

Client Update

Brexit: Where Do We Go from Here?

INTRODUCTION

Since the triggering of Article 50 in March 2017, there has been considerable uncertainty as to the blueprint for the United Kingdom's exit from the European Union.

Up until very recently, very few details had been announced. At the time of the trigger of Article 50, we were told that the UK did intend to seek continued Single Market membership and would instead seek a new customs agreement with the EU. We were also advised that there was unlikely to be a deal based on freedom of movement of people, services and capital. On the legislative front, the EU (Withdrawal) Bill, which repeals the European Communities 1972 Act and at the same time enshrines much of EU law into UK domestic legislation, has just passed a second reading in Parliament. Beyond these measures, there remained significant uncertainties relating to the UK's position.

Theresa May's 22 September speech in Florence¹ attempted for the first time to clarify some of the parameters of what was described as a 'new era of cooperation and partnership between the UK and the EU', but a significant number of important points were left open. Some of those parameters have been further clarified in Mrs May's statement to the House of Commons on 10 October and in two published papers on the UK's future trade policy² and customs arrangements³. A few important points for businesses have emerged.

There is now an acknowledgement that a period of implementation will be necessary following cessation of membership. It is also now confirmed that there would be an initial period of

¹ <https://www.gov.uk/government/speeches/pms-florence-speech-a-new-era-of-cooperation-and-partnership-between-the-uk-and-the-eu>.

² <https://www.gov.uk/government/publications/preparing-for-our-future-uk-trade-policy>.

³ <https://www.gov.uk/government/publications/customs-bill-legislating-for-the-uks-future-customs-vat-and-excise-regimes>.

regulatory convergence. Finally, the government has also set out, for the first time, its detailed plans for trade and customs arrangements, both of which envisage contingency arrangements in the event that the UK does not strike a deal. This is important given recent reports of a potential 'stalemate' in negotiations between the UK and the EU.

In this update, we describe the impact of these recent developments for businesses operating in the UK.

Proposed Two-Year Period of Implementation

The Prime Minister's Florence speech set out for the first time that the UK thinks that a 'time-limited' implementation will be necessary following the UK's cessation of membership from 29 March 2019. This is consistent with the stated policy positions of the City of London and organisations such as the British Bankers' Association⁴. A two-year period was proposed as the minimum that was needed for businesses, people and public services to plan for what was described as a single set of changes. This would mean that the status quo will remain in place until at least 29 March 2021. The Prime Minister has also now confirmed that the jurisdiction and oversight of the European Court of Justice (ECJ) will continue to apply during this implementation period.

This proposal is a welcome one for most UK businesses. A four-year 'incubation' period allows for better and more extensive planning and adaptation. It is an attempt to minimise business disruption and to avoid a cliff-edge scenario. This is particularly in the sectors such as banking and financial services, where existing operating arrangements are subject to legal uncertainty and where adaptation may require operating out of branches/subsidiaries in the EU.

Clarification that the ECJ will provide oversight over the rules that continue to apply is also welcome, particularly because important legal questions relating to affected parties' rights and obligations will ultimately require speedy, expert resolution, and it is too late to agree and develop a separate, independent, judicial organ to perform this role.

It should, however, be noted that there has not yet been a commitment from the EU with regard to this proposed arrangement. Michel Barnier, European Chief Negotiator for Brexit, has stated that the EU would have to decide whether such a period was in its interest. He also made it clear that any transition would have to respect fully the legal and financial framework of the Single Market such that 'regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures'⁵ continued to apply in full. There is therefore no assurance that the EU will agree to any transitional arrangements. Indeed, certain EU member states may take the

⁴ <https://www.bba.org.uk/wp-content/uploads/2017/02/BOB-6-2.pdf>.

⁵ http://europa.eu/rapid/press-release_STATEMENT-17-3427_en.htm.

view that they will benefit from the lack of certainty that will ensue in the United Kingdom if there is no deal.

The UK's position is also susceptible to change. Internally, the UK cabinet is still divided over the transition period and its length, and the Prime Minister is also subject to significant political pressures following her losses in the June general elections. There is no guarantee that the proposed transition period will withstand parliamentary scrutiny or that the position she has articulated on behalf of the government will continue to remain her or even the government's position in the long term.

Finally, a two-year implementation period is a brief one, particularly when considering the long-term stability of the existing regulatory framework and when one observes that Britain benefited from a seven-year transition period when joining the then European Community in 1973. Businesses may ultimately wish for a second, longer time period to establish regulatory equivalence and mutual recognition. This is not, however, assured.

Regulatory Convergence as a Proposed Starting Point

Another key confirmation is that immediate large-scale regulatory changes at the time of Brexit was to be avoided.

Whilst it was clear from the terms of the EU (Withdrawal) Bill (pursuant to which EU rules, and regulations will continue to apply and will be carried over into domestic law) that the government wished to avoid the sustained business disruption that would follow from 'a black hole' in the statute books, it has not always been clear what the UK's regulatory climate would be in the medium term. In particular, it was not certain whether it was the intention that the UK would continue to adhere to EU legislation or whether Britain would adopt what was referred to as a 'Singapore-on-Thames style' model whereby the regulatory burden imposed by EU rules would be lowered to promote competitiveness.

We know now that even following the proposed implementation period, the UK's regulatory position is intended only to reflect necessary modifications to the current regime as opposed to an entirely fresh start. Mrs May cited the 'pre-existing regulatory relationship' that made it easier to secure mutual market access, and she expressly singled out as a benefit the fact that the EU and the UK 'share[d] a commitment to high regulatory standards'. This suggests that the regulatory framework for the UK once it exits the EU will be one of close partnership or convergence.

If this period of regulatory convergence is accepted, businesses operating in the UK with a presence in Europe can operate without fear of an immediate regulatory 'double-whammy'. Therefore, although passporting rights (which allow UK businesses validly registered in the EEA to do businesses in other EEA states without needing further authorisation) would be lost,

the UK should be able to demonstrate that it has 'equivalent' regimes which would allow EU market access in certain sectors to UK-registered firms.

In principle, this should not be difficult given that most existing UK regulation stems from EU rules. However, this is not a perfect solution as equivalence does not cover all services provided by passporting. Also, in order to maintain equivalence, the UK would need to closely mirror additional changes to EU legislation in the future. This is not guaranteed given the lack of consensus on what will occur when, as the Prime Minister put it, 'we differ from the EU in our regulatory choices'.

Trade and Customs Arrangements

When addressing trade arrangements in her Florence speech, the Prime Minister rejected what she saw as a binary choice between an arrangement based on European Economic Area membership and one based on a traditional free-trade agreement. She instead suggested designing a bespoke, 'ambitious economic partnership' that would respect both the freedoms and principles of the EU and 'the wishes of the British people', but no details of how this arrangement would work in practice were offered.

Proposed Trading Arrangements

The UK's position, as set out in the recently published paper, 'Preparing for our Future UK Trade Policy', appears to focus on the period post-transition. Whilst the paper states that the government is committed to the principle of free trade with the EU, it does not at all focus on how a UK-EU deal would work in practice. What is made clear is that the UK has given significant thought to how it intends to establish and operate an independent trade policy without the support of the EU. The paper sets out that the UK will be regaining its seat at the WTO and that it will be seeking to boost relationships with 'old friends and new allies'. To maintain stability, all existing EU trade agreements and preferential agreements will be transitioned domestically, and a trade preferences scheme (with particular focus on developing countries) will be instituted.

It is also made clear that the UK intends to pursue free-trade negotiations with third countries during the proposed transition period, even though it will not be able to bring into effect any negotiated agreements during this time.

Proposed Customs Arrangements

The paper on the UK Customs Bill also addresses the eventualities of 'deal or no deal' in detail.

In line with the position on legal and regulatory convergence (see above), it is made clear that at the point when the UK leaves the EU, the government will keep UK customs rules as consistent as possible with EU law, responding to business requests for continuity and certainty.

In relation to the future relationship with the EU, two models are proposed.

The first is described as a ‘highly streamlined customs arrangement’ pursuant to which customs formalities will be introduced, but additional requirements would be minimised in respect of goods either by, inter alia, negotiating waivers for entry and entrance declarations or by the UK remaining a member of the Common Transit Convention (simplifying border crossings), negotiating mutual recognition of authorised economic operators, implementing technology to minimise delays and simplifying administrative requirements. The second proposed model is described as a ‘new customs partnership’ whereby the UK mirrors the EU customs’ approach at its external border for goods that will be consumed in the EU, even if they are a part of the UK supply chain. Finally, a contingency scenario is also detailed on the basis that there is no deal. In that scenario, the UK will establish a stand-alone customs regime including setting tariffs and quotas and establishing a goods classification system in line with its WTO obligations.

It remains to be seen which of these scenarios (all of which are subject to consultation and comments from stakeholders) ultimately will be adopted. The second ‘customs partnership’ scenario seems most similar to existing arrangements, and it is doubtful whether it will be agreed to by the EU without concessions by the UK on the other freedoms.

RECOMMENDATIONS FOR BUSINESS

Given the nascent stage of the UK’s proposals and the accompanying uncertainties, it is our view that businesses should continue to plan for the future taking a strategic review of all risks and modeling a combination of best-case, worst-case and most-likely scenarios. The government has stated that it is preparing for ‘all eventualities’ and so, therefore, should businesses.

Much has been made of the proposed implementation period, but it is important to underline that it is only a proposal. It is, therefore, imperative that businesses factor in the possibility that there may be a sudden ‘hard Brexit’. Similarly, although it appears that the United Kingdom will be guided by the principle of regulatory convergence post-Brexit, rights that are predicated on agreement by the EU should not be taken for granted.

Legal counsel should therefore be consulted for comprehensive commercial reviews of legal and regulatory strategy and operations including:

- the challenges and costs of the risk of regulatory divergence and trade and customs barriers;
- the effect on profits of possible price inflation, currency and tax variations and fluctuations;
- the impact on key contracts and supply chains; and
- the effect on staffing requirements.

In all cases, there must be careful contingency planning in case there is no implementation period or if no agreement is achieved during this time. The government has repeatedly reiterated that it is prepared to walk away from the negotiating table with no deal, and, given the lack of progress following five rounds of negotiations, this is a risk that now must be taken even more seriously.

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Please do not hesitate to contact us with any questions.

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