GIDE
GIDE LOYRETTE NOUEL

client alert

EU | BREXIT | 28 JUNE 2016

CONSEQUENCES AND LEGAL IMPLICATIONS OF BREXIT - PRELIMINARY ASSESSMENT

The referendum on the United Kingdom's membership of the European Union took place on 23 June 2016. With a turnout of over 71%, the final results are Leave winning by 52% to 48%, raising many questions regarding the legal consequences of this vote for the future status of the UK and its relationship with the EU.

Following on from our previous issue, this Client Alert proposes to give a high-level view of the main consequences and legal implications of a “Brexit”, notably regarding the withdrawal process (1), the possible options for the new status of the UK (2) and the concrete impact in the shorter and longer term for companies, regarding notably access to the Single Market, competition rules and tax matters (3).

« *In a free and democratic process, the British people have expressed their wish to leave the European Union. We regret this decision but respect it. This is an unprecedented situation but we are united in our response.* »
Donald Tusk, President of the European Council

1. WITHDRAWAL PROCESS

- **A minimum 2-year negotiation period**. There is no directly comparable precedent of a Member State leaving the EU. The relevant EU law provisions have never been tested in practice or interpreted by the European Court of Justice, putting both the UK and the EU in uncharted territory. Article 50 of the EU Treaty provides for a 2-year negotiation between the withdrawing Member State and the other Member States. It may be extended but such an extension could be vetoed by any of the EU 27 Member States.

- **Uncertainty regarding the starting point**. The 2-year period will start when the UK notifies the European Council of its intention to leave. The UK may be unwilling to notify quickly after the referendum (as confirmed by David Cameron’s initial press conference). However, the European Parliament, the European Commission and the President of the European Council Donald Tusk have all called for a swift activation of the process.

- **Arm-wrestling the decision to notify?** There is already significant internal and external political pressure on the UK government to notify the Council very soon. Markets are also likely to react negatively to any further uncertainty surrounding the withdrawal process of the UK. The UK may argue that negotiations will first require internal discussions, notably given the result of the vote in Scotland and in Northern Ireland (where a majority voted Remain). But eventually, unwarranted delays to the notification would create additional resentment and make negotiations more difficult for the UK. Provided the announcement of David Cameron that he would step down in October 2016 is realised, the withdrawal of the UK from the EU could take place in Q4 2018 at the earliest.

- **Procedure and mapping.** According to Article 50 of the EU Treaty, the Commission is to make recommendations to the Council. The Council should then adopt a decision authorising the opening of negotiations and nominating the head of the Union's negotiating team.
- Negotiations are to be concluded on behalf of the Union by the Council, acting by a qualified majority (72% of the remaining 27 Member States, representing 65% of the population), after obtaining the consent of the European Parliament (majority of votes cast). The Commission has therefore a rather limited role in this procedure.

2. OPTIONS FOR THE NEW STATUS OF THE UK

General consequence

Upon withdrawal from the EU, the UK would become a "third country". This would impact not only the UK-EU relationship, but also UK relationship with non-EU countries (e.g. the multiple trade agreements in place between the EU and non-EU countries). A new status could be negotiated by the UK along the lines of one of the following models.

Norway (EEA model)

The Norway model is the closest to full EU membership. It provides for access to the EU internal market; it also requires from the country to adopt all EU legislation in relevant areas, but without participating to the EU's decision-making process. This model builds on reciprocity and mutual recognition, allowing individuals, companies and capital to benefit from free movement.

Switzerland (EFTA model)

The Swiss model provides more limited rights compared with the Norwegian model. Like Norway and other EEA countries, there is free movement for goods; however, services are not included in the agreement with Switzerland and bilateral sector-specific agreements are needed for Swiss companies to access the EU single market, under the condition of equivalence of Swiss legislation with EU rules. Since equivalence is a thorny topic, in particular when it comes to financial services, a number of Swiss entities rely on presence and establishment within the EU territory in order to access the Single Market. This model and approach would be fraught with difficulties for the UK, and unlikely to be considered at as a viable option by the EU.

The Association Agreement / Free Trade Agreement model

Several non-EU countries rely on an Association Agreement or Free Trade Agreement to interact with the EU. These Agreements may combine various elements, and range from customs union (Turkey) to free-trade agreements (South Korea, Canada, Mexico). The focus is typically on goods rather than on services, although services may also be included. In such a model, the UK would not be able to influence the negotiating process with third countries regarding “external” tariffs.

International agreements

Another approach could be to rely on international agreements, such as those of the World Trade Organisation (WTO). The default Most-Favoured-Nation clause would not be to the advantage of the UK, since it would have to apply its lowest tariffs to all WTO countries, while these countries would not have to apply reciprocity. Furthermore, this approach does not address several aspects, including regulatory ones.

Moreover, these models do not account for the political factor, the strong emotions following the Leave vote, and the necessity for the Union to make an example out of the UK negotiations to prevent contagion and further exit referenda.

3. CONSIDERATIONS FOR COMPANIES

- **In the short term**, EU institutions as well as UK authorities have made clear that EU law applies fully, in terms of both rights and obligations. Implementation of legislation which was recently agreed (for instance, the MiFID II/ MiFIR reform) must also continue, things being presented so far as "business as usual".

- **In the longer term**, and depending on the outcome of the negotiations with the EU, a significant amount of UK legislation may need to be amended. Parts of the legislation applicable in the UK would fall (directly applicable European Regulations) and may be replaced; parts could be amended (European Directives transposed in UK law). Many other consequences would unfold[1] the final impact of which will depend on the content of the negotiations.

- **Regulatory impact**. From a regulatory perspective, two factors are likely to influence the outcome of the negotiations: whether the norms applied are also international in nature (significant changes were introduced in response to G20 commitments, for instance); and whether the UK decides to maintain the *acquis communautaire* (which would affect the assessment of equivalence) in order to preserve an access channel to the Single Market (see below).

- **Access to the Single Market for UK firms and to the UK market for EU firms**. Withdrawal from the EU would imply a change not only to UK obligations (e.g. no more contribution to EU budget), but it would also affect its rights, notably with respect to the access to the Single Market (as well as benefit from structural funds, etc.).

- Several EU Member States represent a high percentage of UK exports, but UK financial services contribute also to a significant part of EU capital flows and transactions. Trade-offs across sectors may therefore take place in the context of Article 50 negotiations, subject to the manner in which these negotiations will be organised.

- Several industries rely today on passporting to access EU markets (e.g. banking, investment services, asset management), and post-Brexit they would still have to comply with a number of EU rules in the context of a third country passport / equivalence system. Otherwise, Brexit may require UK entities to relocate, so as to allow them to keep benefitting from the regime open to companies established in the EU.

- **A balance between rights and obligations**. The objective announced in Brussels would be to reach a swift conclusion to the negotiations with the UK, with an agreement reflecting a balance in terms of rights and obligations. This encompasses not only financial markets and free flow of capital, but also the free movement of workers. A sensitive topic such as immigration will undeniably play a role in the negotiations. It can be expected that the EU will strive to protect the interests of EU citizens who have moved/will move to the UK, in exchange for easier access to the EU market for UK firms.

[1] **EU internal and institutional arrangements** would also be impacted - for instance, with respect to the British members of the European Parliament, of the Commission, of the Court of Justice. The European Banking Authority currently established in London would have to be relocated. The body of case law produced by the ECJ would be at stake, at least when not directly integrated into UK law.

- **EU competition law**. The application of EU competition rules in the UK would change post-Brexit. Merger law would likely see UK-centred transactions being notified to the UK authority, while certain concentrations will have to be notified to both the UK authority and the European Commission (unless the UK opts for the EEA model, in which case the one-stop shop principle would apply). State aid rules would not apply anymore to UK grants and similar mechanisms (unless a Norway-like model is adopted).

- Article 101 and 102 of the EU Treaty would however remain fully applicable, to the extent that alleged cartels or abuses of dominant position involving UK entities have an effect on EU 27 territory. Moreover, the recent emergence of a UK class-action litigation system may be undermined, with plaintiffs considering that in a Brexit context, the UK is not the most relevant and appropriate jurisdiction anymore to introduce damages claim for cartel involving EU companies.

- **Tax matters**. Post-Brexit, the UK would no longer be bound by EU Treaty freedoms; but it is unlikely that the UK Government will wish to reverse or amend previous changes made to comply with EU law, or introduce new rules that do not comply.

- That said, an area where multi-national groups may be impacted - even with existing double tax treaties in place - relates to withholding taxes on dividends, interest payments or royalties flowing between the UK and EU member states. EU-based rules such as the Parent-Subsidiary and Interest and Royalties Directives will cease to apply to the UK, which could make the UK a less attractive holding company location for European groups. Other areas of concern for companies, depending on their structure, would include social security contributions and VAT.

« We stand ready to launch negotiations swiftly with the United Kingdom regarding the terms and conditions of its withdrawal from the European Union. … Until this process of negotiations is over, the United Kingdom remains a member of the European Union, with all the rights and obligations that derive from this. »
Donald Tusk, President of the European Council

Businesses that may be affected by any of the above are advised to review their structure and their operations in the UK and the EU, in order to determine to what extent these points may be relevant. Our offices will be pleased to assist in conducting any such review. For further information, please get in touch with your usual Gide contact.

CONTACT PARTNERS

BENOIT LE BRET
Brussels
tel. +32 2 231 11 40
lebret@gide.com

STEPHANE PUEL
Paris
tel. +33 (0)1 40 75 29 69
puel@gide.com

RUPERT REECE
London
tel. +44 (0)20 7382 5768
reece@gide.com

You can also find this legal update on our website in the News & Insights section: **gide.com**

This newsletter is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide's clients and business associates. The newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee. In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communications department (privacy@gide.com).