BREXIT

What the vote to leave means for your business

The outcome of the UK's referendum on its membership of the EU raises multiple questions and, at this point in time, uncertainty for firms that do business in the UK. The implications of withdrawal will depend upon exactly how the UK's future relationship with the EU will be structured. What is clear is that, until the UK leaves the EU, UK companies will still have to comply with EU laws when doing business in the EU. What is less clear is the extent to which UK companies will have to obey those laws when operating outside of the EU and the degree of influence the UK will have in shaping those laws.

What happens now?

Now that the UK electorate has voted for Brexit, the critical question is "what happens now?" A simple answer is that the UK will present its application to withdraw from the EU in accordance with Article 50 of the Lisbon Treaty. After a period of up to two years, unless extended by mutual agreement, the UK will withdraw from the EU. However, given the importance of the relationship between the EU and the UK, the UK Government will be obliged to have some formal relationship with the EU-27. What that relationship will be, and how the UK and EU-27 arrive at it is currently unknown. The Brexit referendum has told us what the UK electorate does not want, but there is currently no legal or political process in the UK for establishing what the UK electorate, in fact, wants our relationship with the EU to be.

The UK Government and Civil Service now has to establish a framework for withdrawing from the EU but continue its relationship in some other form. Subsequent events after the referendum indicate that the UK Government did not give significant consideration to these issues.

Well-advised businesses will now be active in shaping the post-referendum discussions as to what formal relationship the UK will have with the EU.

Most commentators agree that there are five distinct models for that formal relationship, each with a different outcome for UK businesses. Once the UK Government provides clarity on the form of the post-Brexit relationship it seeks with the EU, a vital step for a company will be to understand the impact of each relationship option on its trading environment. Once the options and their implications for the company are understood, businesses can seek to advocate for one or more options.

UK businesses should start this analysis and consider how their company might be affected by Brexit. Once the options for an UK/EU-27 relationship are understood, companies can consider which of the options provide the best outcome for the company.

Timing

It is at this early stage difficult to predict how the withdrawal will be managed, and we are likely to see lengthy negotiations between the UK and the EU on the shape of their future relationship.

What are the UK/EU-27 relationship options following the vote to leave the EU?

1. UK joins the EEA and EFTA ("the Norway Model")

Of the various relationship options being considered, the Norway Model would likely be the most straightforward option from the perspective of transitioning to it. Being part of the EEA would enable the UK to maintain its access to the EU internal market, and EU businesses would have access to the UK market, as the current free movement of goods, persons, services and capital between the UK and the rest of the EU would continue to apply. The UK would have to contribute to the EU budget and adopt EU laws in return for maintaining its position in the EU internal market. There would not be a common external tariff around the UK and the EU and so the UK would need to negotiate independent FTAs (as part of EEA and/or alone) with third countries. However, as a non-EU member, the UK would have only limited rights formally to participate in EU legislative processes and trade policy development.

As part of the EEA, the UK would no longer have to participate in a number of EU policies, such as the common agricultural and fisheries policies (CAP), the common energy and transport policies, or the common foreign and security policy. However, withdrawal from such policies would be highly disruptive for those industrial sectors, and so the UK would likely have to negotiate some form of transitional arrangements whilst alternative policies are established. For example, the CAP protects EU farmers from unlimited third country imports, and in some cases subsidises over-production. Upon withdrawal from the EU, both would cease, and so the UK will have to replace them with an equivalent system.

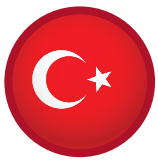
Free movement of persons was perceived by Eurosceptics as a key driver for Brexit, so its retention given the Brexit vote is unlikely to be tenable and indeed may be a reason why the Norway Model is rejected.

There is also a significant question about the effect of an Article 50 withdrawal on the UK's membership of the EEA. There is some commentary to the effect that if the EU withdraws from the EU under Article 50, that process does not cause the UK to withdraw from the EEA. This is because the UK is a separate signatory of and contracting party to the EEA, and so withdrawal from the EU may not result in automatic withdrawal from the EEA. Staying in the EEA may not be easily compatible with the vote for Brexit and so the UK Government may be required, as a political matter, to withdraw from the EEA Agreement under Article 127 of that Agreement at the same time as it withdraws from the EU under Article 50 of the Lisbon Treaty. If the UK withdraws from the EEA at the same time as the EU, this makes any subsequent re-application to the EEA a rather remote possibility.

2. A Customs Union ("the Turkish Model")

The Turkish Model would remove tariff barriers on goods and certain agricultural products, but in addition, would erect a common external tariff around the EU and the UK. If this were the chosen model, the UK could export goods to the EU without then being subject to tariffs, although customs controls at the border would apply. The UK would also not have to contribute to the EU budget and there would be no free movement of persons/employees.

A customs union of this kind is similar to current arrangements between the EU and Turkey. The Turkish Model does not, though, cover trade in services which currently accounts for a significant proportion of UK/EU-27 trade. The UK would therefore need to negotiate access to the EU internal market for services. Furthermore, under this model, the UK would have to comply with large parts of EU trade policy without being able to influence most aspects of EU legislation.



3. Bilateral agreement(s) between the UK and EU ("the Swiss Model")

The Swiss Model would be similar to the current Swiss/EU bilateral accord. This would involve the negotiating individual sector-by-sector agreements with the EU and free trade agreements with EFTA countries. Switzerland has around 130 separate bilateral agreements with the EU. The Swiss Model would therefore be a significant endeavour for UK negotiators. Furthermore, UK businesses would not automatically be entitled to full access to the EU internal market, whether for goods or services. There would be free movement of persons/employees and the UK would have to contribute to the EU budget. There would be no common external customs tariff around the UK and EU so that the UK would need to negotiate independent FTAs with third countries. However, the EU has indicated that the Swiss Model is not working well and as such, there is a question mark over whether it would adopt a similar arrangement with the UK. Nonetheless the model remains a potential option.

4. Free Trade Agreement ("FTA") Model

Under a Free Trade Agreement Model, the UK would simply negotiate independent FTAs with third countries plus a straightforward FTA between the UK and EU. What such an FTA would contain is uncertain at this point, and it is unclear how distinct this option would be when compared to variants of the above options.

5. A simple WTO Approach

This model entails a "complete" Brexit, whereby the UK would not enter into any new agreements with the EU or with separate EU Member States. The WTO rules would apply to the UK's right to trade with the EU in respect of both goods and services, but there would likely need to be some negotiations over a new Schedule of Concessions as the UK has not had to have one with the EU up to this point. There would be no free movement of persons/employees and no obligation on the UK to contribute to the EU budget and it would not have any say in the EU legislative process. UK exports to the EU would be subject to EU import tariffs, and the UK would have the right to impose "most favoured nation" (MFN) tariffs on exports from the EU-27. Under this approach, the EU would be very unlikely to waive duties on imports from the UK, since if the EU waived such duties, given MFN, all WTO Contracting Parties would have the right to ask for similar treatment.

Summary of post-Brexit options

	UK joins the EEA and EFTA (Norwegian model) **Norway Model**	A customs union with EU 27 (Turkish model) **Turkish Model**	Bilateral agreements between the UK and EU-27 (Swiss model) **Swiss Model**	Multiple FTAs **Free Trade Agreement**	Operating only under the World Trade Organisation rules (WTO) **WTO Approach**
Preferential access to EU Market for goods	**YES** (except certain agriculture and fish products), but must meet rules of origin	**YES** full (agricultural, steel and coal products are subject to rules of origin)	**YES** (except for certain agricultural products) but must meet rules of origin	**YES** but must meet rules of origin (generally applies to industrial and processed agricultural products only)	**NO**
Access to EU market for services	**YES** full	**NO** unless negotiated	**YES** but limited	**NO** unless negotiated	**NO**
Common external customs tariff	**NO**	**YES**	**NO**	**NO**	**NO**
Contribution to EU budget	**YES**	**NO**	**YES** (under respective bilateral treaties)	**NO**	**NO**
Free movement of persons/ employees	**YES**	**NO**	**YES** (except Croatia)	**NO**	**NO**
Influence over EU legislation and trade policy	**NO**	**NO**	**NO**	**NO**	**NO**

How does the UK leave the EU?

Now that the UK has voted in favour of Brexit, the UK has to present an application to withdraw from the EU. This will take place under the conditions of Article 50 of the Lisbon Treaty.

The object of the Article 50 procedure is stated to be that:

> “…the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union.”

This Article has not been used before and there a number of uncertainties about its operation.

What is clear is that the Article 50 process will have to be completed within two years, except where all parties agree to extend that period. If the withdrawal negotiations conclude sooner, then the UK can leave the EU before the end of the two year period. It is highly likely that the 2 year period will be extended. For example, Greenland voted to leave the EU (then known as the EEC) in 1979, but only actually withdrew in 1985. For the UK to achieve the same result in 2 years with a far more complex set of facts seems extremely ambitious.

It is also clear that the UK will not have the right to be present in the “EU side” of the discussions about its withdrawal.

A key unknown is whether the discussions about the UK's future relationship with the Union will take place during the Article 50 withdrawal process. Does the Article 50 process oblige the two sides to agree on the formal relationship between them as part of the withdrawal process? Or is the negotiation of that formal relationship to be discussed after the conclusion of the withdrawal? While there may not be any practical difference in terms of outcome, there would be a significant difference in terms of timing. If the UK withdraws but only then seeks to negotiate, for example, a free trade agreement with the EU, this will significantly extend the period of uncertainty. This seems unlikely.

Planning ahead

The implications of the vote to leave for businesses will depend upon the structure of the revised UK/EU-27 relationship, as discussed above. Businesses should be aware that Brexit - in whatever form - will have implications for the import and export of goods and services into and from the EU, and for the movement of persons/employees between the EU and UK, for example. Individual businesses should now be evaluating the risks and opportunities arising from each potential outcome, and, if appropriate, take steps to influence the post-Brexit outcome.

Baker & McKenzie has created a Brexit Working Group which is considering, together with our clients, the potential legal and commercial implications of the UK's withdrawal from the EU, based on each of the potential relationship models described above. We are keen to engage with you about the impact that Brexit could have on your business or sector. If you would like to discuss, please get in touch with your usual Baker & McKenzie contact or alternatively, Ross Denton or Samantha Mobley in our London office.

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