666-668.

arisen from the EU sanctions regimes.
As long as Article 75 TFEU is concerned instead, it empowers the Parliament and the Council to define a framework for administrative measures with regards to capital movements and payments by means of regulations, in order to achieve an area of freedom, security and justice (as set out in Article 67 TFEU, to which Article 75 makes explicit reference). The provision at issue allows the EU to adopt measures such as *"the freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities"*, as regards preventing and combating terrorism and related activities.
Then, both the provisions seem apparently capable of being used by EU Institutions to impose sanctions with the aim of limiting economic operations and the flow of capital within the territory of the European Union, in order to pursue and achieve counter-terrorism results.
Nevertheless, the above mentioned articles present many different features that are that is worth mentioning to better understand their functioning: first of all, contrary to the previous legal framework, where the sanctions provided for by ex-Article 60 and ex-Article 301 EC could be activated using the same legislative procedure, at the present time Articles 75 and 215 TFEU present different procedure requirements[111]. Article 75 TFEU contains indeed an explicit reference to the ordinary legislative procedure[112], where the European Parliament and the Council have the same decision making power in the process which leads to the adoption of an act of the European Union. Restrictive measures on the basis of Article 215 TFEU instead, require two different acts of the Council: firstly, the provision at issue states that there should be a decision *"adopted in accordance with Chapter 2 of Title V of the Treaty on European Union"*; this decision shall follow the Common Foreign and Security Policy procedural requirements and it is considered to be the necessary prerequisite for the adoption of a successive supranational legal act

[111] Zagel, Gudrun, *"Article 215 TFEU on Restrictive Measures"* (Smith& Herzog on the Law of the European Union, Researchgate, 2015), p.37.
[112] The European Commission submits a proposal to the Council and the European Parliament, who adopt a legislative proposal either at the first reading or at the second reading. If the two institutions do not reach an agreement after the second reading a conciliation committee is convened and if the text agreed by the conciliation committee is acceptable to both institutions at the third reading, the legislative act is adopted.
If a legislative proposal is rejected at any stage of the procedure, or the Parliament and Council cannot reach a compromise, the proposal is not adopted and the procedure ends.
The legal basis for this procedure consists of Articles 289 and 294 of the TFEU.

through which the Council will adopt the already mentioned *necessary measures*[113]. This supranational act of the Council then, shall be adopted on a joint proposal from the High Representative of the Union for Foreign Affairs and Security Policy and the European Commission: here, contrary to the ordinary procedure considered in Article 75 TFEU, the European Parliament is merely to be informed.

This difference in the core structure of the two provisions though, generates vagueness in relation to the correct legal basis the European Union should rely on when it is of the opinion of limiting or blocking definitively the flowing of capital to or from the EU territory, when counter-terroristic aims are at stake.

This uncertainty is demonstrated indeed by the dissimilar approach of scholars on the matter: in fact, there is who supports that the idea of a relationship *lex specialis-lex generalis*[114], where the former will be Article 75 TFEU and the latter Article 215 TFEU, is not viable due to the different procedural requirement; on the other hand there are experts which are convinced about the possibility of this type of relationship[115]; then, there are others who seem to be positioned in-between[116].

Surely, the *Table of Equivalence*[117] published in the *Official Journal* is not of great help in this context. In fact, it offers a more complicated answer, as ex-Article 60 EC is described as *moved* to the present Article 75 TFEU, while ex-Article 301 EC is labelled as *replaced* by Article 215 TFEU. According to these facts, the document above mentioned can be considered even unhelpful, given the differences between the old and the new provisions (in particular ex-Article 60 EC and Article 75 TFEU) and the complexity of such a situation which seems has been addressed with too much simplicity[118].

Then, at this stage, it appears crucial to recall the case *"European Parliament v. Council of the European Union"*[119] where this issue has been approached even by the European Court of Justice.

In that judgement the Court stated that Article 75 TFEU *"simply refers to the definition, for the purpose of preventing terrorism and related activities and*

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[113] Zagel, Gudrun, *Article 215 TFEU on Restrictive Measures* (Smith& Herzog on the Law of the European Union, Researchgate, 2015), p.23.

[114] Ibid, p.38.

[115] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.129.

[116] A.Engel, *The Choice of Legal Basis for Acts of the European Union* (Springer Nature Switzerland, 2018), p.38.

[117] *Tables of Equivalences* C326/363 (Official Journal of the European Union, 2012).

[118] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.129.

[119] Case C-130/10 *European Parliament v. Council of the European Union* OJ 2010 C134.

combating the same, of a framework for administrative measures with regard to capital movements and payments, when this is necessary to achieve the objectives set out in Article 67 TFEU" and thus could be related only to internal actions of the European Union[120]. Moreover, it continued, the action to combat terrorism is certainly in line with objectives enshrined in that provision, as the one to maintain an area of freedom, justice and security; nevertheless this objective should be considered as *internal*, if compared with the aim of combating and fighting international terrorism, which clearly constitutes an *external* action of the European Union[121]. In relation to this Article 215 TFEU *"may constitute the legal basis of restrictive measures, including those designed to combat terrorism, taken against natural or legal persons, groups or non-State entities by the Union when the decision to adopt those measures is part of the Union's action in the sphere of the CFSP."*[122].

In conclusion, from this legal framework it is possible to draw the conclusion that the European Union is concretely persuaded that capital movements within the Union, and more in general economic and financial operations, can be subjected to the above mentioned safeguarding mechanisms to face and combat critical circumstances as terrorism. At the same time though, even if those resulted to be an important weapon of EU institutions, it is to be recalled that at the present time the Council never has used Article 75 TFEU as a basis for legislative action to combat terrorism[123]. Instead though, when the Member States were called to decide which EU law provision should be used to amend their national legislation to implement the sanctions against Al Qaeda and Taleban, they chose to act through Article 215 TFEU rather than Article 75 TFEU[124]. Having regard of these tendencies, if even the European Court of Justice rejects the external application of the latter provision, Article 75 TFEU risks to be deprived and undermined in its very substance and *rationale*[125].

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[120] Ibid, para. 54.
[121] Ibid, para. 61.
[122] Ibid, para. 65.
[123] Zagel, Gudrun, *Article 215 TFEU on Restrictive Measures* (Smith& Herzog on the Law of the European Union, Researchgate, 2015), p. 37.
[124] C.Murphy, *EU Counter-Terrorism Law, Pre-Emption and the Rule of Law* (Hart, 2012), p.129.
[125] A.Engel, *The Choice of Legal Basis for Acts of the European Union* (Springer Nature Switzerland, 2018), p. 40.

CHAPTER THREE

The UK's decision to *Leave* the European Union: from the history of the Euroscepticism to the activation of Article 50 procedure

1. Background history and characteristics of the EU-UK relationship

When considering the numerous States which are part of the European Union, and consequently subject to EU law and regulation in all its fields of application, particular attention should be paid to the situation of the United Kingdom.
The relationship between the latter and the European Union has long been, almost from the very beginning of the project of a European Community after the Second World War[126], a disruptive issue in British politics.
The membership of a supranational organization such as the European Union, has always been considered as a *toxic* affair[127] which created divisions not only between British political parties, but mostly within those parties, to such an extent that the majority of the British population (as the Referendum of the 23 of June 2016's results showed) demonstrated to want the United Kingdom to be part of Europe only from a geographical point of view.
Then it is worth analyzing the most relevant episodes which have characterized the difficult relationship between the UK and the EU during the past decades, essentially because retracing those steps will be crucial in order to better understand the reasons behind such a relevant decision to leave the European Union.
Moreover, it reveals of decisive importance to point out that along with the examination of the legal instruments necessary to carry out the withdrawal process, the present chapter of this thesis will be mainly characterized by a political analysis of Brexit. This, however, is mostly due to the political standstill the United Kingdom demonstrates to be at in the present time, especially as long as next steps of the withdrawal process are concerned.

[126] S.Wilson, *Britain and the EU: A long and rocky relationship* (BBC News, 2014).
[127] V. Bogdanor, *Britain and the Continent* (Gresham College, London, 2013).

1.1 The *rocky* steps towards the admission to the European Economic Community

As anticipated above, the United Kingdom's integration process with the European Union, previously European Economic Community, has long been one of the most divisive issues in British history. This difficult relation, can be analyzed as composed of different stages, embodied in the prior decisions not to be part of the six European States which firstly gave birth to the 'Coal and Steel Community'[128], and then led to the ratification of the Treaty of Rome in 1957[129]. Other crucial episodes, which necessarily should be recalled are the two rejected application to join the EEC in 1963 and in 1967, and finally the entry in 1973. Additionally, for a better understanding of the reasons behind the United Kingdom's behavior in the course of those above mentioned stages, it is impossible not to describe which were the various sources of influence for the British institutions when dealing with the *European Membershi*p's issue.

Firstly, an important role has been played by the geography of the UK: according to many scholars[130] then, the fact of being an island caused that the Britain and British people have never felt politically part of Europe. The United Kingdom had always been convinced that they had nothing to do with the Continent, as they were living in their *splendid isolation*, relying only upon the efforts of the British Empire itself and its colonies. This situation of isolation though, allowed the UK to build its thriving Empire taking the distance from the numerous conflicts which instead

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[128] The European Coal and Steel Community (ECSC) was an organization of six European countries created after the Second World War to regulate their industrial production under a centralized authority. The primary objective of the ECSC was to bring together the six European countries who had signed it to organize the free movement of coal and steel and to free up access to sources of production. It was formally established in 1951 by the Treaty of Paris, signed by Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany, and it was the first international organization to be based on the principles of supranationalism, and anticipated the process which led to the creation of the European Union.

[129] The Treaty of Rome is the document through which the six European States who were part of the ECSC gave birth to the European Economic Community (EEC), and came into force the 1st of January 1958. The Treaty's name has been amended during the history of the Community and, eventually in 2009, with the Lisbon Treaty, it has been renamed as the Treaty on the Functioning of the European Union.

[130] V.Bogdanor, *Britain and the Continent,* cit., p.2; M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea* (Rivista di Studi Politici Internazionali, Vol.82, No.3, 2015), p.359.

engaged the States of the Continent: *"We had no troops on the Continent in 1900, and we did not agree to maintain troops on the Continent in time of peace until 1954, and we had no alliances. We lived in splendid isolation, protected by the Navy and the Empire."*[131]. During the first part of the 20th century indeed, the United Kingdom had no commitments on the Continent at all.
The British army intervened only in occasion of the two World Wars, when it seemed necessary to the United Kingdom's government in order to fight the threats of the German hegemony and to restore the balance between the European powers.
A second factor, which is essential in the perspective of the analysis of the British attitude in relation to the EU, is undoubtfully the importance of the British Empire and the Commonwealth. Moreover, the latter had been considered for a long time as a priority in British politics, beside the two other issues of a United Europe and the relationship with the United States. In particular after the Second World War then, the attention given to the governance of Commonwealth had risen to the extent that it was considered a priority, to the detriment of the European Economic Community's project. A clear example of this approach is what asserted by Harold Macmillan, by then the Prime Minister, in 1957 (the same year of the ratification of the Treaty of Rome): *"If there should at any time be a conflict between the calls upon us, there is no doubt where we stand; the Commonwealth comes first in our hearts and in our minds"*. Britain's ties to the Commonwealth though, should be considered only as *one* factor why Britain stood aside from the early moves towards European integration in the late 1940s and 1950s. It should be recalled that in those years indeed, important changes in Britain's relationship with the colonies were at stake, a clear signal of change in British policy which played an important part when it came the time to decide whether it was wort it to join the EEC[132].
The advent of the Second World War can be considered as another element which took part in the process of intoxication of the relationship between the UK and the EU. Many historians are persuaded that the myth of Dunkirk, representing the idea of Britain standing alone against any type of difficulty or enemy should be traced back to the World War II, when in 1940-41 it was the British Empire fighting alone

[131] V.Bogdanor, *Britain and the Continent,* cit., p.2.
[132] A.May, *The Commonwealth and Britain's Turn to Europe* (The Round Table, Vol.102, No.1, 2013), pp.30-32.

against the Nazi Germany[133]. Most Continental countries had either succumbed to Fascism or Nazism or been occupied, only Britain had escaped all that, so that it was the only State that did not have to be ashamed of its wartime history. Even though the United Kingdom was the only one State who could be considered as a winner of the war, *"the axiom in Britain was: never again! We did not want a Continental commitment and felt that we had been strongest and most secure when we stood alone."[134]*.

All the factors examined above, combined together, had the effect to make Britain not interested in the project for a new Europe united, which was starting to develop within other Western Europe's States[135].

Once the threats of the Nazi Germany hegemony had been defeated, Britain was willing to maintain a leading role in the international politics scenario, leading to the establishment of the Organization for European Economic Cooperation (OEEC) in 1948 and the Council of Europe in 1949, as an example of this objective; nevertheless, many scholars and politicians[136] have considered this desire to participate in international initiatives as mean to strengthen the UK's relationships with the United States of America. On the other side indeed, as already mentioned, the United Kingdom repeatedly refused to take part to initiatives aimed to create a common market for the States of Europe: in 1950 the British government did not accept the invitation enshrined in the Schuman Declaration to establish a Coal and Steel Community, while in 1955 the United Kingdom did not take part to the Messina Conference; consequently, it was not part of those state which in 1957 signed the Treaty of Rome and led to the creation of the European Economic Community and the Euratom.

According to many academics, the British government was persuaded that the coming into existence of a market common to the different States of Europe had to be considered as an impossible outcome, especially based on the assumption that the United Kingdom would not have participated to it; the only question at that time was whether the common market would have collapsed of its own weight or the UK had to *help* this inevitable end. *"It was the price of victory, the illusion that you*

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[133] S.Wilson, *Britain and the EU: A long and rocky relationship,* cit.
[134] V.Bogdanor, *Britain and the Continent,* cit., pp.3-4.
[135] M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.360.
[136] A.Varsori, *Europe 1945-1990s: The End of an Era?* (St. Martin's Press, Macmillan Press, 1995), p.156.

could maintain what you had, without change", claimed Jean Monnet[137] after the British government refused the invitation to join the Coal and Steel Community[138]. And it revealed indeed to be an illusion, because during the 1950s and the 1960s the British economic relationships with the Commonwealth started to be more or less stagnant, where in the meanwhile the European Economic Community project is gaining an ever-increasing success.

In such a situation, the then Prime Minister Harold Macmillan, recognized that being part of an organization common to the various States in Europe could be a successful decision, but the public opinion was still not ready to witness to the application to join the EEC: that is why the United Kingdom created the European Free Trade Area (EFTA), an international organization made of European States that were not part of the European Economic Community that was imagined to perform in competition with the organization born from the Treaty of Rome. Unfortunately, the project revealed to be a failure and becoming part of the EEC seemed to be the only possibility to keep up with other States, in particular France and Germany.

The British is in fact seriously worried about the situation of Germany; Macmillan first is conscious of the fact that the German economy is rising, to the extent that in a letter to the Secretary for the Treasury stated: *"it is really giving them on a plate what we fought in two world wars to prevent (...)a united Europe without Britain would diminish the UK in the eyes of Washington."*[139].

In this context, the United Kingdom decided to make the application to join the European Economic Community, moved on the one hand by the intention to play a key role in the balance of the European powers, limiting in that way the recent growth of France and Germany in particular[140]; on the other hand though, the British government was seeking mutual economic benefits, for example the absence of trade tariffs, which were explicitly part of the EEC project. Conveniently, the historian James Ellison pointed out that Europe has not just been a place of conflict

[137] Jean Monnet was a French political economist and diplomat. He is considered as one of the Founding Fathers of the European Union together with the Italian colleague Altiero Spinelli.
[138] S.Wilson, *Britain and the EU: A long and rocky relationship,* cit.; M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.359.
[139] M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.362.
[140] Ibidem.

for Britain, but it should have been seen also as a place of diplomatic agreement, trade, cooperation, peace, stability and growth[141].

Nevertheless, the application was rejected and the United Kingdom was prevented from being part of the European Economic Community. In particular, the motivations which led to the decision to reject the British application were explicitly affirmed by the French President Charles De Gaulle in a press conference on 14 January 1963. The French President underlined the lack of *European-ness* of the United Kingdom, strictly related to the imperial attitude and to the relationships with the Commonwealth; the UK had been accused of being maritime, insular, focused only on its markets, exchanges and supply lines; in substance, it had been considered of a different nature if compared with the six Continental States which gave birth to the European Economic Community[142].

It should be noted that those words, pronounced more than sixty years ago, might result near to the perspective of the most Euro-sceptics of the present time.

The French veto had been seen as an offence from the British public opinion and had the effect to strengthen the feeling of the British Euro-sceptic party.

Nevertheless, a second application to join the European Economic Community was presented few years later, but still vetoed by General De Gaulle. This time then, it was the 1967, the French President wanted to postpone the sign up of the United Kingdom until the imposition of the new financial regime for the EEC was completed, in order to let the France gain more favorable conditions[143].

Eventually, in 1969 all the conditions revealed to be favorable to Britain for its entry in the European Economic Community: on the one hand in fact, the new financial regime had been approved, while on the other hand the French President Charles De Gaulle ceased to be in charge. From that moment things moved rapidly, with the approval of both the EEC and the British major parties to reopen negotiations in the perspective of a forthcoming participation of the United Kingdom to the European Community. Finally, on January 1st,1973, Britain could enter the European Economic Community and started being part, at least from a formal point

[141] J.Ellison, *Why has Europe been such a difficult subject for Britain?* (London School of Economics, Blogs, Brexit, 2016).
[142] V.Bogdanor, *Britain and the Continent,* cit., pp.3-4.
[143] M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.363.

of view, of the supranational organization that in few years will become the European Union.

1.2 Euroscepticism: nature, reasons and juridical implications

As already analyzed, the desire of Britain to be part of the European Economic Community was strictly linked with self-interest objectives: firstly, the United Kingdom wanted to be part of the Common Market, in order to avoid expensive tariffs when trading with Continental European States; on a second ground though, a key role was played by the aim of counter-balancing the different European powers.

Even though the United Kingdom had been working effectively as other Member States immediately after its entrance, in order to give application to EEC principles and rigorously apply the European legislation [144], the country demonstrated not to be at peace with this reality. Only 18 months after the long-awaited European membership in fact, the British population had been asked to vote if the United Kingdom had to leave or remain in the European Economic Community: it was the 5th of June 1975, and the result revealed to be in favor of the *remainers*, with a 64.5 per cent turnout (more than two-thirds of voters opted to stay in)[145].

Moreover, in 1983 the British Labour Party's manifesto for the general elections was campaigning for a new referendum regarding the future membership of the UK in the EEC: the Labour party though, at that time wanted to withdraw from the European Economic Community, playing a role which is diametrically opposed to its position in 2018[146]. Eventually, the political campaign turned out as a failure, with the abandon of the project of a new referendum.

Ten years later then, two political parties had been formed with the explicit intention and aim to lead Britain outside the, at that time, European Union: they were the UK Independence Party (UKIP), formed in 1993 and still active[147], and the Referendum Party, formed in 1994 and dissolved in 1997.

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144 J.Ellison, *Is Britain more European than it thinks?* (Historytoday, Vol.62, 2012).

145 R.Saunders, *Britain decides: the first European referendum* (BBC History Magazine, Historyextra, 2016).

146 R.Vaidyanathan, *Michael Foot: what did the 'longest suicide note' say?* (BBC News Magazine, 2015).

147 The UK Independence Party was founded in 1993 by a group of secessionist members of the Conservative Party, and since the day of its foundation, the main objective of the UKIP has been to

Having regard of all the events recalled, it is worth to mention that there are some scholars which are convinced that the United Kingdom did not participate sincerely to the policies and the actions of the European Union, until the appointment of Tony Blair as Prime Minister. In this context then, the expression used by the British European Commissioner Roy Jenkins should be reported; he defined the position of Britain in relation to the European Union as *semi-detached*, in this way underlining the British attitude to sit on the fence between its own interests and the ones of the EU[148].

However, the European Union membership has never been so in danger as today; that is why it results crucial to this work to examine not only the historical events, but also the reasons that have characterized the Eurosceptic movement till now.

Again, it is worth to underline the influence the Second World War have had in British awareness and consideration of the European dimension: most Continental countries had either succumbed or been occupied during such a conflict, except for the United Kingdom, which was the only one who did not have to be ashamed the final result of the war. The other European States had to rethink entirely their political systems and constitutions, being so much easier for them to welcome the introduction of such an innovative project as the European Economic Community. It is possible to say then, that the idea of a European unity was born from the decline of the Europe itself as a whole, as the World War II had demonstrated; it goes without saying that those feeling could not be perceived by Britain, the real winner of the war[149]: *"We have our own dream and our own task. We are with Europe, but not of it. We are linked but not combined. We are interested and associated but not absorbed. If Britain must choose between Europe and the open sea, she must always choose the open sea."*, claimed Winston Churchill in 1953[150].

Another historical reason might be seen in the fact that from the very beginning of the British European membership, the United Kingdom had been treated differently

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bring the United Kingdom out of the European Union. In the recent history of the party the most influent political leader (and one of the founders) of the UKIP has been Nigel Farage, the one who has strongly campaigned against the membership of the European Union for its whole career in British Politics. Even though the referendum of 23 June 2016 can be considered a victory of his own and of the UKIP as a whole, Nigel Farage decided to retire from politics before the commencement of the withdrawal process. From that time the UKIP has been characterized by several complications which caused the changing of four leaders after Nigel Farage.

[148] M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.363.

[149] V.Bogdanor, *Britain and the Continent,* cit., p.4.

[150] Winston Churchill's speech on Foreign Affairs, 11 May 1953 (Hansard).

from the other contracting parties, especially from an economic point of view. In fact, after the UK accepted the terms of the European negotiations, it resulted to be the biggest contributor of the European Economic Union's balance, and this issue had been characterizing the political campaign of British parties for a long time; it was only in 1985 though, with the decisive effort of the Prime Minister Margaret Thatcher, that the United Kingdom obtained the so much desired reduction of the contribution and the imposition of a regime equal to the other Member States[151].
Furthermore, another important factor behind the historical Euroscepticism of a large part of British parties, is the existence of a decisive difference in the conception of constitutional arrangements and the organization of institutional powers between the United Kingdom and the other Member States of the European Union, which faced different evolution processes. As many scholars have repeatedly considered[152], the main difference between the protagonists mentioned above is that Continental Countries are more familiar with the new political constructions deriving from the European Union level, mostly because those States have *recently* created constitutions codifying their imperative principles, while the United Kingdom tended not to create codifications but to operate pragmatically, even when it was an empire. According to Bogdanor then, the fundamental feature of the British constitutional development during the time has been the enormous power attributed to the Parliament; in particular, *"the continuous and undivided parliamentary sovereignty has no parallel on the Continent, and it is because of this principle of sovereignty that we have no constitution- it is pointless having a constitution if Parliament can do what it likes."*[153].
In a juridical perspective though, the European Union is seen as capable of undermining that sovereignty of the British Parliament: the acts coming from the EU in fact, are often directly applicable to Member States and this prevent their institutions from emending or altering the content, or in general the characteristics, of those acts. In this way the Parliament (in particular the British one) results deprived of its original and distinctive power. In relation to this argument, it is worth to recall the position of a famous British politicians member of the Tory

[151] M.Castaldo, *Il difficile rapporto tra Regno Unito e Unione Europea,* cit., p.364.
[152] R.Morgan and C.Tame, *Parliament and Parties: The European Parliament in the Political Life of Europe* (Macmillan Press, 1996), pp.211-215.
[153] V.Bogdanor, *Britain and the Continent,* cit., p.7.

party, Enoch Powell: he was convinced that while the Continental Member States were looking at the relationship between their institutions and those of the European Union as a *dialogue* between different layers of government, the relationship between the European Parliament and Westminster was to be considered as a *duel*, in which only one of them could survive[154].

The *semi-detached* position of the United Kingdom in the European Economic Community first and in the European Union after, mainly due to the key role played by the spread Euroscepticism in British politics, has implied many juridical consequences.

In general, the law of the European Union is applicable to and in all the (still) twenty-eight Member States. Actually, the status of the United Kingdom within the European Union is quite different from those of the other Countries, especially in terms of the applicability of rules, principles and systems conceived by the EU institutions for the Union as a whole. In fact, occasionally, the European Union allows Member States to negotiate certain derogations from the Community's legislation or treaties, with the result that the States at stake do not have to participate in certain policy areas: that is the so called *opt-out mechanism*.

At the present time, the United Kingdom is the Member State of the European Union which has been using this particular instrument of derogation from EU law the most. The European membership status of the UK is indeed characterized by four opt-outs, more than any other Member State.

The first derogation which results worth to mention is the opt-out approved during the negotiations of the Maastricht Treaty in 1992 for the Economic and Monetary Union, which allowed the United Kingdom to maintain its own legal currency and not to adopt the Euro.

The second, not in order of importance, opt-out clause adopted by Britain is the one about the Schengen Agreement: the Schengen Agreement abolished border controls between Member States, but the United Kingdom (and Ireland) received opt-outs from implementing that agreement in 1997, with the incorporation of the Treaty of Amsterdam into the EU Treaties. This derogation implies that in order to cross the

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[154] R.Morgan and C.Tame, *Parliament and Parties: The European Parliament in the Political Life of Europe,* cit.

UK’s borders, it is mandatory to be controlled by the British authorities, as the national law provides for.
Thirdly, Britain decided to apply a different regime from other EU’s Members as long as the Charter of Fundamental Rights of the European Union is concerned.
Thanks to this opt-out then, the power of European courts to rule on issues related to the Charter has been limited when British law is at stake, or when the content of the Charter is brought to courts in the UK.
The last opt-out mechanism activated by the United Kingdom relates to the Area of Freedom, Security and Justice; it allows them to apply or derogate from legislation and legislative initiatives in that sector on a case-by-case basis.
More precisely, Under Protocol 36 of the Lisbon Treaty, the UK had the option to opt out of all the police and criminal justice legislation adopted prior to the treaty's entry into force which had not been subsequently amended. However, as anticipated above, it is not a *full* opt-out because the United Kingdom was given the possibility to decide which measures or legislative initiatives opting back into[155].
Ultimately though, it is crucial to recall that all these peculiar situations will be soon solved by the Brexit’s outcome. If the United Kingdom will definitively leave the European Union without a deal, then those opt-out clauses will not be valid and binding anymore; otherwise, if a deal will be achieved to let the UK continue a close relationship with the EU, it is plausible that the parts will have to find new arrangements for the concerned sectors. The only sure thing is that until the 29th of March 2019 the United Kingdom, even though with all the ideologic and practical consequences of its characteristic Euroscepticism, will maintain its *peculiar* status of Member of the European Union.

[155]UK Secretary of State for the Home Department, *Decision pursuant to Article 10(5) of Protocol 36 to The Treaty on the Functioning of the European Union* (London, 2014).

2. Article 50 of the Treaty on the European Union: how to withdraw from the European Union

2.1 The nature and rationale of Article 50 TEU

Never before has a provision of European Union Treaties become so well known in such a short space of time as Article 50 of the Treaty on the European Union[156]. In fact, it is more than two years that this provision has attracted the attention of the media and the public opinion, more precisely after the resounding United Kingdom Referendum on the European Union membership, which on the 23 June 2016 revealed a majority of the voters willing to leave the EU.

Article 50 TEU then, is the only instrument through which the process of withdrawing the European Union can be *triggered* by Member States, and it provides for a specific procedure which requires the participation of the major institutions of both the EU and the concerned Member State.

However, in order to perform a precise analysis of the Treaty's provision at stake in this work, it is worth to recall the scenario in which EU founders have been developing the idea of such an "escape mechanism" as the one enshrined in Article 50 of the Treaty on the European Union.

According to some scholars which have been studying the issue here considered, the need to include a secession clause in the Treaty of Lisbon was a decision of both the federalists and their opponents: on the one hand there were the federalists, which were convinced that including a safety clause in the new treaty would allow a way out for any Member State that could be scared by the leap forward in European integration that was at the time hoped for; on the other hand the possibility to withdraw from the European Union was considered as a clever instrument also by those Member States which could be worried by the possibility of a less-integrated Union, with many competences returned to Member States[157].

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[156] P.Eeckhout and E.Frantziou, *Brexit and Article 50 TEU: A constitutionalist reading* (Kluwer Law International, Common Market Law review, No.54, 2017), p.695.

[157] A.Duff, *Article 50: How to leave the European Union* (De Gruyter, The Federalist Debate, Vol.29, No.3, 2016), p.51.

The government of the United Kingdom for example, was in favor of the inclusion in the Lisbon Treaty of such an instrument because it was aware of the risky nature of its ever-increasing exceptionalism, which could have moved the majority of the other Member State towards the decision of its abrupt expulsion[158]. Despite of all these precautionary reasons, the decision of the United Kingdom to leave the EU after the June 2016 Referendum is the first time in the European Union history that a Member State has undertaken the decision to withdraw from such a supranational organization. This could then be the reason why a large part of the doctrine results to be skeptical about the helpful nature of Article 50 of the Treaty on the European Union, which has bee also defined as *"a sparsely worded provision, which raises more questions than it answers, and which is of course wholly untested"*[159].
Nevertheless, it is essential to study the content of that norm in order to better understand all the steps of the path that the United Kingdom and the European Union have undertaken and will have to face in the next future.
Article 50 of the Treaty on the European Union sets out and explains the stages, differentiated by a textual division in five paragraphs, of the process that a Member State has to undertake in order to leave the Union.

2.2 Article 50 in practice: the steps followed by UK and EU Institutions

Starting from the very beginning of this series of actions necessary to leave the EU, Article 50 TEU affirms in Paragraph 1 that *"Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements"*.
In relation to this first paragraph though, it is worth to recall the period immediately after the June 2016 Referendum was occupied with legal contestation as to the correct process from a legal or, better to say, constitutional point of view, for triggering Article 50 TEU. The fact under discussion indeed, was that the UK's Secretary of State had activated the withdrawal procedure without a prior act or consent of the Parliament, violating in this way the requirement of Paragraph 1 of Article 50 and the British constitutional requirements themselves. This legal

[158] Ibidem.
[159] P.Eeckhout and E.Frantziou, *Brexit and Article 50 TEU: A constitutionalist reading,* cit., p.696.

contestation was faced by the Courts of the United Kingdom in the *Miller* case[160], in conclusion of which the UK Supreme Court decided that the executive could not trigger the withdrawal process through the means of the *royal prerogatives*; thus the above mentioned Supreme Court stated, the 24 of January 2017, that the approval of the Parliament, the *statutory approval*, was a constitutional condition precedent under the law of the United Kingdom before the exit process could begin. After the decision of the UK Supreme Court[161], the government introduced the *European Union (Notification of Withdrawal)Bill 2016-2017* to Parliament in response to the above mentioned judgement, which confirmed that the government could only give the Article 50 notice under authority of an Act of Parliament.
The European Union (Notification of Withdrawal) Act 2017 received Royal Assent on 16 March 2017, authorizing the Prime Minister to give notice of Article 50 to EU Institutions: Article 50 of the Treaty on the European Union was definitively triggered by the United Kingdom, in accordance with its own constitutional requirements, the 29 of March 2017. In accordance with some doctrinal opinions though, this constitutional litigation could have been avoided with a different approach from the UK government: the prime minister could have secured her aims by saying in October 2016 that, even if she was not accepting in theory that she had to seek for a parliamentary authorization before triggering Article 50 TEU, she would nonetheless present the appropriate Bill before the Parliament for its prior consent; as a consequence of this formal approach then, the European Union (Notification of Withdrawal) Act would have been enacted well before Christmas without neither a legal dispute nor the intervention of the Supreme Court of the United Kingdom[162].
As long as the stage regarding the negotiation of the withdrawal is concerned though, the text of the Second Paragraph of Article 50 of the Treaty on the European Union states that: *"A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement*

[160] *R (on the application of Miller) v Secretary of State for Exiting the European Union* [2017] UKSC5.
[161] R.A.Greene and A.Dewan, *Brexit ruling: UK Supreme Court gives Parliament Article 50 vote* (CNN Europe, 24 January 2017).
[162] P.Craig, *The Process: Brexit and the Anatomy of Article 50* in F.Fabbrini, *The Law and the politics of Brexit* (Oxford University Press, 2017), p. 51.

with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.". As a starting point, in relation to the first sentence of that paragraph, it is important to remember that, as previously reported, the UK's Prime Minister Theresa May have formally notified the European Council the intention of the United Kingdom to withdraw from the European Union on 29 March 2017[163]. From a formal perspective, Article 50 TEU describes the steps that should be made in order to conclude a *withdrawal agreement*, and the process described there conceives also the application of Article 218 paragraph 3 of the TFEU, with the aim to set out the procedure applicable specifically to the negotiations: "*The Commission, or the High Representative of the Union for Foreign Affairs and Security Policy where the agreement envisaged relates exclusively or principally to the common foreign and security policy, shall submit recommendations to the Council, which shall adopt a decision authorizing the opening of negotiations and, depending on the subject of the agreement envisaged, nominating the Union negotiator or the head of the Union's negotiating team."*. According to this complex procedure the Council of the European Union plays a key-role in the negotiation's stage, because the Council has to authorize the opening of the negotiations based on the recommendations of the European Commission, it has also to adopt the negotiating directives acting by qualified majority and finally, it has to nominate the European Union negotiator[164]. In addition then, while the Commission submit recommendations to the Council and conducts the detailed negotiation, the European Parliament has no formal role, but considering that it has a veto on the withdrawal agreement, its position will surely be taken into account during the negotiation stage. Having regard of a large part of the doctrine, the observance of the set out procedure to withdraw is only one of the issues related to the Second Paragraph of Article 50 of the Treaty on the European Union: a second, and

[163] Practical Law, *Brexit: Article 50 and the withdrawal process* (Thomson Reuters, 2018), p.2.
[164] On 22 May 2017 the Council has authorized the opening of the negotiations and consequently nominated the European Commission as the EU negotiator.
The Council also established a Working Party on Article 50 to liaise with the European Commission, which has thereafter appointed Michel Barnier as its chief negotiator.

informal, point is that the agreement shall take into account the framework of future relationships between the European Union and the *leaving* United Kingdom[165]. The informal dimension to the process is not to be underestimated; foremost in this regard is the ordering of the negotiations, more precisely whether the discussion on the withdrawal agreement should proceed in parallel with the one on future relationships or whether there should be a phased ordering; the United Kingdom strongly favours a parallel discussion, while the European Union is convinced of the necessity of a phased ordering. A phased discussion is capable of allowing the EU to refuse to discuss trade relations until it has secured an agreement which fulfill all the necessary requirements; a parallel approach instead, would enable the UK to bring on together the discussion about future trade relations and the one about the terms of the withdrawal agreement, in the perspective of gaining some advantages from this approach[166].

Moreover, while the United Kingdom's Prime Minister affirmed in the notification of withdrawal that it was necessary to agree the terms of the future partnership alongside those of the withdrawal from the European Union[167], the President of the European Council Donald Tusk repeated many times that before discussing the future relationships *"we must first sort out our past"*[168].

2.3 The negotiations with the European Council

It is to say that eventually the European Council formally endorsed the negotiation guidelines in April 2017 and adopted the phased approach: the first phase concerns indeed the disentanglement of the United Kingdom from the European Union, though the second phase concerns future trade relations, which can only be finalized after the UK has left the EU[169].

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[165] A.Duff, *Article 50: How to leave the European Union,* cit., p.52.

[166] P.Craig, *The Process: Brexit and the Anatomy of Article 50,* cit., p.52.

[167] Formal Notification of Withdrawal (29 March 2017) (Notification of Withdrawal): https://www.gov.uk/government/publications/prime-ministers-letter-to-donald-tusk-triggering-article-50

[168] Remarks by President Donald Tusk on the next steps following the UK notification: https://www.consilium.europa.eu/en/press/press-releases/2017/03/31/tusk-remarks-meeting-muscat-malta/

[169] P.Craig, *The Process: Brexit and the Anatomy of Article 50,* cit., p.54.

This second stage of the withdrawal process, the one which focuses on negotiations between the European Union and the *secessionist* Member State, presents also many important implication from a national point of view. As a starting point, it is essential to consider the role of the UK Parliament in this period of negotiations: the Parliament has established a select committee on Exiting the European Union[170], but there are no legal obligations to keep it informed during that process; it is important how much the executive has chosen to inform the Parliament and how far the information is leaked. Another crucial issue at the UK level as long as the withdrawal process is concerned is the role given to devolved legislatures[171]: in this respect the Supreme Court decided that there was no legal obligation to obtain the consent of the devolved legislatures before triggering Article 50 TEU. A last issue which should be considered fundamental in this second stage of the withdrawal process is the approach of the government if negotiations are bound to take a turn which could not be seen as positive; *"no deal for Britain is better than a bad deal for Britain"* is what the UK's Prime Minister Theresa May claimed in her Lancaster House Speech[172] to underline that if the agreement is not fulfilling the requirements set out by the British government, the United Kingdom will quit the negotiation process, causing the default application of the international law rules[173] to the relationship with the European Union. With the objective of explaining why the negotiation phase is so twisted but at the same time so vital, it is worth to recall the opinion of large part of the experts which consider the

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[170] Exiting the European Union Committee: https://www.parliament.uk/business/committees/committees-a-z/commons-select/exiting-the-european-union-committee/

[171] The process of Devolution in British Constitutional scenario has transferred, and continues to transfer, varying levels of power from the UK Parliament to the UK's nations (Scotland, Wales and Northern Ireland) - but kept authority over the devolved institutions in the UK Parliament itself. The so called devolved legislatures, Scotland, Wales and Northern Ireland, all held successful referendums on devolution in the late 1990s. This led to the establishment of separate Parliaments or Assemblies and the democratic election of officials. Reserved powers including, amongst others, UK defence and foreign policy remain with Parliament in Westminster.
In each case, the legislation establishing the separate bodies determined which powers were devolved and which were reserved. Ultimately Parliament can still legislate on devolved matter but generally doesn't do so.

[172] P.Dominiczak, *Brexit: Theresa May tells EU that 'no deal is better that a bad deal for Britain'* (The Telegraph, 17 January 2017).

[173] The international law rules which will would apply in this situation are those of the World Trade Organization (WTO). The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to ensure that trade flows as smoothly, predictably and freely as possible.

withdraw as the converse of how a State joins the EU: this means that, just as with accession[174]the difficulty lies in the way of assimilating the *acquis communautaire*, with the secession process the rocky aspect are those related to cutting the ties that bind the United Kingdom to the constitutional order of the European Union after 43 years of integration[175] .

2.4 Effects and functional implications of the Withdrawing Procedure

After having described the rules and the procedure of the negotiation phase, Article 50 of the Treaty on the European Union provides for the entry into force of the withdrawal agreement, stating in the Third Paragraph as it follows: *"The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period."*. As the decision to leave has been notified to the European Council the 29 of March 2017, the UK government has two years from notification to negotiate and conclude a withdrawal agreement with the EU, otherwise the date on which the relationship will cease automatically, without any agreement, is the 29 of March 2019. In this perspective it is important to understand which are the consequences provided for by Article 50 TEU, paragraph 3: firstly, if the United Kingdom successfully concludes a withdrawal agreement with the European Union by the end of two years after having given the notice of the decision to leave, the secession takes effect by the date explicitly agreed in the arrangement; secondly then, as already mentioned, if the parties do not conclude any agreement by the end of the two years indicated in

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[174] The accession to the European Union is covered by Article 49 of the Treaty on the European Union, which states as it follows: "*Any European State which respects the values referred to in Article 2 and is committed to promoting them may apply to become a member of the Union. The European Parliament and national Parliaments shall be notified of this application. The applicant State shall address its application to the Council, which shall act unanimously after consulting the Commission and after receiving the consent of the European Parliament, which shall act by a majority of its component members. The conditions of eligibility agreed upon by the European Council shall be taken into account.* (par.1). *The conditions of admission and the adjustments to the Treaties on which the Union is founded, which such admission entails, shall be the subject of an agreement between the Member States and the applicant State. This agreement shall be submitted for ratification by all the contracting States in accordance with their respective constitutional requirements.*(par.2)*"*.

[175] A.Duff, *Article 50: How to leave the European Union,* cit., p.53.

Article 50(3) TEU, the withdrawal takes effect after two years from the notification automatically, without an agreement. This ultimate hypothesis could become reality if negotiations overrun, the Member States or the European Parliament put a veto on the agreement, or the national institutions of the United Kingdom reject the agreement (a possibility which is even more likely during the days at the time of the writing[176]). The provision of the *guillotine* after two years responds to the necessity of preventing the United Kingdom from an endless procrastination and prevarication of Union-wide interests: further delay and uncertainty are widely considered as unacceptable in the perspective of the other 27 Member States of the EU. In another perspective though, the setting out of a fixed time to undertake and achieve the result of a withdrawal agreement has the objective to avoid time losses that could distract the European Union and its Institutions from other actual problems: *"Brexit is just an enormous distraction from dealing with the plentiful other crises that now confront the Union"*[177].

However, there are few rare circumstances that, if they come true, could cause an extension or also the annulment of the withdrawal process. The extension of the time conceived by the Third Paragraph of Article 50 could be faced, on the one hand, if the agreement is concluded with a postponed commencement date, which must be agreed by the European Council with a qualified majority; on the other hand the Council and the United Kingdom could agree and unanimously decide to extend the two years period planned by Article 50 TEU. Instead, the annulment of the process can be cause only if the United Kingdom decides to revoke its Article 50 notice. Nevertheless, Theresa May has frequently repeated that there will not be any extension or revocation of the process to withdraw from the European Union[178].

"For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.
A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union."; the text of the Fourth

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[176] On the 15th of January 2019 the UK's parliament is called to vote on the project withdrawal agreement presented by Theresa May, which in case of a vote that will reject her project of agreement is due to present a second project on the 21 of January. An interesting point is that the UK's Parliament was supposed to vote the withdrawal agreement in December, but the Prime Minister decided to postpone it in order to convince part of the MPs.
[177] A.Duff, *Article 50: How to leave the European Union,* cit., p.53.
[178] Practical Law, *Brexit: Article 50 and the withdrawal process*, cit. p. 13.

Paragraph of Article 50 of the Treaty on the European Union, which specifies how the discussions around the withdrawal agreement should take place within the EU institutional context. That provision then, clearly states that the member of the concerned European Union institution representing the State who triggered the secession mechanism is not allowed to take part during the talks and dialogues which appear to be necessary. The decision to exclude the withdrawing Member State demonstrates that Article 50 TEU is explicitly on the side of the remaining EU 27 Member States, and the United Kingdom cannot expect better conditions as an ex-Member State than it had as a full Member State, in particular being prohibited to it to participate to formal discussions as Paragraph 3 of Article 50 states. Furthermore, on the side of the European Union the withdrawal agreement is to be approved by the Council with a qualified majority of 20 States out of 27, while on the side of the United Kingdom the agreement needs to be approved by the UK Parliament.

2.5 The discussed issue of Revocability

Eventually, in order to complete a correct and precise analysis of such an important provision as Article 50 TEU is demonstrating to be at the time, it is of vital importance to consider as well the possibility of a shift in the direction of this withdrawal process by the United Kingdom: it is worth to examine if the UK could have the power and the right to revoke its notice of Article 50, and the interconnection between this surprising decision and the Fifth Paragraph of Article 50 of the Treaty on the European Union. According to scholars, it is still unclear whether the United Kingdom could unilaterally revoke an Article 50 notice once it has been served, or it needs the approval of the other Member States to stop the withdrawal process and the *guillotine* countdown. There has been in fact considerable discussion about this topic, and experts are persuaded that the argument will be finally determined by the Court of Justice of the European Union[179] . Article 50 does not say anything about the right or the power of a Member State to revoke its notice of withdrawal. It only provides that, in the Fifth Paragraph, if a State which has withdrawn from the EU asks to rejoin, then its accession will

[179] Practical Law, *Brexit: Article 50 and the withdrawal process*, cit. p. 9.

have to fulfil the legal requirements and the procedure set out in Article 49 of the Treaty on the European Union: *"If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49."* Revocability is to be certainly considered as a political issue, but it clearly represents a legal one as well[180]. Firstly, it should be kept in mind that the legal consequences related to the revocability issue have important constitutional implications: if it were established that the UK could not decide to revoke its Article 50 notice before Brexit, this approach could be capable to lead to a forced exit contrary to the same provisions of Article 50(1), where it is stated that the decision to withdraw must be in accordance with the constitutional requirement of the Member State. In this perspective, a prohibition to revoke the notice would cause that, even without the parliamentary approval of the agreement, the United Kingdom would have nothing to do to avoid the secession. However, this conclusion would certainly be in contrast with the UK's constitutional requirements[181].

Otherwise, if it were recognized that the UK could unilaterally change its mind about the decision to withdraw, this would have significant implications on the vote of the Parliament on the final agreement; MPs could vote against the final agreement to let the United Kingdom remain in the European Union[182].

Looking at the international legal context instead, things may appear and can be interpreted differently: it has been argued that an element of help in this situation could be drawn from the Vienna Convention on the Law of Treaties (VCLT)[183] and, in particular from its Article 68. In order to analyze the issues from a correct point of view, it is crucial to remember that the European Union is not part of the Vienna Convention, so its provision could only be used to help in the interpretation of EU Treaties if that convention is considered to be a codification of customary

[180] Ibidem.

[181]P.Craig, *The Process: Brexit and the Anatomy of Article 50,* cit., p.64.

[182] Ibidem.

[183] The Vienna Convention on the Law of Treaties (VCLT) is a treaty concerning international law on treaties between states, adopted on 23 May 1969, but entered into force on 27 January 1980. It defines a treaty as "an international agreement concluded between states in written form and governed by international law". However, the scope of the Convention is limited. It applies only to treaties concluded between states, so it does not cover agreements between states and international organizations and it does not apply to agreements not written in form.

international law. Having said that, Article 68 provides that a notification of intention to withdraw from a treaty *"may be revoked at any time before it takes effect"*. Even if the EU is not part of the VCLT then, the direct reference to the rules provided for by international consuetudinary law (in this case Article 68 VCLT) is capable of demonstrating that there is nothing illegitimate and *contra legem* about revocability.

3. Status of the Withdrawal Process and essential developments

Once the functioning of the withdrawal procedure enshrined in Article 50 of the Treaty on the European Union has been explained, an analysis of the recent developments in the Brexit process reveals to essential to this work at this time.
It therefore results crucial to this work the understanding of the different positions of the protagonists involved: on the one hand the United Kingdom, and on the other hand the European Union. In the end then, it will be described how important it is to find an agreement and which will be scenario in the case of a *no deal* decision.

3.1 The position of the UK's government

In order to better comprehend the whole Brexit scenario, whose conclusion is getting closer and closer, a description of the position the United Kingdom has been developing in the past years appears to be useful and necessary.
On 23 June 2016, the UK overall voted to leave the European Union, by a majority of 51.9% to 48.1%[184]. However, before examining the terms of the British politics during these two years since the 23 June, it is worth it to spend few words on the Referendum itself. The EU Referendum held in 2016 was a creature of the EU Referendum Act 2015, and in that document there were no requirement that the UK government had to implement its result, nor did the statute set any time limit for the implementation of the vote to leave the EU: the EU Referendum was indeed an advisory rather than a mandatory referendum, enabling the electorate to express its

[184] See the Electoral Commission, UK Referendum results: https://www.electoralcommission.org.uk/find-information-by-subject/elections-and-referendums/past-elections-and-referendums/eu-referendum/electorate-and-count-information

opinion on the permanence of the United Kingdom in the European Union.[185] However, during the whole history of Britain, referendums have not been highly significant in the context of UK Constitutional Law and most of the chaos generated by this momentous act is due to the uncertainty as to the place of referendums in the British Constitutional context[186]. In this perspective it is important to recall that UK-wide referendums were not used until the later 20th century, when they became more common in cases about Devolution and the membership of the European Union: an example is the already mentioned referendum to leave the European Economic Community held in 1975. At that time, as it appeared to be in 2016, the referendum has been used to try to overcome government divisions: in 1975 Harold Wilson wanted to deal with divisions in the Labour party; the 2016 referendum instead, was both a response to the dissent within the Conservative party and a reaction to the pressure posed by the Ukip party[187].

Being the EU Referendum only an advisory instrument, from a legal point of view both the UK government and the Parliament could choose to ignore its result never triggering Article 50 TEU. Yet the government did not mind to ignore the referendum results and, in order to meet the commitments with the population, in February 2016 had already published the policy paper "The Process for withdrawing from the European Union", where it was stated that it was under a *"democratic duty to give effect to the electorate's decision"*[188].

Once the EU Referendum had been made and the results clearly demonstrated that the intention of the majority of the British population was to leave the European Union, the government of the United Kingdom was ready to activate the Article 50 TEU procedure. The Prime Minister then, introduced the "European Union (Notification of Withdrawal) Bill 2016-2017" to Parliament in response to the Supreme Court's ruling which confirmed that the government could only give the Article 50 notice under the authority of an Act of Parliament, thus explicitly stating that it could not use its prerogative powers to activate the withdrawal procedure[189].

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[185] See the EU Referendum Act: http://www.legislation.gov.uk/ukpga/2015/36/introduction/enacted
[186] S.Douglas-Scott, *"Brexit, Article 50 and the Contested British Constitution"* (The Modern Law Review, 2016), p. 1020.
[187] Ibid, p.1021.
[188] *The process for withdrawing from the European Union*, UK Government, 29 February 2016, at 7, para 2.1.
[189] *R (on the application of Miller) v Secretary of State for Exiting the European Union* [2017] UKSC5.

On 29 March 2017 the United Kingdom sent to the Council of the EU the Article 50 TEU notice, in this way starting the procedure to leave the European Union. Moreover, this document also included the notification of the intention of the United Kingdom not to be part of the Euratom[190] anymore. Even if that organization and the European Union remain distinct subjects from a legal point of view, since the definition of the EU in Section 3(2) of the *"European Union (Amendment) Act 2008"*[191] sets out that the term *"EU"* includes Euratom, the UK's notice of the intention to withdraw from the EU includes the withdrawal from the Euratom as well Instead, on the contrary, the European Union (Amendment) Act 2008 does not appear to authorize the UK to withdraw from the EEA[192], because it is not included in the definition of the term *"EU"* enshrined in the above mentioned act [193]. Nevertheless, the government has confirmed in the "European Union (Withdrawal) Bill 2017-2019" that the United Kingdom's intention to withdraw from the EU and at the same time from the EEA Agreement, since the UK will fall outside the geographic scope of the EEA Agreement and will therefore no longer be a member of the EEA.

On 26 June 2018, the above mentioned "European Union (Withdrawal) Bill 2017-2019" received Royal Assent to become the "European Union (Withdrawal) Act 2018" (abbreviated EUWA)[194]. The EUWA has the explicit objective of repealing

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[190] The Euratom, the European Atomic Energy Community (also called EAEC), is an international organisation established by the "Euratom Treaty" on 25 March 1957 with the original purpose of creating a specialist market for nuclear power in Europe, by developing nuclear energy and distributing it to its member states while selling the surplus to non-member states.
Euratom aims to pursue nuclear research and training activities with an emphasis on continually improving nuclear safety, security and radiation protection, notably to contribute to the long-term decarbonisation of the energy system in a safe, efficient and secure way. Even if in many cases the Euratom remains out of the attention of the public opinion, it is an active organization still in development: On 19 October 2018 the Council adopted a regulation extending the Euratom Programme for 2019-2020. It is legally distinct from the European Union, nut has the same membership and it is governed by many of the EU's institution. Nevertheless, it remains an independent organization out of the control of the European Parliament. See also the EU Commission website: https://ec.europa.eu/programmes/horizon2020/en/h2020-section/euratom.

[191]United Kingdom's *European Union (Amendment) Act 2008*: https://www.legislation.gov.uk/ukpga/2008/7/contents

[192] The European Economic Area (EEA) brings together the EU Member States and three of the EFTA States (Iceland, Liechtenstein and Norway). It was established by the EEA Agreement, an international agreement which enables these three EFTA States to participate fully in the Single Market. It covers the four freedoms, i.e. the free movement of goods, capital, services and persons, plus competition and state aid rules and horizontal areas related to the four freedoms.
See also http://www.efta.int/eea/eea-agreement/eea-basic-features - 1.

[193] Practical Law, *Brexit: Article 50 and the withdrawal process,* cit., p.9.

[194] *European Union (Withdrawal) Act 2018*: https://services.parliament.uk/bills/2017-19/europeanunionwithdrawal.html

the "European Communities Act 1972" (also known as ECA 1972) which, until the secession of the United Kingdom from the European Union, enables the EU law to become part of the UK law, giving effect to the principles and dispositions of the Treaties and giving direct effect to EU law, establishing and recognizing its supremacy. In this respect, the government has published a document containing *explanatory notes*[195] on the EUWA, which are intended to clarify and specify the content of the European Union (Withdrawal) Act 2018.

Of particular interest about this document, is the fact that it makes it clearer that, with its entering into force, the EUWA will: firstly, it will convert EU law as it is at the moment of exit into domestic law, at the same time having the care to preserve laws made in the UK to implement obligations coming from the Union; that act also indicates that the same rules and laws will apply on the day after exit as on the day before, being the Parliament the subject capable of making further changes to the *retained EU law* when it appears to be appropriate. Furthermore, those notes confirm that the EUWA does not aim to make massive changes to policy, or establish in the UK new legal frameworks which go beyond those that are appropriate to let the law continue to function properly from exit day; those policy and legal framework changes will be performed through proper means, as primary legislation instruments[196]. In addition to that, the EUWA will create time-limited, delegated power enabling ministers to make secondary legislation to deal with many different issues.

After having recalled the most important steps, at least from a legal point of view, made by the United Kingdom towards the positive conclusion of the withdrawal procedure, it results essential to pay particular attention to the position of the UK's government in terms of a future relationship with the European Union. It has been already said that the European Council explicitly considered necessary to adopt a phased approach when dealing with the withdrawal process, having decided to face the topic of future relationships only once the UK has left the EU. Nevertheless, it results useful to this work to mention the *"White paper on future UK-EU relationship"* published by the government of the United Kingdom on 12 July

[195] *Explanatory Notes* on the EUWA: https://publications.parliament.uk/pa/bills/lbill/2017-2019/0079/18079en.pdf

[196] Practical Law, *Brexit: Article 50 and the withdrawal process* (Thomson Reuters, 2018), p.21

2018[197]. This paper sets out the vision of the UK government in many fields as the economic and the security one, and also proposes institutional arrangements for the future relationships with the Union. The government's policy is for the UK to leave the Single Market and the customs union, end the free movement of people and the jurisdiction of the Court of Justice of the European Union in the UK, end significant contributions to the EU budget and achieve many other objectives in different fields which extend from the Agricultural Policy to the International Policy. Notably important to this work though, is how the above mentioned White Paper addresses key issues of the future relationship between the UK and the EU: in particular the *Economic Partnership* issue and the *Institutional Arrangement* one.

As long as the Economic Partnership issue is concerned, it is important to point out that the White Paper firstly proposes a free trade area specifically for goods, with a phased introduction of new facilitated customs arrangements that would remove the need of customs checks between the UK and the EU on the one hand, while on the other hand enabling Britain to control tariffs for its own trades with the rest of the world[198]. It is also added that the proposed free trade area for goods would ensure that the UK and the EU honor their shared commitments to Northern Ireland and Ireland through the overall future relationship.

In the same context of future Economic Relationship between the United Kingdom and the European Union, the White Paper considers new arrangements about capital movements as well: the arrangements considered are thought to deal in particular with Financial Services. Those then, would be based on the principle of autonomy for each party on decisions relating to access to its market, with a bilateral framework of treaty-based commitments; in addition, the existing equivalence legal framework should be extended to encompass a broader range of cross-border activities. Even though, the government is aware of the fact that this mechanisms could not replicate the EU's passporting regime. The future relationship between the UK and the EU in the field of capital movements and, especially, as long as Financial Services are concerned, will be governed by *"common principles for the*

[197] UK Government's White Paper: *The future relationship between the United Kingdom and the European Union:* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725288/The_future_relationship_between_the_United_Kingdom_and_the_European_Union.pdf

[198] Practical Law, *Brexit: government publishes white paper on future UK-EU relationship* (Thomson Reuters, 2018), p.3.

government of the relationship", which will demonstrate the shared intention of the two protagonist of the Brexit process to avoid adopting regulations and legislative provisions that could produce formal and substantial differences in relation to the sector of cross-border financial services. Furthermore, the UK and the EU will commit themselves in order to guarantee the functioning of an *"Extensive supervisory co-operation and regulatory dialogue"*, which will necessitate the engagement of a structured consultative process of dialogue at political and technical levels between the parties on the one hand, though on the other, the objective of a supervisory co-operation should include an appropriate reciprocal participation in supervisory colleges and other structures which can guarantee the exchange of information and the functioning of mechanisms for consultation[199]. In this way then, even though the project of a free trade area concerns only goods, the UK government is convinced to have found also for movements of capital and payments, in particular in the field of Financial Services, a clever solution based on the spirit of collaboration and co-operation. With this solution the government is also intended to minimize the introduction of discriminatory barriers to the cross-border provision of services, where barriers are considered to be permitted only when prior agreed. Of particular interest is the objective of ensuring the free and timely flow of financial capital for day-to-day business needs, including payments and transfers[200].

Shifting the attention to the Institutional Arrangement issue instead, it is essential to bear in mind that since the day of the definitive withdrawal, the Institutions of the European Union will no longer be have the power to influence and make laws as long as the United Kingdom is concerned. The proposal of the UK government is to create a relationship structured around an *"overarching institutional framework"*, that would take the form of an *"Association Agreement between the UK and the EU"*[201]. The White Paper then adds that the future relationship is likely to consist of a number of separate agreements, each of them regulating a different issue, but the details of each agreement will be discussed separately during the

[199] Ibid, p.6.
[200] Ibid,p.9.
[201] UK White Paper: *The future relationship between the United Kingdom and the European Union:* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725288/The_future_relationship_between_the_United_Kingdom_and_the_European_Union.pdf

period of negotiations of the future relationship between the United Kingdom and the European Union.

To conclude, it is worth to mention that the British government affirmed that the rights stemming from the future relationship would be enforced in the UK by UK courts and in the EU by EU courts, even though, when it appears to be necessary, a court could decide to interpret the provisions giving effect to the agreement on the basis of the relevant case law of the courts of the other party.

Obviously, the content of the White Paper at stake is only indicating the British vision and position in the perspective of a future relationship with the EU, but the content of the final and definitive withdrawal agreement will surely be a compromise of the position of the two main Brexit's protagonists.

3.2 The position of the European Union

As it has been already recalled in the previous paragraphs, the United Kingdom and the European Union institution's vision of how the withdrawal procedure should be brought on has been characterized by few divergences, as it was obvious to be.

Just to mention the most relevant ones, in the perspective of the issues analyzed in this work, firstly it results worth to recall the different approach the two protagonist of the Brexit process demonstrated to have about the sequence of issues to be discussed in the negotiation phase. As it has been discussed in paragraph 2.1 of this chapter, the European Council has been strongly in favor of a phased approach to withdrawal negotiations , as it set out in the *negotiation guidelines* of 29 April 2017. This phased approach, promoted and strongly supported by the European Council, outlined a first phase of Article 50 negotiations which should be focused on arrangements for the UK's "*orderly withdrawal from the EU"*, including the financial settlement, citizens' rights and the Irish situation; a second phase then, should have included the arrangements for the transitional period which is expected to start after the 29 of March 2019, and *"preliminary preparatory discussions"* to find an overall understanding on a "*framework for the future relationship"*; furthermore, the third phase should be focused on finding a future relationship

agreement, but the European Council repeatedly claimed this phase could be started only once the United Kingdom has left the European Union[202].

In this respect, it is essential to understand that the full agreement on future relationship will be covered by a separate and autonomous agreement, since it falls outside the scope and the procedure set out by Article 50 of the Treaty on the European Union. The EU institutions in fact, could not apply EU law sources to that situation, which will be based on a different legal source, ratified and finalized only once the UK has left the EU[203].

Another element of difference in the position of the United Kingdom and the European Union, is the UK government's frequently spelt out desire of *selecting* the matters that will be included in a free trade area which will be part of the future relationship with the EU. In relation to this it is worth to mention that the European Union Institutions, and in particular the EU Chief Negotiator for Brexit Michel Barnier, repeatedly affirmed they could not permit the weakening of the Single Market. Of particular interest is what Michel Barnier claimed on the British intention to adopt different solutions for each freedom of the Single Market: *"The UK wants to leave our common regulatory area, where people, goods, services and capital move freely across national borders. These are the economic foundations on which the EU was built. And the European council – the 27 heads of state or government – as well as the European parliament have often recalled that these economic foundations cannot be weakened."*[204]. In a more recent speech to the European Commission, the Chief Negotiator repeated that the European Union is convinced of the importance of safeguarding the Single Market, also from an economic point of view: "*All of us here understand that such a system of single market 'à la carte' would be tantamount to providing the United Kingdom and its companies with a major competitive advantage over companies operating in the single market."*[205].

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[202] European Council, *Guidelines following the United Kingdom's notification under Article 50 TEU* (Bruxelles, 29 April 2017):
https://www.consilium.europa.eu/media/21763/29-euco-art50-guidelinesen.pdf

[203] Practical Law, *Brexit: Article 50 and the withdrawal process* (Thomson Reuters, 2018), p.20

[204] D.Boffey, *UK's Brexit proposal threaten future of EU, says Barnier* (The Guardian, Brexit, 2018).

[205] European Commission, *Speech by Michel Barnier at the closing session of Eurochambre's European Parliament of Enterprises 2018* (Brussels, 10 October 2018):
http://europa.eu/rapid/press-release_SPEECH-18-6089_en.htm

Instead, considering the behavior of the European Union during this withdrawal process, many scholars at the present time are persuaded that its Institutions have shown remarkable co-ordination and unity, important characteristic that allowed the EU to deal with Brexit in a clever way. Since the day of the UK's referendum results, the European Union underlined that it would have respected Britain's decision to withdraw from the Union: *"In a free democratic process, the British people have expressed their which to leave the European Union. We regret this decision but respect it."*.

This was the position of EU institutions in a statement by EU leaders immediately after the referendum in 2016[206], and it is still confirmed in 2019, as a joint letter of Donald Tusk and Jean-Claude Juncker to the British Prime Minister Theresa May demonstrates[207]. As the European Council itself recognizes on its official website, "*the EU has consistently stood by its determination to be united, transparent in its position and prepared for the future, and to do everything in an orderly way and within the legal framework defined by the EU treaties."*[208].

The Institutions of the European Union are widely considered to have dealt brightly with Brexit scenario: on the one hand, the EU Commission appointed as Chief Negotiator Michel Barnier, which has always received the support of all the 27 Member States and demonstrated to be smart in managing and approaching to the United Kingdom's difficult political situation. On the other hand, at the same time, the European Council has played a very important role, severely restricting the time devoted to Brexit in its timetable, in this way making it difficult for Theresa May to bypass formal talks between the UK government and the European Union[209].

According to the same doctrine though, this clever and united approach of the institutions of the European Union can be seen as a real transformation *"from a*

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[206] Council of the European Union, *Statement by the EU leaders and the Netherlands Presidency on the outcome of the UK referendum* (Brussels, 24 June 2016): https://www.consilium.europa.eu/en/press/press-releases/2016/06/24/joint-statement-uk-referendum/pdf

[207] *Joint letter of President Tusk and President Juncker to Theresa May, Prime Minister of the United Kingdom* (Brussels, 14 January 2019): https://www.consilium.europa.eu/en/press/press-releases/2019/01/14/joint-letter-of-president-tusk-and-president-juncker-to-theresa-may-prime-minister-of-the-united-kingdom/

[208] European Council official website, *The EU's response to Brexit:* https://www.consilium.europa.eu/en/brexit/

[209] D. Hodson and J. Peterson, *Brexit's institutional irony: how the EU has successfully outflanked the UK* (London School of Economics, Blogs, Brexit, 2018).

bloated bureaucracy to a lean, mean negotiation machine" which had successfully gained the objective of *running the rings* around British negotiators and, in this way, have cleverly outflanked the UK[210].
However, the analysis performed in this chapter is not capable of being defined as complete. It lacks indeed of the examination of the last and probably most important document of the Brexit process: the Withdrawal Agreement, published by the United Kingdom in November 2018 along with a Political Declaration.
These two documents reveal to be crucial, as they aim to set the actual and future relationship between the United Kingdom and the European Union; as it will be discussed in the next chapter then, this issue plays definitively a key role in the Brexit process.

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[210] Ibid, p.3.

CHAPTER FOUR

Brexit: juridical problems and economic consequences in the perspective of Free Movement of Capital

1. The Withdrawal Agreement and possible future scenarios

On 14 November 2018, the European Commission and the United Kingdom's negotiators reached an agreement on the entirety of the draft of the Withdrawal Agreement of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, while on 25 November 2018 the leaders of the other 27 Member States met for a special reunion of the European Council through which the Brexit Withdrawal Agreement has eventually been endorsed. Moreover, the Withdrawal Agreement was accompanied by a Political Declaration of future relationships between the United Kingdom and the European Union.
The Agreement was then supposed to be voted by the British Parliament in December 2018, but the likelihood of a rejection by the majority of MPs has caused the Prime Minister Theresa May to postpone the vote on the Agreement to the 15th of January 2019. However, the plan of the Prime Minister failed and the Withdrawal Agreement has been rejected by a majority of 432 votes, while only 202 votes resulted in favor of the deal[211].
Consequentially, the whole future of the Brexit process is at risk and no more certain, because there are many differences of opinion between the member of the British Parliament as long as future steps in the United Kingdom's withdrawal process are concerned. In the meanwhile, the Prime Minister Theresa May has *survived* a no- confidence vote to which she had been subject after the rejection of her Agreement, and she is now supposed to present an alternative plan to be approved by the MPs[212]. However, the political situation in the United Kingdom is

[211] H. Stewart, *May suffers heaviest parliamentary defeat of a British PM in the democratic era* (The Guardian, Brexit, 16 January 2019).
[212] *May's government survives no-confidence vote* (BBC News, Politics, 16 January 2019): https://www.bbc.com/news/uk-politics-46899466.

still fluid and both the Government and the members of the Parliament are seeking solutions to break the deadlock which resulted from the recent events; the vote on the *second version* of the Withdrawal Agreement then, is supposed to be delayed until a solution is found[213].

In this context of uncertainty, where every scenario is likely to be put into practice and realized, the objective of the fourth chapter of this thesis is to discuss and analyze the juridical and economic problems and outcomes which the secession of the United Kingdom from the European Union could be bring with it.

Firstly, the key points of the Withdrawal Agreement and the Political Declaration agreed by the UK and the EU will be presented, in order to understand which are objectives that both the parties are willing to achieve to build a new type of juridical and economic relationship; due to the ambiguity and uncertainty of the Brexit process at the present time, solutions different from the one presented in the Withdrawal Agreement will be discussed as well, the *No-Deal* one above all.

As a second element of discussion, this chapter will focus on the consequences Brexit will cause to the Free Movement of Capital provisions, relying on the uncertain future relationship between the United Kingdom and the European Union: on the one hand it will be examined how the withdrawal from the Union will affect the capital circulation and its allocation in Europe; on the other hand the second paragraph of this chapter will deal with the Free Movement of Capital through the examination of the specific context of financial services, analyzing also the solution devised and imagined in the Political Declaration document by the UK and the EU.

Thirdly, the attention of this chapter will be put on the already mentioned and described project of the European Union's Capital Markets Union. As the United Kingdom is widely recognized as the main basis for financial investments in the Union[214], such a project based on capital markets integration will surely and decisively be touched by the withdrawal of the UK from the European Union.

Nevertheless, it is essential to understand that at the time of the writing it is almost impossible to outline a clear and definitive perspective about the future of the Brexit process: the British political scene itself is being troubled by the large number of different opinions and positions about the key points of the withdrawal process

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[213] J. Elgot, *No second vote on Brexit deal likely before February, says No 10* (The Guardian, 21 January 2019).

[214] K. Allen, *UK finance industry dominates European scene* (Financial Times, September 2018).

which should be prioritized, with the parties still divided on either the possibility of a second referendum to keep the UK in the EU or a *No- Deal* conclusion.

1.1 The Agreement on the withdrawal of the United Kingdom from the European Union

On 25 November 2018 the leaders of the other 27 Member States met for a special reunion of the European Council through which the Brexit Withdrawal Agreement has eventually been endorsed. That step, necessary to give correct application to Article 50 of the Treaty on the European Union, officially begins the final phase of the Brexit process after that it has been considered acceptable by both the United Kingdom and the European Union's Institutions. Immediately after the approval by the European Council then, the UK's Prime Minister Theresa May stressed out that the agreement was respectful of the results of the Referendum held in June 2016, and claimed that it was conceived in the perspective of the United Kingdom's national interest and in line with the British citizens' feelings, regardless of the differences between who wanted to *Leave* and who wanted to *Remain*[215].

The text of the Withdrawal Agreement, while setting out the basis for a smooth separation of the United Kingdom from the European Union, nevertheless allows the former to continue to be linked to the EU, at least for a definite *transitional* period. In this regard, Article 126 of the Withdrawal Agreement states as it follows: *"There shall be a transition or implementation period, which shall start on the date of entry into force of this Agreement and end on 31 December 2020."*[216]. During this period the UK will be treated as an EU member state and EU law will continue to apply in the UK. The aim is to ensure a smooth transition and allow for the necessary time to adapt to the new state of affairs. This means that the UK will continue being part of the EU Single Market and thus will benefit from the free movement of capital and the other three fundamental freedoms. As stated by the following articles though, on the one hand the UK will not be able to participate in

[215] M. Rovelli, *Brexit, vertice dell'UE a Bruxelles: ufficializzato l'accordo* (Website of Corriere della Sera, Esteri, 25 Novembre 2018).

[216] *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 on 25 November 2018:* https://www.gov.uk/government/publications/withdrawal-agreement-and-political-declaration, Part Four, pp.195-208.

the EU institutions and governance structures, such as the European Parliament; on the other hand instead, any change to the law of the European Union during this period will automatically be applicable to the United Kingdom. It will be also bound by international agreements the EU enters into during the here considered period[217].
Article 132 concludes the set of provisions about the transitional period stating that *"Notwithstanding Article 126, the Joint Committee may, before 1 July 2020, adopt a single decision extending the transition period for up to one or two years."*[218].
The Withdrawal Agreement sets out other key terms of the UK's withdrawal from the EU, among which the most discussed are: citizen's rights and the Irish border issues. Given that the objective of this thesis is to analyze the contact points between the consequences of Brexit process and the European Union's fundamental freedom of free movement of capital, the above mentioned key issues will be discussed briefly.
Discussing the subject of citizen's rights, the deal aims at the safeguarding of the rights for more than 3 million EU citizens in the UK, and over 1 million UK nationals in EU countries to stay and continue their current activities. Moreover, all those arriving to live in the UK at any point up until the end of the transition period, which could last until the end of 2022 should it be extended, will enjoy the rights that EU nationals have today to make Britain their home, to live, work and study[219].
Considering the topic of the Irish border, it has been the most and still discussed issue of the Agreement. the core of the solution is the so-called backstop, an insurance plan that kicks in if future trade talks fail to avoid a hard border on the island of Ireland. The backstop means the whole of the UK will remain in the EU customs union, while Northern Ireland will have to follow single market rules[220].
Instead, as long as Financial Services are concerned, it is worth to point out that The Withdrawal Agreement makes no specific provision for financial services. It does provide, however, that when the transition period will come to an end, the UK will no longer have access to EU networks, information systems and databases. The only one element of connection with the EU, as long as the financial services sector is concerned, will be the link to financial authorities of the Union through the

[217] Ibidem.
[218] Ibidem.
[219] Ibidem, Part Two, pp.15-67.
[220] Ibidem, Additional Protocol on Ireland/Northern Ireland, pp.301-473.

databases of the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), unless special provision is made for such access in the future arrangements post-Brexit[221].

In addition to that, other more general financial provisions, which are contained in the Withdrawal Agreement, dispose that the United Kingdom shall contribute and participate in the implementation of the Union budgets for the years 2019 and 2020, in accordance with part four of the Agreement[222]. Article 137[223] then adds that *"In accordance with Part Four, the Union programmes and activities committed under the multiannual financial framework for the years 2014-2020 ("MFF[224] 2014-2020") or previous financial perspectives shall be implemented in 2019 and 2020 with regard to the United Kingdom on the basis of the applicable Union law."*.

According to the *divorce bill* then, calculated on the basis of the above mentioned provisions, the UK would stump up about £39bn (in euros approximatively 50 billions), to cover its contribution to the EU budget until 2020, and accumulated other outstanding commitments such as pensions for EU officials[225].

More detailed provision about financial services are instead included in the Political Declaration[226] on the future relationship between the United Kingdom and the European Union. The second document endorsed by the European Council on the

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[221] M. McKee, *Financial Services Implications of Brexit Withdrawal Agreement* (DLA Piper, Global Finance Updates, 16 November 2018).

[222] *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 on 25 November 2018,* cit., Part Five, Art.135, p.211.

[223] Ibidem,Art.137, p.217.

[224] The "Multiannual Financial Framework" (MFF) provides a stable basis for implementing the budget over a period of at least five years. The MFF allows the EU to carry out common policies over a period that is long enough to make them effective and to complement national budgets, by funding policies with an European value added. This long term vision is important for potential beneficiaries of EU funds, co-financing authorities as well as national treasuries. The current MFF covers 2014-2020 and allows the EU to invest around €1 trillion over that period. It provides a framework for financial programming and budgetary discipline by ensuring that EU spending is predictable and stays within the agreed limits. By defining in which areas the EU should invest more or less over the seven years, the MFF is an expression of political priorities as much as a budgetary planning tool. The annual budget is adopted within this framework and usually remains below the MFF expenditure ceilings in order to retain some flexibility to cope with unforeseen needs. Proposed by the European Commission, the regulation laying down the MFF must be adopted by the Council by unanimity after obtaining the consent of the European Parliament.
http://ec.europa.eu/budget/mff/index2014-2020_en.cfm

[225] D. Boffey and J. Rankin, *Brexit deal explained: backstops, trade and citizens' rights* (The Guardian, Brexit, 25 November 2018).

[226] *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom: https://www.gov.uk/government/publications/withdrawal-agreement-and-political-declaration*

25 of November 2018 does not have legal force, but it politically binds both sides to some basic parameters in the future talks. If the text of the Withdrawal Agreement makes no specific reference in relation to financial services, the Political Declaration, clarifies that the UK will have access to the EU market, and vice versa, under an *equivalence* regime. This means that the usual equivalence assessment process will need to be undertaken for UK firms in the EU market and the UK will have its own similar equivalence process for the EU, as it will be discussed more in depth in the second paragraph of this chapter.

1.2 The correlated Political Declaration

As a starting point, it is necessary to consider that in the Political Declaration which has been endorsed together with the Withdrawal Agreement seems capable of creating a new kind of relationship between the European Union and the United Kingdom, since there is no comparable example of a Member State leaving the Union. In addition to that then, it should be recalled that in the *White Paper* published in July 2018 the UK government was claiming for a relationship based on *a number of separate agreements*, while the European Parliament answered that an appropriate framework for the future relationship between UK and EU could be provided by an *association agreement*[227].

The official text of the Political Declaration indeed, makes reference to a new example of juridical relationship between the United Kingdom and the European Union: it talks about an *economic partnership*: *"In this spirit, this declaration establishes the parameters of an ambitious, broad, deep and flexible partnership across trade and economic cooperation, law enforcement and criminal justice, foreign policy, security and defence and wider areas of cooperation. [...] This relationship will be rooted in the values and interests that the Union and the United Kingdom share."*[228]. It then continues that the future relationship shall be based on a balance of rights and obligations, in accordance with principles of each party; for example, in Paragraph 4 of that document it is specified that the mentioned balance must ensure the autonomy of the Union in its decision making process and must be

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[227] Practical Law, *Brexit: future UK-EU relationship* (Thomson Reuters, 2018), p.5

[228] *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*, cit., para.3, p.1.

consistent with its principles, among which the integrity of the Single Market and the indivisibility of the four fundamental freedoms play a key role. Moreover the parties, relying on a 45-years relationship based on trading and investment, are called to develop a *wide-ranging and balanced economic partnership*, ensuring a *level playing field* for open and fair competition: this means that the United Kingdom and the European Union should guarantee the prevention of any unfair competitive advantage that one or both of the Parties (in particular the UK) could gain by undercutting levels of protection in specific policy areas[229].
Shifting the focus on free movement of capital then, it is worth to mention that, as long as capital movements and payments in the specific are concerned, the newly devised legal regime based on the economic partnership explicitly provides for both the Parties to *"include provisions to enable free movement of capital and payments related to transactions liberalized under the economic partnership, subject to relevant exceptions."*[230].
On the other hand, considering another issue related to free movement of capital, namely the regulation of financial services, the Declaration emphasizes that both the UK and the EU need to ensure that financial stability, market integrity, investor protection and fair competition are preserved. However, it also clarifies that they will do so while respecting the Parties' regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest[231]. It is also specified that the UK and the EU will be able to adopt or maintain any measure where necessary for prudential reasons. The Declaration also urges both parties to initiate equivalence assessments as soon as possible aiming to conclude these assessments before the end of June 2020, immediately after encouraging a "*close and structured cooperation on regulatory and supervisory matters, grounded in the economic partnership and based on the principles of regulatory autonomy, transparency and stability"*[232].
Eventually, even if all these assumptions seem to be encouraging in the perspective of a future economic relationship that will not eradicate completely the UK from the Union's capital movements and financial sector, it is essential to bear in mind

[229] Practical Law, *Brexit: UK-EU economic partnership* (Thomson Reuters, 2018), p.17.
[230] *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*, cit., para.43, p.9.
[231] Ibidem, para.37, p.8.
[232] Ibidem, para.38-39, pp.8-9.

that this Political Declaration, as previously pointed out, is not a Treaty and consequently it shall not be ratified and it is not binding. In this context then, any change in the political lines of the United Kingdom or the European Union could cause crucial amendments or, in the worst case, the decision to put that political document aside.

Moreover, now it is considered worth to mention what the European Union and the United Kingdom have agreed about this topic, having decided to put it in the above mentioned document; the discussion about the consequences related to the applicability and the concretization of those provision is postponed to a further analysis.

1.3 The question about the future legal relationship between UK and EU

In the previous section the Withdrawal Agreement and the Political Declaration proposed by the United Kingdom and endorsed by the European Union have been discussed and analyzed, especially in the perspective of the consequences on the free movement of capital and on the financial services in the specific. In those documents, the UK and the EU demonstrate to have found an agreement on the shape of the future juridical and economic relationship that will bind them after the withdrawal of the United Kingdom from the Union. Therefore, according to the Agreement, the EU membership will be substituted by a *partnership*: this is something completely new as there have been no previous cases of Member States withdrawing from the European Union, and according to what set out in the Withdrawal Agreement, it seems most likely that the UK would need to form with the EU and other Member States a form of cooperation completely different from existing models[233]. As previously analyzed then, the economic partnership that both the United Kingdom and the European Union are willing to establish will be based on a free trade area for goods and a new economic and regulatory arrangement as long as financial services are concerned.

However, it is essential to this work to recall that the British Parliament's vote on the Withdrawal Agreement which took place on the 15th of January 2019 came out

[233] L. Fergusson, *Britain's relationship with Europe: what might the future look like?* (Practical Law UK, Thomson Reuters, 2018), p.3.

with a rejection of the proposed Agreement. This result is to be considered carefully, because the Prime Minister Theresa May is supposed to present to the Parliament a second and updated version of the Withdrawing Agreement, with the hope that it will be accepted the British MPs. Brexiteer MPs have called on the Prime Minister to simply walk away from the negotiations and embrace a *no deal* scenario, but she seems determined to somehow push through the Withdrawal Agreement. Meanwhile, the European Union says it is now solely up to Prime Minister May and MPs to agree on a counter-proposal to the Brexit deal they rejected, with negotiations only reopening once this is achieved[234].

In this intricate context, British MPs are proposing amendments to the Withdrawal Agreement every day, and it is highly likely that the Agreement will not be adopted in the version it has been endorsed by the institutions of the European Union. It is also possible that the second version of Withdrawal Agreement will be stuck in development without being published at all.

Taking into account the present status of the Brexit process, it results worth and coherent to the objective of this thesis to discuss the outcomes which are considered as alternative plausible scenarios.

If the British Parliament will not approve any Agreement to withdraw from the European Union, the United Kingdom could look to a number of other models on which to develop and build a new relationship with the EU.

1.4 The example of already existing models

A first model which could be seen as a source of inspiration is the European Economic Area (EEA)[235], which encompasses the European Union, Norway, Iceland and Liechtenstein. As mentioned in the previous chapter, the British government has already made explicit the intention to leave the EEA (which

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[234] J. Rothwell, *What is Theresa May's Brexit Plan B and when will Parliament vote on it?* (The Telegraph, 26 January 2019).

[235] The Agreement on the European Economic Area, which entered into force on 1 January 1994, brings together the EU Member States and the three EEA EFTA States — Iceland, Liechtenstein and Norway — in a single market, referred to as the "Internal Market". The European Economic Area (EEA) unites the EU Member States and the three EEA EFTA States into this Internal Market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.

encompasses also the United Kingdom as a member of the European Union), but this fact does not prevent the two protagonists of the Brexit process from taking a leaf from this peculiar juridical relationship. At the present time then, the EEA enables the members of the EFTA[236](Norway, Iceland and Liechtenstein) to enjoy the benefits of the EU Single Market and the related four fundamental freedoms, namely the free movement of goods, people, services and establishment, capital; however, being a member of the EEA entails that the above mentioned States do not enjoy the full privileges and responsibilities of EU membership. Furthermore, the members of the EEA which at the same time do not take part in the European Union are supposed and required to adopt much of EU law and contribute to the budget of the Union, but do not have voting powers or formal access to the decision making process.

Another example of juridical relationship that could be seen as an example to build on the new *partnership* between the United Kingdom and the European Union is the Swiss model. Switzerland has concluded a large number of bilateral agreements with the EU to give it access to the Single Market[237]; those agreements though, provide only for the free movement of goods and people. In relation to this, Swiss goods must meet EU regulatory requirements and Swiss law must be considered *equivalent*[238] to corresponding relevant EU legislation. A peculiar aspect of this relationship then, is that at the present time the Swiss financial contribution to the budget of the Union is much lower than that of the non-EU EEA member states, and this has moved the EU institutions to conclude that the actual model is no longer viable and a new framework agreement along the lines of the EEA agreement will need to be discussed in the future[239].

Having described the Swiss model though, it should be recalled that the European Parliament has repeatedly emphasized that the future relationship could be characterized by an association agreement, which would allow for varying degrees of cooperation across the various policy areas and, consequently, would avoid *"a*

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[236] The European Free Trade Association (EFTA) is the intergovernmental organization of Iceland, Liechtenstein, Norway and Switzerland. It was set up in 1960 by its then seven Member States for the promotion of free trade and economic integration between its members.
[237] T. Stephens, *Would the Swiss model suit a post-Brexit Britain?* (Swissinfo, March 2018).
[238] See the next paragraph for the functioning of the *equivalence* mechanism.
[239] L. Fergusson, *Britain's relationship with Europe: what might the future look like?*, cit., p.5.

proliferation of bilateral agreements and the shortcomings which characterize the European Union's relationship with Switzerland."[240].

A third model of inspiration for a future relationship for the European Union and the United Kingdom is the agreement between the EU and Turkey: the latter, which started its accession process to the EU more than ten years ago[241], is part of a customs union with the EU which allows for tariff-free access without quotas to the internal market for goods only, not for services. Turkey has, to a large extent, control of its own trade policy and it is not bound by EU law as long as free movement of persons is concerned. However, Turkey is required to harmonize its laws with those of the Union in subjects which have been specifically decided by both parties.

Moreover, a viable hypothesis could be the signing of standalone free trade agreements with the EU. In fact, a many countries as Singapore and Canada for example, have those model of standalone agreements with the European Union. However, the ability to export services, in particular financial services may not be easily achieved through a simple and only free trade agreement: in addition to that, these types of agreements indeed, tend to be designed for free trade in goods and not in services. Thus, the model at stake would be capable of bringing more disadvantages than advantages to the United Kingdom, which is a significant exporter of services in general, and financial services specifically speaking[242].

Eventually, having regard of all the above mentioned options, the model which seems similar and suitable the most for the future relationship between the United Kingdom and the European Union, is the European Economic Area (EEA)'s one: this is also because it looks like it presents much more similarities with the *economic partnership's* model presented in the Withdrawal Agreement and Political Declaration than the other described options. In fact, relying upon the characteristics of the peculiar juridical relationship existing between the EEA's member States and the European Union, this model would allow the UK to benefit from the four fundamental freedoms which arise from the EU and consequently the

[240] European Parliament, *Resolution on the framework of future EU-UK relationship* (Brussels, March 2018).
[241] U. Cevikoz, *EU-Turkish relations: the beginning of the end?* (European Council on Foreign Relations, September 2017).
[242] L. Fergusson, *Britain's relationship with Europe: what might the future look like?,* cit., p.5.

Single Market's membership; on the other hand though, the United Kingdom will have to contribute to the Union budget and adopt much of the EU law.
This is in broad terms what constitutes the core of the two documents endorsed by EU institutions in November 2018, with the difference that from the Withdrawal Agreement it appears that after the transitional period EU law will not apply to the United Kingdom anymore. Instead, in specific fields (as for example in the one of financial services), the United Kingdom will guarantee the maintaining of an *equivalent* legal regime.

1.5 The hypothesis of a *No-Deal* scenario

Unfortunately, it is also possible that the two parties will not find a compromise before the deadline foreseen for the 29th of March 2019. If the *No-Deal* scenario will materialize, it should be recalled that the relationship between the United Kingdom and the European Union will not be left without a juridical relationship and a legal framework: in the absence of any agreement, the relation between the parties will be governed by the international law and, in particular, by the legal framework of the World Trade Organization[243].
As long as the functioning of the WTO legal regime is concerned, it is important to understand that every member State of the World Trade Organization has a list of tariffs, which are the taxes on imports of goods, and quotas, which are the limits on the number of goods, that they apply to other countries.
The United Kingdom is already a Member of the World Trade Organization and it already does trade with many countries on the basis of those international law rules, as for example the United States, China, Brazil and Australia[244] ; however, the UK is part of this international law regime not on its own, but as a member state of the

[243] The World Trade Organization (WTO) is the only international organization dealing with the global rules of trade. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. The WTO was officially founded on 1 January 1995 under the Marrakesh Agreement, signed by 124 nations on 15 April 1994, replacing the General Agreement of Tariffs and Trades(GATT), which commenced in 1948. It is the largest international economic organization in the world. At the heart of the system – known as the multilateral trading system – are the WTO's agreements, negotiated and signed by a large majority of the world's trading economies, and ratified in their parliaments. These agreements are the legal foundations for global trade. Essentially, they are contracts, guaranteeing WTO members important trade rights. They also bind governments to keep their trade policies transparent and predictable which is to everybody's benefit.
[244] C. Morris, *Brexit: What is the 'no deal' WTO option?* (BBC News, August 2018).

European Union, which acts on its behalf at the WTO level. In this situation, one could easily think that the United Kingdom could continue to apply that legal framework on its own once it has left the EU, but the situation is more intricate:
"Current EU WTO tariffs will automatically apply to products and goods exported between Ireland and the UK. Changes to the current agreement will only be made by a) reducing a tariff rate charged by the UK on imports from all WTO member countries which will not require negotiation with the WTO membership or b) full renegotiation of all tariffs under WTO rules with all WTO members including Ireland."[245].

Furthermore, in addition to that, the relationship between the Union and the above mentioned non-Member States (USA, China, Brazil, Australia and others) does not rely solely upon the WTO rules; those big economies have stipulated also a series of bilateral agreement with the EU to regulate specific areas as trade and services (the United States for example, has at least 20 agreements[246] with the European Union which cover almost everything in trade relationships, from goods like wine and bananas to insurance and energy-efficiency labelling).

Since the Union has exclusive competence in the area of trade policy, the existing agreements stipulated with third countries by the EU results as entered into as a block rather than by the individual Member States. Consequently, the United Kingdom will not automatically continue to be part of those agreement after its withdrawal from the EU, unless the parties agree a different solution.

Any new agreement which the UK could be willing to stipulate then, would require separate negotiations with the relevant countries and the United Kingdom alone may not have the same negotiating power as the European Union, which represent a much larger market[247].

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[245] *Brexit, WTO Tariff Briefing Document* (Enterprise Ireland):https://www.prepareforbrexit.com/wp-content/uploads/2018/01/Brexit-WTO-Tariff-Briefing-Final-Version-2.pdf

[246] List of Treaties by Country, United States of America (Treaties Office Database, European Union External Action Service): http://ec.europa.eu/world/agreements/searchByCountryAndContinent.do?countryId=6063&countryName=United States of America&countryFlag=treaties

[247] L. Fergusson, *Britain's relationship with Europe: what might the future look like?,* cit., p.3.

A number of recent articles by supporters of Brexit have made reference to the WTO's Trade Facilitation Agreement (TFA)[248], which came into force in 2017, arguing that it obliges the EU to treat the UK fairly[249]. However, it is argued that the TFA is aimed primarily at less developed countries and it seeks to encourage transparency and streamline bureaucratic procedures. It does mean the EU cannot discriminate against the UK but it does not mean the UK can expect to be treated in the same way that it is now. As a direct consequence of this, the United Kingdom would be treated like any other third country, and in the absence of any trade agreement, that means tariffs and border checks.

Eventually then, if the *No-Deal* scenario will take place, and if the United Kingdom and the European Union will not reach an agreement for any other future relationship model, the World Trade Organization legal regime will automatically govern the relation of the two parties: the UK would control its own trade policy, it would not have to allow for free movement of persons and would not need to contribute to the EU budget. Nevertheless, British exports to the Union would face tariffs and exporters will be required to meet EU standards. In addition to that, it should be mentioned that the WTO arrangements are also of less benefit in the area of services and financial services, this being a concrete disadvantage for the United Kingdom future relationship with Europe.

Having regard of this complicated situation, both the timing and terms of future the arrangements that might be achieved are difficult to predict.

2. Consequences of Brexit for the Free Movement of Capital

The Free movement of capital is one of the key elements in the EU single market, and is enshrined in the Treaty of Maastricht. With the entry into force of this treaty in 1994 all restrictions on capital movements and payments across borders were prohibited. The aim of liberalization is to enable integrated, open, and efficient European financial markets[250]. Even if it has already been discussed in previous chapters, it is important to recall that, even though the Treaty on the Functioning of

[248] World Trade Organization, *Trade Facilitation Agreement*: https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm

[249] C. Morris, *Brexit: What is the 'no deal' WTO option?*, cit.

[250] European Commission Website, *Capital Movements*: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/capital-movements_en

the European Union provides for the liberalization of capital movements performed within the Union and between third countries, the Treaty does not define the term *capital movements*. The Court of Justice of the European Union instead, clarified that the definitions included in the above mentioned Directive 88/361 EEC can be use in order to define the term. Between the various definitions, capital movements are supposed to include Foreign Direct Investments (FDI), real estate and securities investments and other economic operations with financial institutions[251].

According to the European Parliament, *"the free movement of capital underpins the single market and complements the other three freedoms. It also contributes to economic growth by enabling capital to be invested efficiently and promotes the use of the euro as an international currency, thus contributing to the EU's role as a global player. It was also indispensable for the development of Economic and Monetary Union (EMU) and the introduction of the euro."*. It has also pointed out that capital liberalization should be backed up by full liberalization of financial services and the harmonization of tax law in order to create a unified European financial market[252].

The role and the functions of the fourth between the fundamental freedoms which characterize Single Market of the Union then, have been here recalled in order to better understand the magnitude and the importance of such an exceptional event as the withdrawal of the United Kingdom from the European Union is.

In the perspective of the free movement of capital, it will be analyzed the impact that Brexit will have on foreign direct investments in the EU Internal Market dynamics. Afterward then, the subsequent section will focus on the consequences within the specific field of financial services, considered also that in the above mentioned Political Declaration it has been explicitly agreed by the United Kingdom and the European Union that the UK will adopt an *equivalence* regime as this branch of free movement capital is concerned.

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[251] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A31988L0361

[252] D.Rakic, *Fact sheet on Free Movement of Capital* (European Parliament, October 2018), p.4: http://www.europarl.europa.eu/ftu/pdf/en/FTU_2.1.3.pdf

2.1 The traditional central position of the United Kingdom in European financial markets and the consequent impact of Brexit on capitals and investments allocation

It has already been reported that the Withdrawal Agreement created by the United Kingdom and the European Union Institutions has failed to receive the approval of the British Parliament, even though it had been previously endorsed by the Union. This outcome makes the terms and the time of the withdrawal even more uncertain and this aspect present significant implication as long as the legal relationship and the consequent legal framework between UK and EU is concerned. At the present time, the hypothesis of the absence of an agreement, with the consequence result of a *No-Deal* Brexit, is more plausible than ever.
The *No-Deal* scenario though, as it has been considered in the previous paragraph, will probably cause the exclusion of the United Kingdom from the Single Market of the European Union, with the consequent inapplicability of the legal regime set out by the four fundamental freedoms, free movement of capital included as well.
The applicability of the legal framework provided for by the international law rules of the World Trade Organization, will cause significant difficulties in the outline of the legal regime applicable to capital movements, considered that the United Kingdom will have to be considered as a third party in dealing with economic operations and capital movements with the European Union.
Bearing in mind that Article 63 of the TFEU still encompasses a prohibition to any kind of restriction in capital movements not only within the EU, but also between the EU and third countries, this aspect does not exclude that the exclusion of the UK from the Single Market would cause a reallocation of foreign direct investments (FDI) because of the higher tariffs provided for by the international law rules.
In this situation, the other Member States of the European Union will have more chances to attract investments from countries which are interested in investing within the territory of the Union[253], but Brexit could also present elements of concern for the financial future of the European Union.

[253] T.Buccellato and P.Mambriani, *Brexit, tempi e modalità di uscita più incerti. Quali conseguenze per le imprese italiane (ed europee)?* (Centro Studi Confindustria, 16 January 2019), p.2.

Experts in the field of capital circulation are persuaded that it will be dangerous for the European companies and consumers if London's market will not be easily accessible anymore: finding a new financial centre for the European Union will not be easy, and a study by Boston Consulting Group reveals that the cost of setting up new European outpost to retain the access to the Single Market will rise for investment banks between 8 and 22 percent[254].

If Brexit happens with little provision for London's financial services, banks, funds and insurers settled in the City will lose their ability to sell many of their services to European companies: *"UK-based financial firms are trying to shift some of their operations to Europe to ensure they can still work for EU clients, but warn such a rearrangement of the region's financial architecture could threaten economic stability not only in Britain but also in Europe because so much European money flows through London."*[255]

Taking into account macro-economic considerations, Britain alone accounts for 5.4 percent of global stock markets by value (according to Reuters data), and it can somehow be considered as the European investment Bank, as a large part of the obligation issued within the European Union involves financial institutions based in the United Kingdom[256]. London's dominance as a financial centre has been built up over decades and would be very hard to replicate.

Nevertheless, the Brexit process is expected to generate economic problems to the United Kingdom as well, especially in the field of capital movement operations such as Foreign Direct Investments. Investments are one of the most important sources of long-term Gross Domestic Product (GDP) growth and all kinds of investments in general are capable of stimulating benefits and development of national economies. Instead, in the specific, *"Foreign Direct Investment (FDI) contributes directly to national income, providing firms with additional funds to invest in expanding their businesses. It also can help raise productivity by giving companies access to new ideas from abroad."*[257]. The UK is one of the biggest

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[254] S. Lewis, *Bridging to Brexit: Insights from the European SMEs, Corporates and Investors* (Boston Consulting Group, July 2017).

[255] A. Davies, H. Jones and A. MacAskill, *How Brexit is set to hurt Europe's financial systems* (Reuters, July 2017).

[256] T.Buccellato and P.Mambriani, *Brexit, tempi e modalità di uscita più incerti. Quali conseguenze per le imprese italiane (ed europee)?,* cit., p.6.

[257] G. Tetlow and A. Stojanovic, *Understanding the economic impact of Brexit* (UK Institute for Government, October 2018), pp.14-15.

recipients of FDI among major advanced economies. About two fifths (42.6%, as of January 2018) of foreign investment in the UK comes from other EU countries. Leaving the EU could affect the UK's attractiveness to foreign investors. There are at least three reasons why FDI into the UK might have been boosted by being a member of the EU – and thus why it could be reduced as a result of Brexit: a first reason is that being part of the Internal Market of the European Union would allow the United Kingdom to continue to benefit from the free movement of capital, which has made it easier for investors from other EU Member States to invest in the UK; a second reason is that acting within the boundaries of the Single Market makes it easier for any Member State to be an attractive platform for investments of foreign multinationals and this is particularly true for the UK's active business environment, which would continue to gain significative benefits and advantages; a third advantage which the UK could retain from being part of the Single Market of the Union is that EU internal policies and mechanisms are able to reduce co-ordination costs for the companies, especially multinational with complex supply chain, that have the objective of investing in the European Union[258].

However, in the perspective of a *No*-Deal Brexit, exiting free trade agreements stipulated by the United Kingdom do not seem to go as far in reducing barriers to cross-border investment or facilitating the movement of services and capital as the Single Market, with its four fundamental freedom has been doing until now. In this intricate scenario then, the other European Union Member States are also capable of gaining an advantage from the withdrawal of the UK from the EU. Even though in the short term it results difficult that existing investments and productive activities will be dismantled from London, in the long term it is plausible that new foreign direct investments will not be created and the existing ones will not be stimulated anymore, being penalized from the great uncertainty that characterizes the future relationship between the United Kingdom and the European Union. In this context then, experts are persuaded that new investment opportunities could be exploited by the Member States which are capable to act within the boundaries of the Internal Market of the Union. However, this result is expected to be achieved in the long term, being the short term conditions of the Brexit process in general extremely difficult to be predicted. Nevertheless, experts estimate that in 10 years

[258] Ibidem.

the amount of foreign direct investments in the United Kingdom will face a reduction of 22%, with an equivalent loss of investment of 282 billions of euros which could be reallocated in other Member States of the European Union[259].

For instance, according to a research of the Centro Studi Confindustria, Italy could be, at least in theory, one of the Member State capable of gain advantage from that reallocation of capital previously invested in the City. In fact, Italy has good chances because the national sectors with the highest concentration of foreign capital investments are the same sectors to which the United Kingdom results to distribute its FDI the most. The Brexit effect then, could determine an increase of FDI for Italy of 26 billions of euros, with a consequent increase of the national added value of 5,9 billions of euros (the 0,4% of the Italian Gross Domestic Product)[260].

Nevertheless, the situation is still fluid and it is highly likely that it will soon face new developments, with a consequent change in the estimated legal and economic consequences. Thus, it has been considered relevant for the objective of this thesis to discuss also what will be the situation of financial services if the Withdrawal Agreement and the Political Declaration enacted by the United Kingdom and endorsed by the European Union will be accepted by the British Parliament and consequently put into force.

2.2 Brexit's impact on Financial Services: some considerations on the regulatory aspects

In the previous chapter it has been discussed the possibility of a reallocation of capital and Foreign Direct Investment in the circumstance of the United Kingdom withdrawing from the European Union without an agreement regulating that issue. Instead, in this section the discussion will be focused on the specific field of financial services, considered that in the above mentioned Withdrawal Agreement and Political Declaration it has been provided that the United Kingdom will guarantee the application of an *equivalent* legal regime as long as financial services are concerned.

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[259] T.Buccellato and P.Mambriani, *Brexit, tempi e modalità di uscita più incerti. Quali conseguenze per le imprese italiane (ed europee)?,* p.8.
[260] Ibidem.

In the first paragraph of this chapter then, it has been analyzed that the Withdrawal Agreement do not dedicate much space to the regulation of financial services as the attached Political Declaration does. In this document it is proposed an economic and legal arrangement with the EU which will have the form of an economic partnership. As long as financial services are concerned in the specific, this arrangement would be based on the principle of autonomy for each party on decisions relating to access to its market, with a bilateral framework of treaty-based commitments[261]: *"The Parties are committed to preserving financial stability, market integrity, investor and consumer protection and fair competition, while respecting the Parties' regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest. This is without prejudice to the Parties' ability to adopt or maintain any measure where necessary for prudential reasons. The Parties agree to engage in close cooperation on regulatory and supervisory matters in international bodies."*[262]. Moreover, the Political Declaration continues stating that there should be reciprocal recognition of *equivalence* between the United Kingdom and the European Union under all existing third countries regimes, that takes effect at the end of the transition period: *"both Parties will have equivalence frameworks in place that allow them to declare a third country's regulatory and supervisory regimes equivalent for relevant purposes, the Parties should start assessing equivalence with respect to each other under these frameworks as soon as possible after the United Kingdom's withdrawal"*, with the aim of concluding the assessments before the end of June 2020[263]. However, even if such a compromise agreed by the parties could be seen as a clever solution, it is crucial to bear in mind that this arrangement will not replicate the passporting regime the European Union provides in the field of financial services. This passporting regime is considered as an essential feature of the Single Market as long as financial services are concerned, and losing it would have important consequences not only for the United Kingdom.

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[261] Practical Law, *Brexit: government publishes white paper on future UK-EU relationship*, cit., p.6.
[262] *Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom*, cit., para 37, p.8.
[263] Ibidem.

"UK investment firms will no longer benefit from the MiFID[264] authorization to provide MiFID investment services and activities in the Union (they will lose the so-called "EU passport") and will be third-country firms. This means that those investment firms will no longer be allowed to provide services in the EU on the basis of their current authorizations."[265]. This means that the benefit of the MiFID passport will therefore be limited to investment firms established in the EU having obtained a MiFID authorization in accordance with the authorization and substance requirements set out in the MiFID framework. In fact, it is not just UK banks that enjoy this freedom in providing financial services within the Union, by also foreign financial firms based in the United Kingdom. This means that an American bank with a subsidiary in the City at the present time can currently sell services across the EU as if it were a European financial company itself, but after the Brexit's transitional period this will not be any longer possible[266]. According to this aspect then, experts are persuaded that the existing equivalence framework should be expanded to encompass a broader range of cross-border activities, presumably in the perspective to include activities such as banking that are not currently covered by existing EU equivalence regimes[267].

Having regard of what above considered, it results essential for the objective of this thesis to briefly consider what is the already mentioned *equivalence* regime of the European Union and how it will works, especially in the field of financial services.

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[264] The Markets in Financial Instruments Directive 2004/39/EC (known as MiFID) is a source of EU law that provided harmonization regulation for investment services across the 31 member States of the European Economic Area. The directive's main objectives are to increase competition and investor protection in investment services. The 1st November 2007 it has replaced the Investment Services Directive (ISD).
On 20 October 2011, the European Commission adopted formal proposals for a "Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council" (MiFID II Directive), and for a "Regulation on markets in financial instruments (MiFIR)", which would also amend the proposed European Market Infrastructure Regulation (EMIR) on OTC derivatives, central counterparties and trade repositories.
The MiFID II legislative package, consisting of a directive (the MiFID II Directive) and a regulation, the Markets in Financial Instruments Regulation (MiFIR), together with delegated legislation, will replace the existing Markets in Financial Instruments Directive (MIFID I). Both MiFID II and MiFIR entered into force on 2 July 2014.

[265] European Commission, *Notice to Stakeholders- Withdrawal of the United Kingdom and EU rules in the field of Markets in Financial Instrument* (Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Brussels, 2018), p.2: https://ec.europa.eu/info/sites/info/files/file_import/financial_instruments_en.pdf

[266] B. Chu, *Brexit: What does Britain losing its EU 'passporting' rights mean for banks and how will it affect the economy?* (The Independet, Business Analysis & Features, November 2017).

[267] Practical Law, *Brexit: government publishes white paper on future UK-EU relationship*, cit., p.6.

If the Brexit process will not be upset by surprising changes, at the end of the agreed transitional period the United Kingdom will no longer be part of the European Union, and it will consequently be considered as a third country. In this way it will be available the application to the field of financial services of the equivalence regime, which has already been set by the EU in other fields of sectorial legislation. Starting from this premise, it is worth mentioning that in certain circumstances the European Union provides for the recognition of non-EU regulatory frameworks, and this is thanks to its *equivalence* mechanism[268]. According to EU Institutions, this recognition of foreign legal frameworks is capable of bringing benefits to both parties, because, for instance, it makes certain services, products or activities of non-EU companies acceptable for regulatory purposes; furthermore, it reduces or even eliminates overlaps in compliance requirements for both European Union and foreign market players, and it brings many other benefits.

As long as the *equivalence* mechanism in the specific is concerned, it should be recalled that most of EU laws on financial regulation adopted in recent years include provisions that make it possible for the Commission to adopt equivalent decision[269]. In practice, the European Commission is required to assess and evaluate the legal framework of a certain non-EU country, and consequently decide if it is capable of provide for a legal regime which should be considered equivalent. To receive the qualification of *equivalent*, a certain non-EU legal framework: first of all, it has to present legally binding requirements, being characterized by mandatory provisions; secondly, there must be appropriate supervision authorities that ensure it effective application; thirdly, but not less important, the assessed non-EU legal framework must be considered capable of achieving the same result as the corresponding rules of European Union law. The Commission usually carries out these assessments on the basis of technical advice from the European supervisory authorities, and once the technical assessment is complete and all technical criteria are satisfied, the Commission can formally adopt an equivalence decision.

Here it results worth to recall that, according to the above mentioned Political Declaration, both the United Kingdom and the European Union have agreed that

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[268] European Commission, *Recognition of non-EU financial frameworks (equivalence decisions)* (European Commission Website): https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en
[269] Ibidem.

they should endeavor to conclude the above mentioned *equivalence assessment* before the end of June 2020.

At the present time, the sector of financial services is one of the most intensely regulated of the modern economy and the governance of the UK financial sector is no different from the financial governance arrangements of others major economies in the world and in Europe. However, although the UK financial market is different from the one of the other 27 Member States of the European Union, being significantly larger and hosting the deepest and wholesale market[270], many of the rules regulating the UK market are set by the EU, which is increasingly deciding how supervision in the sector of financial services should be carried out[271].

According to Moloney then, the UK financial governance will experience changes after Brexit, mostly in order to ensuring EU supervisory coordination and cooperation arrangements which support the UK regulators are replicated. The UK has shaped much of EU financial regulation in its image, and this is one of the aspect which suggest that there are several friction obstructing a process of deregulation. At the present time the United Kingdom hosts more or less 35% of the wholesale financial activities provided in the European Union, and it is essential to the liquidity, stability and efficiency of the EU financial system[272].

The major part of the uncertainty relates to the competitive position of the financial market in the case of a *No-Deal* hard Brexit. That post-Brexit scenario though, without a concrete agreement, is likely to be characterized by the material deterioration of UK's dominant position as a major global financial centre[273]: therefore, the hope of UK's financial market operators is that EU financial institutions will keep their actual presence in London, or may even open a new one. To support this tendency, the UK regulations continues to offer wide access to their establishment by way of branches, not only for the large international wholesale

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[270] See European Commission, *European Financial Stability and Integration Review* (2017)*:* *https://ec.europa.eu/info/sites/info/files/european-financial-stability-and-integration-review-2017_en.pdf*

[271] N. Moloney, *Extracting the UK from EU Financial Services Governance: regulatory recasting or shadowing from a distance?,* in M. Dougan, *The UK after Brexit: Legal and Policy Challenges* (Intersentia, 2017), p.138.

[272] TheCityUk, *The UK: Europe's Financial Centre* (August 2016): https://www.thecityuk.com/assets/2016/Reports-PDF/f3a8ce24cd/The-UK-Europes-financial-centre.pdf

[273] N. Moloney, *Extracting the UK from EU Financial Services Governance: regulatory recasting or shadowing from a distance?,* cit., p.158.

banks, but also for smaller institutions provided the supervisory regime is equivalent or at least acceptable to the UK authorities. The statements by the UK authorities significantly contrast with the European ones: they are less explicit and do not enter into the details of future access to the UK markets, which will be governed by the UK regulations, initially largely similar to the EU ones[274].

The European Union instead, has adopted a different approach: it is ready to accept the relocation within the boundaries of the Single Market of companies and firms based in the UK[275]. Even though the relocation of firms and the reallocation of capital movements are operations difficult to be performed in the short term, it seems like this could be the only plausible solution if the withdrawal of the United Kingdom from the European Union will take place without a deal.

3. Brexit's impact on the Capital Markets Union project

As Europe emerged in the early 2010s from its worst financial crisis since the 1930s, it sought to protect its economy and financial sector against future shocks. This challenge forced national governments and EU institutions to take extraordinary steps to stabilize their economies and to promote European integration, helping to preserve the integrity of the euro area and its internal market. At the June 2012 European Council meeting, euro-area leaders asked the European Commission and the president of the European Council to issue proposals "to develop a specific and time-bound road map toward a genuine Economic and Monetary Union (EMU)," including greater fiscal and financial integration, to ensure the irreversibility of the EMU. Together with banking union, capital markets union (CMU) is a fundamental step toward completing the EMU architecture.

In the previous chapters it has been stated that the CMU is not the result of a single legislative project, but it consists of a series of different but strictly related initiatives which have the aim to create a single, integrated and well-structured European market for capital which is able to encompass all 28 Member States.

It should be here recalled that the core and main aspect on which the whole project of the Capital Markets Union is structured is the development of capital markets as

[274] E. Wymeersch, *Brexit and the provision of financial services into the EU and into the UK* (European Banking Institute , 2018), p.20.
[275] Ibidem, p. 21.

a financing source alternative to bank lending, usually the principal source of financing chosen by enterprises located in the European Union; this results particularly true for Small and Medium Enterprises (SMEs), which can be considered as the main addressee of the program. It should be added then, that the idea behind the CMU initiative is to simplify the mechanism through which the enterprises and financial operators can attain access to investment and funding. Particularly after the 2007-2008 economic and financial crisis, which was generated from the failure of big worldwide bank institutions, a consequent objective of the Capital Markets Union is to avoid a future collapse of the European and World economic sector, especially in case of a possible new failure of the worldwide credit system.

According to EU Institutions reports, today, European businesses are heavily reliant on banks and this makes the whole economy vulnerable to a tightening of bank lending. Thanks to this Union of capital markets indeed, the access to finance for companies, in particular for SMEs, could be facilitated to the detriment of the traditional bank funding.

CMU is a far-reaching project requiring surrender of national sovereignty and far-reaching changes in national laws. The global financial crisis provided the impetus for the CMU project by revealing the gaps in the euro area's architecture.

According to experts, the key factor for the success of the Capital Markets Union was the United Kingdom. As the undisputed financial centre in Europe, the UK was seen as ready to gain disproportionally from deeper capital markets integration, in a scenario which was considering the UK still as a part of the European Union. Harmonized accounting standards, new securitization and venture capital practices were considered capable of opening up new opportunities for the City of London, even if the British Government repeatedly opposed to any move towards a common EU regulator, for example on auditing firms[276].

However, the results of the 2016 Referendum and the actual uncertainty about the shape the future relationship between the United Kingdom and the European Union will present, make it difficult for experts and institutions as well to predict the future for a project such as the Capital Markets Union. In particular, being so uncertain

[276] U. Marengo, *Avoiding a Brexit will be crucial for the success of Europe's Capital Markets Union* (London School of Economics, Blogs, Brexit, 2016).

how the sector of financial services will be regulated, it would be not so inappropriate to question the whole CMU project, strongly supported by the European Union Institutions.

However, it is to be mentioned that many scholars are persuaded that this project will survive the aftermath of the Brexit process, the remaining Member States being more motivated to develop a single, integrated and well-structured European market for capital: "*There is a strong case for the CMU project to continue with the remaining EU members (the "EU27") after the United Kingdom leaves, as capital market financing represents a lower proportion of total financing in the EU27 than in the United Kingdom, and the need to develop capital markets is correspondingly greater."*[277]. Moreover, The economist Nicolas Véron has even argued that the United Kingdom's departure from the European Union makes it possible to *open a window for a vigorous CMU relaunch,* stating also that Brexit will make it comparatively less difficult to move toward stronger EU-level institutions for capital markets supervision and enforcement — a trend the United Kingdom had opposed[278]. A new opportunity of relaunching CMU's agenda would be focusing on the objective of achieving capital market integration in continental Europe, including EEA countries. Such a project should be viewed as part of the EU long-term agenda, rather than as a short-term expedient to overcome the reluctance of banks to lend and boost investment.

The deepening and integration of the European Union's capital markets is a long-term structural endeavor. Although difficult to achieve, it is worthwhile for several reasons, and the departure from the EU of the United Kingdom, the home to the EU's main capital market centre, makes the project even more relevant. However, if on the one hand the UK's eventual departure from the European Union makes CMU more urgent, it also represents a clear setback in view of the dominance of the City of London as Europe's financial centre. Near term, the Brexit vote appears to have slowed the implementation of the CMU's action plan, as the attention of European institutions has shifted toward managing the future relationship with the United Kingdom. At the current pace, however, the building blocks of CMU are

[277] M. Xafa, *European Capital Markets Union Post-Brexit* (Centre for International Governance Innovation, CIGI Paper n. 140, 2017), p.15.
[278] N.Véron, *Brexit may (counter-intuitively) revive the Capital Markets Union project* (Bloomber, July 2016).

unlikely to be in place by 2019. Priority should be placed on deepening financial market integration, as opposed to helping SMEs access market-based finance, tackling investment shortages and promoting infrastructure investment, green bonds or energy- efficient mortgages. These are valid objectives, but they are not central to the CMU project[279].

A the present time though, a few milestones in the process of building CMU have already been completed and much remains to be done. The CMU agenda must ultimately include the transfer of authority over capital markets regulation and supervision to a pan-European authority, an objective that was not part of the EC's vision largely because of UK opposition.

In this fluid situation of strong uncertainty it is only possible to wait for future development, hoping that the outcomes of the Brexit process will not cause to the leaving aside of the Capital Markets Union project but, instead, the above mentioned outcomes of Brexit will be the occasion for a bright relaunching of the CMU.

[279] M. Xafa, *European Capital Markets Union Post-Brexit,* cit., p.22.

CONCLUSION

In this work attention has been put on some of the rules which govern the Internal Market of the European Union and the consequences of their correlation with the recent phenomenon that has involved not only the United Kingdom, but also the European Union and the whole World: the Brexit.

This phenomenon, which shall be considered as an unexpected step in the European Union integration process, has been attracting the attention of the national and international institutions, governments and media from all over the Europe, and not only, all concentrated on understanding the impact it will have on the international situation.

In the case of this thesis then, the objective has been to restrict the focus and the attention of the discourse on a more precise aspect and its related consequences. The discussion which has been pursued during all the chapters of this work indeed, aims to a specific and clear scenario: present the European Union law Internal Market legal framework which safeguards the free movement of capital not only within the boundaries of the Single Market, but also in operations which involve the Member States Union and third countries, and consequently discuss which consequences is the Brexit process capable of causing to the free flowing of capital. The idea which inspired this work then, has been the intention to understand how the European Union and the United Kingdom would have dealt with the exclusion from the Internal Market and its consequential rights, obligation and benefits, of a strategical and vital point such as London is for the Union from the perspective of free movement of capital. The withdrawal of the United Kingdom from the European Union indeed, means on the one hand that EU law will be no longer a binding legal source for the UK, while on the other hand means that the United Kingdom will be no longer entitled to rely upon rights and advantages of being a Member State of the European Union: thus, in this delicate situation, the aim of this work has been also to underline the importance for the parties involved in the Brexit process of finding an agreement on a model for a future relationship that could reveal to be considered as forward-looking alternative.

However, to do so, it resulted essential to present the groundwork which characterizes the field of interest of this thesis, the free movement of capital, and the various developments it has undergone during the years.
In fact, the free movement of capital has always been considered the *fourth* of the four fundamental freedoms which characterize the Internal Market of the European Union.
As it has been discussed in the first paragraph, the project of an Internal Market of the Union can be traced back to the 31 of December 1992, when the enactment of the Single European Act entailed the creation of a space with no barriers and the core of which had to be the respect of the Four Fundamental Freedoms: the Single Market officially started to exist the 1st January 1993.
Article 26 of the Treaty on the Functioning of the European Union explicitly states that *"The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured in accordance with the provisions of the Treaties.",* even though in the first chapter it has been demonstrated how the legal regime set out for each freedom developed with significant differences from the others. They had been conceived with the economic intent of establishing and structuring the Internal Market, with the consequent aim to prohibit and eliminate both direct and indirect discriminations, and more in general, any kind of restriction applied by a Member State.
Nevertheless, in particular in the field of free movement of capital, it demonstrated to be a tortuous route towards the level of a complete liberalization. As long as capital circulation is concerned then, before the entry into force of the Maastricht Treaty, the previous legal framework provided by the EC Treaty encompassed a set of articles about capital circulation that was not as developed as the one about goods, persons or services: those were much more advanced in terms of scope and interpretation. In particular, according to Article 67 EEC (now Art.63 TFEU), Member States should progressively abolish as between themselves restrictions on the movement of capital only *"to the extent necessary for the proper functioning of the Common Market*". This specification was absent in the provisions related to other freedoms.
It has been also recalled that the first step towards a full liberalization of the free movement of capital was the enactment of the Council Directive 88/361 EEC for the implementation of Article 67 EEC, which provided for the first time that

Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I."

This time, any kind of clause that could have the effect to restrict the capacity of the provision is undoubtedly absent: capital movements are unconditionally freed for the first time. Directive 88/361 EEC played indeed a vital role in the development of free movement of capital.

More to the point in fact, at the time of the writing, the influence of that Directive is still capable of being perceived in the text of Article 63 TFEU and the *nomenclature* included in the Annex to that Directive is still used by the ECJ with purposes of interpretation. More to the point of the core issue, the difficulties occurred during the process towards a complete liberalization of capital circulation, at first between Member States and afterwards between the European Union MS and third countries, clearly demonstrate how many delicate implications the field of interest for this thesis has to deal with and partly explain why it has taken so long to achieve this result.

After having examined the legal framework within which the object of this thesis should be put, in the second chapter the focus of the discourse has been moved on the *practical* implications of such a flowing of capital free from barriers.

In fact, as a first element of discussion of the second chapter, it has been presented the intention of the Institutions of the Union to give birth to a deeper and more integrated market for financial services, which could reach in a near future the result to substitute or complement the typical investment method of bank loans. This aim is the one which encouraged the EU institutions to launch the project of a Capital Markets Union, which could achieve the result to link and connect the single capital markets of the different Member States in order to obtain a unique and integrated capital market, as it already happens in the United States of America. This issue then, has been considered worth of mentioning not only because it is a clear example of the importance of concretization of Treaty rules about free capital circulation, but also because, as demonstrated in the fourth chapter, it will be strongly influenced and touched by the withdrawal of the United Kingdom from the European Union after the completion of the Brexit process.

Moreover, still in the same chapter, the analysis shifted to the instruments and mechanisms the European Union is allowed to use to intervene on capital movements and operation between persons or organizations which can be considered dangerous for the safety of the Union and the rest of the World. It is the case of the above discussed *smart sanctions*: today, the power of the European Union to impose restrictive economic measures directly against non-State entities is confirmed and enshrined in Articles 75 and 215 of the Treaty on Functioning of the European Union, introduced by the Lisbon Treaty in order to replace the previous legislative framework. This issue has been considered particularly noteworthy because in a scenario which will see the United Kingdom out of the Internal Market and not subject anymore to the law of the European Union, investments performed by the same *dangerous subjects* which today could see their funds freeze in accordance to Articles 75 and 215 TFEU would not be subject to punishment anymore. London indeed, as the whole United Kingdom, is the centre of investments from and towards the European Union but, once it will not be subject anymore to EU law, the above mentioned rules will not be helpful in the fight against terrorism anymore.
As long as the third chapter is concerned though, the objective of this work was provide a clear overview of the historical and legal background of the Brexit process. Reporting the ancient ups and downs of the relationship between the European Union and the United Kingdom, whose government organized a first referendum to leave the EEC only one year and a half after the entrance, has been considered useful to this work because it is could be helpful in the perspective of understanding possible future moves from the UK institutions.
Considering the analysis on the withdrawal from the European Union indeed, it is deemed that the *ad hoc* rule of Article 50 TEU must be taken into account. The related section of this thesis results, in fact, particularly topical and crucial to the whole discourse, especially when the issue of *revocability* of the Brexit process is analyzed. At the present time then, many politicians and experts present the revocability of the Article 50 notification to withdraw, if not the organization of another referendum, as a viable assumption.
However, it is to say, it is highly likely that, at the more after the winning of the no-confidence vote, the Prime Minister will in charge as long as the future moves of

the government of the United Kingdom will remain the same: Theresa May seems clearly decided to bring on the withdrawal process without getting *cold feet*.
As last, but not less important issues, the legal and economic consequences of Brexit have been described in chapter four. The necessary space has been given to the description and analysis of the Withdrawal Agreement and the Political Declaration, the two documents presented by the United Kingdom and endorsed by the European Union in November 2018. According to those document, as long as the field of interest of this thesis is concerned, the future relationship between the two parties will be shaped on the model of an *economic partnership*, with a free trade area for goods and separate agreements for the other subjects. It has been recalled then, that the Withdrawal Agreement does not say anything in particular about capital and financial services, instead the Political Declaration underlines the importance of a future relationship based on an *equivalence* regime: relying mostly on EU law principles, it has been made possible to say that the United Kingdom agreed to give application and maintain, in the field of financial services in the specific, a legal regime equivalent to the one applied by the Union.
This aspect is therefore of significant importance because if the United Kingdom would decide not to do so, it could be easily excluded as a preferred option for investments by international trade operators. In fact, those are usually willing to rely on high standards and guarantees in financial services and economic operations, as the ones the European Union is capable of provide. Though, according to the Agreement there is no reason to fear a hostile behavior from the UK in the application of the EU equivalence regime.
Nevertheless, many problems could arise from the not so far possibility of a *hard Brexit* based on a *No-Deal* withdrawal. As it has been analyzed in chapter four then, this hypothesis would imply the automatic application of the international law regime provided for by the World Trade Organization. In case of a similar scenario, all the types of trade between the United Kingdom and the European Union will be characterized by tariffs which would discourage the exchanges.
In particular, in the field of free movement of capital and financial services in the specific, this scenario would only mean a highly likely re-allocation of Foreign Direct Investments and branches of UK-based companies. The *No-Deal* option then, is capable of generating a massive shift from London to other European cities

as investment centers: Frankfurt, Milan and Dublin are the most trusted options in this process of re-allocation of capital.

Over and above, the Brexit will surely have an important influence on the project of the Capital Markets Union, even if it is to be said that in these cases the experts and scholars tend to be more uncertain in respect of the plausible consequences.

The departure from the EU of the United Kingdom, which in the recent years has clearly demonstrated to be the EU's main capital market centre, makes the project even more relevant. However, if on the one hand the UK's eventual departure from the European Union makes CMU more urgent, it also represents a clear setback in view of the dominance of the City of London as Europe's financial centre. However, taking into account the current agenda of EU institutions, the CMU project seems to have been slowed down, making the accomplishment *in time* of all the necessary steps to its implementation relatively difficult.

Eventually, at the end of this thesis on the influence that the Brexit phenomenon is likely to have on the free flowing of capital within the boundaries of the Internal Market of the European Union, it is necessary to admit that sure and definite conclusions are difficult to be drawn.

More to the point, this work does not cover, and neither could have done so, such a problematic and complex issue in all its entirety, mostly due to the limits of an academic work.

However, as a conclusion to this thesis and essentially relying upon the findings presented and discussed there, it is to say that the most probable outcome will be the adjustment of the Withdrawal Agreement on the basis of some of the amendments presented by the British MPs. This adjustment then, will be followed by a secession from the Union that will be in the end identified in a *Soft Brexit*, with the consequent creation of an economic partnership between the European Union and the United Kingdom.

Nevertheless, the situation is characterized by a high degree of uncertainty and is capable of sudden changes due to its strong political fluidity.

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