STEPHENSON HARWOOD

BREXIT: What now?

An overview

The results of the referendum on whether or not the UK should remain in the European Union (EU) are in and the British public have voted to leave. What does this mean?

This overview can only attempt, given the multitude of options now open to the government and parliament, to explore some of the possible ramifications of Brexit. Whist we acknowledge that Brexit might lead to a number of difficult constitutional questions being raised we have not addressed these. Whilst trading full EU membership for EEA membership is an option, this overview assumes that the UK ultimately adopts one of the other options set out below as becoming part of the EEA would broadly preserve the status quo with respect to EU regulation.

When will Brexit actually happen?	The government could trigger Article 50 of the Treaty on the European Union [available here] and notify the European Council of the UK's intention to leave the EU. This is however, not obligatory and not the only route open to the government. On 15 June 2016, Vote Leave published its "Framework for taking back control and establishing a new UK-EU deal after 23 June" [available here]. In broad terms, the framework suggests the partial repeal of the European Communities Act 1972 in this parliament with the aim of "*immediately end[ing] the … European Court of Justice's control over national security, allow[ing] the Government to remove EU citizens whose presence is not conducive to the public good (including terrorists and serious criminals), end the … use of the EU's Charter of Fundamental Rights to overrule UK law, and end payouts under EU law to big businesses.*" Vote Leave then proposes that rather than triggering Article 50, the government could opt to enter into direct negotiations with EU on the terms of the UK's withdrawal from the EU. Whichever route is ultimately taken, it seems likely that the transition process would take at least two years and probably longer. It is possible that a second referendum could be called on the terms of the Brexit agreement.
What form would a Brexit take?	In very broad terms, Brexit could take any one of at least five different forms: (a) remain in the EEA (the **Norway option**): likely to mean similar financial services rules (including reciprocal passporting arrangements) but reduced influence for the UK in Europe; (b) join the EFTA only (the **Swiss option**): would preserve more limited ties with the EU and require negotiation of numerous new bilateral agreements; (c) form a customs union with the EU (the **Turkey option**): would facilitate more comprehensive free trade arrangements than the World Trade Organisation (**WTO**) option (below) but would otherwise keep integration limited; (d) rely on WTO membership only, like 130 other countries (the **WTO option**): this would enable UK-EU trading based on established WTO trading models at a global level (including G20 agreements); or (e) rely on a network of bi-lateral trade agreements (the **Bespoke Bilateral option**): many Brexit supporters believe that Britain could forge a new, more favourable set of bilateral terms for UK-EU trading that strikes a better balance between independence and integration (although it is difficult to see what the incentives would be for the EU side).
Great Britain, Little England?	The UK's status as an EU member state currently includes England, Scotland, Wales and Northern Ireland. As the results have proved, Scotland is largely pro-EU membership; it would not be unreasonable to expect today's result to trigger demands for a (second) vote on Scottish independence from the rest of the UK, with Scotland likely having to re-apply to join the EU.

Funds and financial services	Possibly the biggest immediate concern for both buy and sell-side financial institutions will be the continued availability of the pan-EEA financial services passport under the CRD, MiFID, UCITS and the AIFMD. If the UK were to become a member of the EEA, then the passports under these four directives should remain available for UK entities. **MiFID and CRD:** If the UK ceases to be a member of the EU and the EEA then it is likely that UK entities will ultimately lose their rights to use the various passports (i) to market their products and services across the EEA, (ii) to provide their services cross-border in the EEA and (iii) to establish a branch in the EEA. If the UK maintains "equivalent" rules, this may enable UK firms to continue to operate in the EEA from the UK on a cross-border basis. For certain services, however, (particularly retail business) firms may need to establish further branches and/or subsidiaries within the EU, which would compromise the UK's current position as a European financial services hub. **AIFMD:** Timing is crucial with respect to AIFMD passports. The European Committee will likely begin to extend the Pan-EEA AIFMD passport to third country managers from 2016. Assuming that the UK does not repeal its AIFMD implementing regulations the UK's regime should be deemed AIFMD equivalent and, as a result, the AIFMD passports should be extended to UK AIFMs. It will however be crucial for non-EEA managers to the UK authorised before the date on which the UK ceases to be a member of both the EU and the EEA in order for them to continue to use the AIFMD passports. **MAR:** The new Market Abuse Regulation will come into force on 3 July as expected. Given that the UK has traditionally been at the forefront in Europe of the prohibition on insider dealing and market abuse, we can expect MAR or equivalent legislation to remain in place in the UK regardless of the form that Brexit ultimately takes.
Tax	A key area of focus in the post-Brexit world will be customs duties. If the UK sits outside the customs union, which seems the most likely outcome, there is the prospect of tariffs and customs procedures being imposed on trade with the EU and elsewhere. Quite what this will mean in terms of the level of any tariffs and the customs procedures involved remains to be seen and will depend on the UK's ability to negotiate beneficial free trade agreements with the EU and the rest of the world. Although VAT is fundamentally a European tax, it is very unlikely that we will see any major structural changes in the short term. Issues may arise in cross-border situations, with import VAT on goods moving between the UK and the EU a prospect. In the short term, we may see some political tinkering with rates and reliefs (for example reducing VAT on domestic energy bills). Over the longer term, particularly as the UK would no longer be bound by decisions of the CJEU, we may see a steady divergence between the UK and EU VAT systems. Group structures which rely on the Parent-Subsidiary Directive or the Interest and Royalties Directive in order to avoid withholding taxes may need to be revisited. In many cases, the UK's existing network of double tax treaties will still remove withholding taxes but these are not comprehensive and do not always reduce withholding to zero. More widely, there are a number of instances where the design of UK tax legislation has been restricted by the need to comply with the EU freedoms, state aid rules and CJEU case law. Examples include the group relief rules, CFC rules and patent box. It will be interesting to see whether the UK will still in principle aim for "EU compliant" tax legislation post-Brexit, bearing in mind that EU jurisdictions would also have more scope for non-equal treatment of UK companies. European tax litigation will also be affected and interesting questions will arise both in relation to cases which are currently in the European courts as some of the high value defeats suffered by the government in the past.
Employment	Although many rights enjoyed by employees in the UK stem from or are enshrined in EU Directives, it is unlikely that even a majority of those rights would be weakened or removed on the repeal of the European Communities Act 1972. It would be practically difficult to do so given the number of separate pieces of domestic legislation which would need to be repealed and, in any event, so many of the protections have become deeply embedded in the working culture of the UK. It would be a brave government that would seek to remove the protections against discrimination enshrined in the Equal Treatment Directive and domestically legislated under the Equality Act 2010 (and, indeed, some of the protections contained in that legislation were introduced in the UK before they were imposed by the EU – sex, disability and race discrimination, for example). There are, however, particular areas of employment law which have

	traditionally been unpopular with employers – and some which have been "gold plated" on implementation – which are more likely to be watered down or removed altogether. The 48 hour limit on a working week and complex rules around holiday pay imposed by the Working Time Directive and developed in case law, for example, are ripe for reform and the extra protection provided to agency workers under the Agency Workers Regulations 2010 could also be subject to repeal. In addition, the very restrictive provisions of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") which currently go above and beyond what is required under the Acquired Rights Directive could be watered down to make them more business friendly – perhaps by making it easier to harmonise employment terms or dismiss employees after a transfer. Generally, it is likely that there will be a move towards greater freedom of contract in the employment sphere rather than a wholesale bonfire of rights.
Immigration	Immigration has been one of the most controversial aspects of the referendum campaign. In order to reach a deal on movement of people, it is likely that the UK will have to enter into negotiations with the EU as a whole and, therefore, will not be able to treat French nationals, say, more favourably in terms of UK immigration rights than those from newly acceded states, such as Romania and Bulgaria. Alternatively, the UK government could choose to enter into bilateral agreements with each of the remaining 27 Member States. This would be hugely complex from a legislative perspective and there is no certainty that all Member States would engage with the UK at all. Considering that immigration control is one of the primary motivations behind Brexit, there is likely to be substantial political pressure on the government to keep its promise to reduce overall inward immigration. In the event of a complete Brexit with no free movement arrangement, the three million EU migrants currently in the UK by virtue of exercising their "Treaty rights" would become subject to UK domestic immigration law. The government could consider creating a new EU/EEA/EFTA-centric tier specifically to deal with such applications and could use that tier to treat such applications more favourably than those from non-EU/EEA/EFTA members but with more restrictions than is currently the case (especially where it concerns access to state benefits). This would create a monumental administrative burden for the Home Office and Border Control, who are already under considerable strain. Conversely, Brits who have settled in the EU will be subject to the varying domestic immigration rules of the countries in which they now work and reside. It is unclear how receptive other remaining Member States would be to applications from those expats given the inevitable political tensions that will arise following the Leave vote. Given the numerous economic incentives on the UK to negotiate favourable withdrawal terms with the EU and the disruption that would be caused by imposing domestic immigration law on all EU citizens, it has been widely speculated by academics and practitioners that there may, in fact, be little change to immigration for the post-Brexit UK; at least for the immediate future.
Competition	EU competition law is a key area for business which currently benefits from a 'one stop shop' structure based around the European Commission's Competition Directorate (**DG COMP**) and national competition authorities (**NCAs**) in each EU Member State. Companies involved in large-scale international M&A have used the existing European merger regulation to secure a single merger clearance from the European Commission valid for the entire EU, rather than seeking multiple approvals from various NCAs. With the UK leaving the EU, some transactions may fall outside of DG COMP's jurisdiction but within the scope of certain NCAs' merger regimes. Should the UK enter the EEA, then the UK will remain subject to the European merger regulation. However, outside of the EEA, the merging parties would have to notify both DG COMP and the relevant NCAs, duplicating matters and potentially leaving transactions open to greater political pressure from national governments. Within the UK, the British authorities may struggle to block a merger between foreign companies, even if it would result in higher prices for UK consumers. The UK authorities may find their case load increasing as a result of Brexit, having to review multi-national mergers that affect both the UK and EU member states. Costs would therefore rise for both the UK authorities and notifying companies. UK-based companies selling into the EU will still be subject to the EU's prohibitions on anti-competitive conduct, such as fixing prices and abusing a dominant position, just as US or Japanese companies have always been. However, UK-based 'leniency' applicants seeking immunity from or reductions in fines in respect of cartel activity may have to

	make duplicate applications in the UK and to DG COMP, increasing the risk of that material being disclosed to other authorities, including criminal prosecutors in the UK or US. UK law already prohibits anti-competitive conduct in a very similar way to the European Commission, so those provisions will stay in place, with the complication that the UK authorities will no longer be bound by European precedents. The UK courts and regulators may diverge from EU practice and will no longer be members of the network of European NCAs led by DG COMP. Investigations may not be as well co-ordinated as they have been to-date and it may be harder for the UK authorities to investigate foreign cartels and potentially dominant companies. For companies seeking to bring damages actions against infringements of competition law, the English courts may not be as attractive as they have been to-date, as they have served as a 'one stop shop' for claims covering the entire EU. Future actions might only cover the UK and the rest of the EEA, rather than the entire EU, meaning that any awards would be limited and further actions might need to be brought in other jurisdictions, increasing cost and uncertainty. If the English courts can only regard a DG COMP infringement decision as persuasive rather than binding, then the defendant is placed at an advantage relative to the status quo.
Intellectual property	Over the past 20 years, IP rights have become more harmonised, particularly with the development of a number of pan EU IP rights, such as the EU Trade Mark and Design Right. As a result, there is significant European jurisprudence from the CJEU which applies in English law. There are also a number of other harmonising directives in the pipeline such as the trade secrets directive. There is also the Unified Patent Court, where London has been designated as the location of the court dealing with life science patents. With so much harmonisation and integration of legal systems in this area, it must be one of the most difficult areas to deal with in the event of a Brexit. Some of the most important and pressing questions for clients will be what will happen to their pan EU rights, together with what should be their filing and enforcement strategy, pending resolution of the laws in the field of IP, which could take years.
Private wealth	The Chancellor promised to hold a post-Brexit Budget but in the light of the resignation of the Prime Minister today it looks likely that this will be postponed until we have a new leader and, presumably, a new Chancellor. We would expect the Budget to be pro-business, given that the international business community will be re-assessing its relationship with the UK. We have already seen a massive flight from the UK's stock market and currency, so the government will want to make sure that our business tax regime remains attractive. On the personal tax front, we would expect planned increases in the personal allowances and thresholds to be delayed or cancelled. We cannot rule out tax rises. More structural changes will follow in the coming years, given that much of our domestic tax legislation is based on EU rules, most notably VAT.
Data Privacy	Data Protection is an area where recent developments have been driven by the institutions of the European Union and has also consistently seen regulators acting in a co-ordinated European manner both in issuing guidance and enforcement. In particular, while the current legislation is a UK statute – the Data Protection Act 1998 (albeit one based on an EU Directive) - the recently approved EU General Data Protection Regulation is due to come into force across the EU with direct effect in May 2018. This means no national act of parliament would be required to give effect to its terms. Quite what the status of this Regulation would be post-Brexit given it would come into force prior to such exit being effected is unclear but it is likely it would fall away unless a national implementing act was put in place. For what it is worth, however, such a national implementing act would in our view be highly likely. First, the Information Commissioner (the UK DP regulator) has already gone on record to state that data protection and information rights are concepts which are very important in the UK and pointing out that the UK had a data protection act prior to the passing of the 1995 EU Directive. Second, the terms of such national act would be likely to be very similar or identical to the Regulation given the incentive for the UK to be deemed "adequate" for EU data protection purposes post-Brexit and therefore facilitate free movement of data (if no longer people!) between the EU and UK. As the recent controversy surrounding so-called "Safe Harbour" and the transfer of personal data to the US shows, ensuring "adequacy" of data protection laws is a key incentive to continue to have a law on equivalent terms with EU requirements.

Insolvency and restructuring	So far as restructuring and insolvency is concerned, once the exit is effected, English insolvency regimes and their effects will no longer be automatically recognised elsewhere in Europe pursuant to the EC Regulation on Insolvency Proceedings. As such, the recognition of English insolvency proceedings in Europe will become dependent upon specific cross border insolvency rules of other Member States which may exist over and above the uniform recognition framework of the EC Regulation. For example, certain European jurisdictions have adopted the UNCITRAL Model Law on Cross Border Insolvency which provides an alternative gateway for the recognition English insolvency regimes in those jurisdictions. By a similar token, European insolvency regimes will no longer benefit from automatic recognition in England under the EC Regulation, though they may be recognised via other means and/or new laws may be enacted here to replicate the current position under the EC Regulation. Schemes of arrangement are a very popular, flexible and effective process for effecting debt restructurings, and English schemes are often used by foreign companies wishing to restructure their debts, as few other jurisdictions have an equivalent mechanism. Schemes of arrangement are not an insolvency procedure and so the EC Regulation does not apply to them. Their utility (and attractiveness to both English and foreign debtors) is unlikely to be affected by Brexit.
Finance	The main legal impact of the Brexit vote from a debt finance perspective is uncertainty relating to the possible loss of EU passports, i.e. losing the right to sell products and services into Europe from London. This may result in banks needing to change their European legal entity structure and the location of some roles. In terms of wider impact, the extent (if any) to which the City loses its leading role in banking, trading, clearing and financial services is the big question. Banks may cut staff and costs in London and shift global resources from London to the Eurozone due to uncertainty over the terms of exit. Further, Eurozone banks with operations in London may get hit by the FX translation as sterling weakens and it is quite likely that the European Central Bank will try to drive euro trading activities - today done largely in London - back to the continent.
Pensions	Any impact on pensions law is likely to be felt over the medium and longer term rather than immediately and will be dictated by the terms of any exit and for example whether we join EFTA or the EEA (where there may be obligations to comply with much of EU law in any event). Many key aspects of pensions law driven by EU law are already incorporated in domestic legislation (for example pension provisions on a TUPE transfer, also the equal treatment obligations now in the Equality Act 2010 and the Pensions Act 2004 contains pension scheme funding requirements which were based on the 2003 IORP Directive). As such, the domestic legislation must continue to be complied with until such time as any amending legislation is introduced and we expect the UK Government would be reluctant to amend where much of the legislation offers protection to employees/members of pension funds. Trustees of defined benefit pension funds should take action to assess the impact of Brexit on the financial covenant of their sponsoring employers and assess whether or not any weakening of the covenant as a result of Brexit requires them to revisit the funding valuation and funding plans and any increase in security arrangements to support the pension fund and indeed whether any security is triggered by any downgrading of the employer covenant. Employers need to be ready to respond to trustees who will be carrying out this further assessment and as such the employers may want to have a risk assessment updated to address the impact of Brexit on their business. Employers and Trustees of pension funds should be prepared to review their investment strategy with a view to assessing whether pension funds are exposed to too much risk post Brexit.

Key contacts

Kate Brearley
Partner (Employment, immigration and pensions)

T: +44 20 7809 2107
E: kate.brearley@shlegal.com

Marta Garcia
Partner (Competition)

T: +44 20 7809 2141
E: marta.garcia@shlegal.com

Jonathan Kirsop
Partner (Outsourcing and data protection)

T: +44 20 7809 2121
E: jonathan.kirsop@shlegal.com

James Linforth
Partner (Finance)

T: +44 20 7809 2060
E: james.linforth@shlegal.com

John Meehan
Partner (Tax)

T: +44 20 7809 2375
E: john.meehan@shlegal.com

Sue Moore
Partner (Insolvency and restructuring)

T: +44 20 7809 2111
E: susan.moore @shlegal.com

Eifion Morris
Partner (Intellectual property)

T: +44 20 7809 2347
E: eifion.morris@shlegal.com

James Quarmby
Partner (Private wealth)

T: +44 20 7809 2364
E: james.quarmby@shlegal.com

Richard Small
Partner (Regulatory compliance)

T: +44 20 7809 2424
E: richard.small@shlegal.com

James Tinworth
Partner (Funds)

T: +44 20 7809 2375
E: james.tinworth@shlegal.com

STEPHENSON HARWOOD