

# Fried Frank

# BREXIT Alert



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## The UK voted to leave the EU- what next?

On 23 June the UK voted to leave the European Union. Now, the UK will start a complicated process of formally exiting, and establishing a new relationship with, the EU.

From a legal perspective, the UK Government is expected (in the next few months, following the election of a new Prime Minister) to serve notice to withdraw under Article 50 of the Treaty on European Union, which envisages a two-year negotiation of a withdrawal agreement. The two-year period can be extended by mutual agreement, but in the event of no agreement and no extension, the UK would cease to be a member after the two-year period. Given the UK's position within Europe, it is more likely that a comprehensive agreement between the UK and the EU would be reached, and it is also likely that the process would last longer than the two years envisaged by the Treaty.

How the UK will regulate its relationship with the EU following Brexit remains to be seen, but the UK's options appear to be as follows: negotiate a series of bilateral agreements (the "Swiss model"), become a member of the European Economic Area (EEA) and the European Free Trade Area (EFTA) (the "Norwegian model") (which would largely mirror the status quo (including free EU migration and contributions to EU budget)), agree a customs union (like Turkey), agree a free trade agreement (similar to the Swiss model but involving a single UK/EU agreement, rather than sector-by-sector) or rely on its World Trade Organisation membership (the most complete form of exit). Commentators say that it is more likely that the UK would prefer to negotiate a free trade agreement than pursue any of the other avenues, but what will ultimately be agreed is uncertain.

How does Brexit affect us in practical terms?

An expected result of Brexit is short-term turmoil in the financial and exchange markets, turmoil which follows any kind of uncertainty. This is likely to affect both equity and debt markets. However, as explored below, there could also be benefits to the UK as a result of reduced regulation, negotiated trade agreements and freedom to dictate its own policies.

As regards other areas of business and law pertinent to our practice, we examine these in turn. The EU was founded on four principal freedoms of movement of people, goods, services and capital. The way that these four principles are affected post Brexit will determine the effect that Brexit will have on British business and economy.

### **Foreign investment and trade policy**

The EU treaties provide a framework for free movement of goods, services and capital, which facilitates investment in the UK. It remains to be seen what trade agreements will be reached in due course and how these will affect businesses with established interests in the UK. However, although there will be

uncertainty, the UK will be free to set its own external trade policies and therefore there may be opportunities to negotiate favourable deals with other jurisdictions outside the EU.

### **Contributions to EU budget**

Depending on what agreement is reached with the EU, the UK could stop contributions to the EU budget; such contributions have amounted to around £8bn a year in recent years (although there have also been rebates received by the UK from the EU amounting to approximately £4bn a year in the form of regional development grants and farming subsidies).

### **Migration**

Large numbers of EU nationals live and work in the UK, and vice versa. The right of such nationals to continue living in the UK and EU has to be considered. This will affect the City of London, as well as businesses throughout the country that rely on a European workforce. It is very likely that those persons that live and work in the UK and EU (from either jurisdiction) would be allowed to continue to do so until Brexit is formalised. So far, the EU has shown strong resistance to separating the free movement of persons from the other three internal market freedoms (goods, services and capital). Any bilateral agreement that allows substantial access to the EU's internal market would most likely also require the free movement of persons, but it remains to be seen what the UK Government can negotiate in this respect.

### **UK businesses**

UK businesses operating in the EU would need to continue to observe EU rules (be it product standards or competition rules) regardless of Brexit.

### **Private M&A and commercial arrangements**

Private M&A transactions are more likely to be affected by uncertainty in the markets, rather than changes in law, as a result of Brexit. Questions may arise as to whether Brexit amounts to a "material adverse change" or "frustration event" in certain agreements, but this would have to be reviewed on a case-by-case basis.

### **Public M&A**

The UK Takeover Code has existed for a long time and has influenced EU legislation relating to public takeovers (the EU Takeovers Directive). Therefore, it is unlikely that there will be significant changes in the legal framework of UK public M&A, as a result of Brexit. The Code will continue to evolve and adapt in response to market conditions as it has done through the years.

### **Financial services and regulation**

EU financial services directives incorporate a 'passport' for cross-border activities. Although the AIFMD makes provision for a 'third country' passport, which may become available to the UK, the others do not. This is likely to have significant implications for UK financial services businesses accessing Europe and European financial services businesses accessing the UK. Following Brexit, there may be opportunity to create less stringent regulation, which may attract foreign investment to the UK, but this has to be balanced with the need to continue trading with the EU.

### **Competition**

Behavioural rules (cartels/vertical restraints/abuse of dominant positions) applicable in the UK are largely based on or harmonised by EU legislation. Such legislation is already enacted in the UK, and as such

would remain in force. However, with Brexit, it is possible that the UK's competition practices, in the future, may take a nuanced approach from EU practice, possibly resulting in more complex compliance requirements. In any event, we expect the European Commission (EC) and the CMA to continue their collaboration on competition enforcement (e.g., similar to the existing collaboration between the EC and the Swiss competition authorities). With respect to merger control, it is unclear yet if under Brexit cross-European mergers can still benefit from "one-shop-stop" clearances through the EC (e.g., this would be the case if the UK would follow the "Norwegian" model) or if clearances from the CMA and the EC in relevant cases would have to be obtained in parallel. Finally, the UK would no longer be subject to the EU's state aid regime, potentially allowing more government support (while the EC could apply rules on countervailing duties in response).

### **Trade/Economic Sanctions**

EU economic sanctions (autonomous "restrictive measures") against third countries, including Russia, will no longer apply directly with respect to the UK. As a UN member, the UK will still implement sanctions adopted by the UN Security Council (currently implemented via EU legislation). As the effectiveness of sanctions also depends on a large block to cooperate, it is likely that the EU and UK will endeavour to align their sanctions regimes (as many European countries that are not EU members currently do). However, it is possible that applicable EU and UK sanctions regimes will deviate in the future, possibly resulting in more complex compliance requirements. With respect to dual-use export controls, it remains to be seen if the vast majority of dual-use items can still be shipped between the UK and the EU without the requirement for an individual license (e.g., if the existing General Export Authorisation 001, that applies to shipment to the EU's western allies, is extended to the UK).

### **Dispute resolution**

As a member of the EU, the UK is required to apply the Recast Regulation (Regulation (EU) No 1215/2012), which harmonises the rules relating to jurisdiction and the recognition and enforcement of judgments as between the Member States. The UK is also party to the Lugano Convention, which applies similar rules on jurisdiction and the recognition and enforcement of judgments as between the EU and the EFTA, minus the oversight provided by the Court of Justice of the European Union. Given the fact that the rules under the present Regulation represent a development of principles spanning back over a period of forty years, it seems unlikely that the UK will withdraw entirely from the European harmonisation measures as they relate to jurisdiction and the recognition and enforcement of judgments. It seems more likely that measures similar to those in the Lugano Convention (i.e., harmonised rules, without the oversight of an EU body) will be put in place.

### **Tax**

Although VAT was introduced to the UK as an EU tax, it has now become an integral part of the UK Government's revenue raising (providing 18% of total revenues) and will almost certainly be retained out of necessity. However, over the years following Brexit, the UK will become free to implement VAT rules which may diverge from those in the residual EU. Although income and corporation tax laws are a matter of national competence, within the EU they must, nevertheless, comply with treaty freedoms and other EU law. After Brexit, this overlay will no longer apply in the UK. However, in general terms, UK domestic tax law has been amended where it appears necessary in order to comply with these EU requirements, and, although those amendments would not necessarily need to be retained post Brexit, as they generally contribute to the UK's international competitiveness, they would be likely to be retained in the short term at least. The benefit of EU withholding tax exemptions may be lost to UK companies, but the UK does have a very comprehensive network of double tax treaties, which should lessen the consequences of this. There

may be some impact for UK holding companies from the loss of the EU reliefs for group payments, however (e.g., in relation to dividends paid from Germany to a UK parent). Future EU tax initiatives, such as the directive on anti-avoidance and the common consolidated corporate tax base, should not now affect the UK.

In conclusion, there are interesting times ahead. Businesses and law firms alike will need to adapt to life post Brexit and deal with the uncertainties, as well as the opportunities, that it will bring. We will update further on important developments.

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