

# BREXIT

## Issues to consider

The UK has voted in favour of leaving the European Union ("EU"), in a so-called "Brexit", however many companies are struggling to understand whether or not they will benefit or be at risk. Asking the right questions now will help companies identify the potential risks and opportunities that the Brexit scenario causes for their organisations.

This checklist aims to outline the core questions that any organisation should be asking itself in order to understand the implications of Brexit. It should also help to identify which alternatives to EU membership are best for your business.



## Now that Brexit is a certainty..

Businesses can and should be prepared to advocate for the trading relationships with the EU and with third countries that best suit them. Upon leaving the EU, the UK will have to have some form of relationship with the remaining EU Member States (the "EU-27"), as well as with third countries. At the moment, there is no legal or political framework in the UK for deciding what such a relationship will look like.

The issue of this future relationship at the very least raises questions around timing. The UK and EU-27 will enter into a process of withdrawal governed by Article 50 of the Treaty on the European Union which, in principle, has to be completed within two years of the process being invoked (though is likely to take longer, provided all parties agree to an extension). The UK Government has said it will trigger Article 50 by the end of March 2017. However, the English High Court ruled on 2 November that the Government cannot trigger Article 50 without Parliamentary approval. The Government has appealed this judgement to the UK Supreme Court - it remains to be seen whether it will take the same view. It is not clear as to whether the UK's new relationship with the EU-27 can be negotiated and completed at the same time as the withdrawal process under Article 50, or whether it will happen once the withdrawal process has been completed. So far the EU has refused to begin negotiations until Article 50 is triggered. If these two processes are sequential (and not concurrent), there will likely be a period of uncertainty as to how the UK is to trade with the EU-27. Even if these two processes are concurrent, it is likely that the UK will give priority to negotiations with the EU-27 as compared to negotiations with third countries.

We also note that it is an open question as to whether the UK will generally align itself with the EU, or undertake an independent course: crucially, will the UK continue to use EU law as the main body of UK law? The European Communities Act 1972 will be repealed by a Great Repeal Bill, ending the jurisdiction of the EU Court of Justice in the UK and the supremacy of EU law. This repeal will stop the UK being obliged to follow EU law as of that date, with a gradual drift emerging.

It is worth noting that a vast body of EU law (in the form of EU directives) has already been implemented in the UK by UK statute, and this would therefore not be affected by Brexit (unless the UK actively decides to repeal the relevant UK legislation). Other forms of EU law, such as EU regulations, apply directly to the UK as a member of the EU. Post-Brexit, EU regulations will no longer apply in the UK unless transposed by appropriate UK legislation.

This is an important issue because some consequences of Brexit will be automatic, because the UK and EU-27 will continue to trade in some form. Other consequences will depend on whether the UK decides to change the way it governs itself when not trading with the EU-27. Will the UK take a conscious decision to stop adhering to EU law, and develop an increasingly separate body of law governing only the UK? Or will it decide to transpose certain EU regulations into UK law by use of appropriate UK statute, and so maintain the status quo? The Government has stated that the current corpus of EU law is likely to be transposed into UK law.

Of course, exporters of goods and services to the EU-27 will always need to adhere to EU-27 rules affecting that trade, in the same way that US exporters to the EU have to comply with EU rules at the moment. But there is no particular legal reason why the UK should align itself with all EU law, particularly those that do not directly affect trade with the EU-27, for example, many employment, tax or competition rules. Nor is the UK required to keep EU rules designed to regulate trade within the EU, for example public procurement rules designed to eliminate national preferences. It is almost impossible to predict the effects that a divergence of UK law from EU law will have, and so this checklist does not cover this issue.

We have looked at five\* broad options for a trading relationship between the UK and the EU-27, and potentially other third countries. These are:

1. UK joins the EEA and EFTA ("Norway model");
2. a Customs Union ("Turkish model");
3. Bilateral agreement between the UK and EU ("Swiss model");
4. Free trade agreements ("FTA"); and
5. WTO approach.

\* It is of course possible that the UK could negotiate a sui generis arrangement with the EU-27, and it is not possible to predict what that arrangement will look like. It may simply be elements of each of the other five models. However, it is the case that both the UK and EU-27 are bound by certain international agreements (i.e the WTO) that place some limitations on sui generis arrangements. It is also the case that the EU has developed preferred models of trade with third countries, and may be reluctant to depart too far from those models.

In posing the questions below, we make the following assumptions:

- The political context behind the Brexit vote will likely be reflected in any new UK arrangements with the EU-27. This is likely to mean that the UK will want to: (i) have controls on, or possibly the exclusion of, free movement of persons into the UK; (ii) reduce, or even eliminate, funding payments to the EU; and (iii) only be subject to EU law when trading with the EU-27 (but not otherwise). We therefore believe that the most likely model that the UK will follow post-Brexit will be to negotiate a series of ad hoc free trade agreements with the EU-27 and with third countries;
- Most, if not all, trade agreements, including the EEA, to which the EU is party to will cease to benefit the UK now that it has voted to leave the EU. This is because only EU Member States can benefit from those agreements, and most are limited to the territorial scope of the EU on the EU side. There is also a question as to how the UK can separate itself from the EU in relation to the WTO. While the UK will arguably remain a member of the WTO, it will need to negotiate a UK-only trade concessions with 160+ other WTO Contracting parties, which is unlikely to be a quick process;
- It is unlikely that new trade agreements with the EU and with all relevant third parties will be completed by the time the UK withdraws from the EU (i.e., two years after Article 50 is triggered). Even if the Article 50 process can technically be run at the same time as new trade negotiations with the EU and with all third parties, in practice it will be extremely difficult for the UK to negotiate an equivalent network of such agreements within two years;
- At some point, therefore, the UK will lose, even if temporarily, the benefit of duty-free trade in goods, and liberalised access to service markets with the EU-27, and all other major trading partners;
- The UK will not decide to waive all duties on imports of goods from the EU. If the UK decides to impose tariffs on imports of goods from some WTO Contracting Parties ("CPs"), then as a result of the Most Favoured Nation ("MFN") principle, the UK must impose the same rate of duty on all other CPs (i.e. including the EU-27), unless it is in an FTA or Customs Union that satisfies the conditions of Article XXIV of the GATT 1947. Waiving duties for the EU-27 would result in waving duties for all other WTO CPs, which would, in effect, make the UK a duty-free country.



Please see our paper "**Brexit - What it means for your business**" for further details on these options.

## CHECKLIST:

### What questions does your business need to consider?

#### Does your business manufacture in the UK? If so where does your business purchase its inputs from?

Why is this important? If you purchase inputs from any third country with which the EU has a FTA, at some point after UK withdrawal, those inputs will become subject to tariffs on import into the UK where previously they were not. In addition, goods which were imported duty free from the EU-27 into the UK will also become subject to tariffs.

It is therefore important to understand what tariffs the UK would impose on those imported inputs, and what impact those tariffs would have on your UK cost of production.

- What do you import into the UK (establish combined nomenclature ("CN") codes and applicable duty rates for the EU-27, or third countries in the absence of a FTA):
  - from outside the EU?
  - from inside the EU?
  - from countries with which the EU has an FTA or other preferential arrangement?
- What is the value of what you import into the UK:
  - from outside the EU?
  - from inside the EU?
  - from countries with which the EU has an FTA or other preferential arrangement?
- Are any of those imports subject to specific preferential customs treatment (e.g Processing, Specific Use, or Storage)?
- What is the effect on imports if you apply MFN/conventional tariff rates to imports:
  - from inside the EU?
  - from countries with which the EU has an FTA or other preferential arrangement?

#### Does your business consume services in the UK provided from third countries?

Why is this important? If you consume services imported from any third country with which the EU has a FTA, at some point after withdrawal, on import into the UK those services may become subject to limitations on provision, where prior to Brexit they were not.

It is therefore important to understand what restrictions the UK might impose on those imported services, and what impact those restrictions would have on your UK cost of production.

#### Where are your business' main markets?

Why is this important? If you sell goods to any third country with which the EU has a FTA, at some point after withdrawal, on export to those third countries, those exports will become subject to tariffs where currently they are not.

It is therefore important to understand what tariffs would be imposed on those exported goods, and what impact those tariffs would have on your

exports from the UK. It is also important to note that this tariff impact will likely occur even if you import goods into the UK as a staging post to the EU, e.g. some form of processing or warehousing in the UK.

Similarly, if your exports of services were liberalised under those FTAs, now that the UK has decided to withdraw from the EU, those services may not be able to be provided on the same basis to all third countries until the UK concludes a similarly beneficial agreement with those countries.

You should therefore consider the following:

- Does your business supply goods or services from the UK to any third country? What are your Top 10 markets for these goods and services?
- What proportion of goods supplied from the UK go to EU Member States?
- What proportion of services supplied from the UK go to EU Member States?

### **Does your business' supply of goods or services into the EU require establishment in the EU?**

Why is this important? Some rights under EU law relate to an entity being established in the EU. If a UK business post-Brexit is not established in the EU, then it will lose access to some of those rights.

### **Does your business have many mobile employees or employees that travel/work in different locations within the EU?**

Why is this important? The free movement of workers between the UK and EU was guaranteed as part of the UK's membership of the EU. After Brexit, this will not be guaranteed and conditions may be imposed on the movement of EU-27 citizens into the UK, and the movement of UK citizens into the EU-27.

### **Does your business have any long term contracts which might be affected by withdrawal from the EU? What if any steps can be taken to rebalance rights and obligations under such contracts?**

Why is this important? Some medium to long-term contractual rights and obligations are likely to be affected by Brexit. If, for example, you are a UK based business and are considering supplying, or have contracted to supply, goods into the EU on long term basis, or are about to or have agreed to build a piece of infrastructure in a third country using inputs from the EU, then, as noted above, Brexit is likely to affect your costs of business under such contracts.

It is important to understand how your rights and obligations might or will change, and understand whether there are any steps you can take now or at a later date, such as contractual wording (e.g. applicability of force majeure clauses), to reduce any risks associated with such a change. Choice of law clauses and dispute resolution mechanisms may also need to be reviewed now that we have voted to leave the EU.

### **Who is responsible for taxes and duties in any contracts you have?**

Why is this important? In many agreements involving supplies of goods from the UK to the EU, the obligation to pay import duties and other taxes is allocated to either the seller or, more likely, the buyer. In current trade between EU Member States this obligation is not very important. However, now that the UK has voted to leave the EU, then import duties and taxes may be imposed.

You should therefore consider whether you have appropriately allocated the obligation to pay such import duties and taxes.

## Does your business receive any grants or subsidies from the UK Government and/or the EU?

Why is this important? In many cases, the subsidies provided by the UK Government can be challenged by the EU under state aid rules. After Brexit, these rules will not apply to the UK which means that the UK Government could provide certain subsidies to UK companies without having to notify the European Commission.

Conversely, if your business is currently entitled to EU funding, that funding may be withdrawn now that the UK has voted in favour of a Brexit.

## Does your business raise capital in the EEA by way of a prospectus/rely on EU 'passporting rights'?

Why is this important? As part of the EU, authorised UK financial institutions can provide cross-border financial advice, set up a branch, or run permitted activities in other EU Member States due to 'passporting rights'. Leaving the EU means a loss of these passporting rights (unless the UK remains a member of the EEA and EFTA), which will lead to increased regulatory burdens on UK firms and could lead to loss of London as a headquarters for financial institutions.

## The implications of Brexit for companies doing business in the UK

The uncertainty around the nature of an EU-27/UK relationship means that companies cannot assume that it will be business as usual now that the UK has voted to leave the EU. The questions above will assist companies in deciding how to prepare for the challenges that might face their fundamental business models. Some companies may already have thought about the issues above, others are just starting the process.

At Baker & McKenzie we are constantly considering the implications of what Brexit might mean for our clients. You can keep ahead of the latest Brexit developments by following our [Brexit Blog](#) or our dedicated website [www.bakermckenzie.com/Brexit](http://www.bakermckenzie.com/Brexit).

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