Client Update
Brexit—The Future UK-EU relationship

LONDON
Katherine Ashton
kashton@debevoise.com

Lord Goldsmith
phgoldsmith@debevoise.com

James Scoville
jcscoville@debevoise.com

Richard Ward
rward@debevoise.com

Aatif Ahmad
aahmad@debevoise.com

Vera Losonci
vlosonci@debevoise.com

Timothy McIver
tmciver@debevoise.com

Alex Parker
aparker@debevoise.com

Robin Lööf
rloof@debevoise.com

Ceinwen Rees
crees@debevoise.com

Boxun Yin
byin@debevoise.com

Konstantin Bureiko
kbureiko@debevoise.com

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Last week, the UK government provided its first firm indication since the June 2016 Brexit referendum of how it intends to depart from the EU. Prime Minister May's long-awaited speech emphasised that Brexit means "hard Brexit" and no deal for the UK is better than a bad deal.

While much remains to be clarified, the Prime Minister announced that the UK will leave the EU's single market, instead aiming for a comprehensive trade agreement with the EU. Furthermore, the UK government will seek to leave behind aspects of the European customs union which could restrict its capacity to strike trade agreements with third countries, while potentially maintaining elements to facilitate Irish border arrangements and the movement of goods in specific sectors.

The UK government anticipates negotiating new arrangements with the EU within the two-year period the EU Treaty provides for the exit talks under Article 50. Doubt has been cast on whether this timeline is realistic given the complexity of the negotiations. The European Commission's chief negotiator, Michel Barnier, has stated no new trade or other arrangements will be discussed before the exit deal has been agreed. Furthermore, the EU may demand as much as €60bn from the UK to cover existing long-term liabilities. Such factors mean that the uncertainty around the UK's future relationship with the EU could persist for many years.

In this context, any predictions about the future need to be made cautiously.

Based on what is now known of the UK government's intentions, we set out some of the potential changes to the legal landscape that may occur following the UK's departure from the EU.

FINANCIAL SERVICES

Whether the "*greatest possible access to the single market*", as Prime Minister May put it, is compatible with non-membership, especially in the context of financial services, is open to debate.

Non-membership of the single market will almost inevitably mean the loss of the passporting rights that UK financial services firms currently enjoy. Many financial services businesses describe passporting rights as essential. An estimated 22% of the UK banking sector's and 26% of the UK asset management sector's overall revenues derive from EU business. Approximately 11% of Lloyd's of London's annual premium income relates to cross-border services in the European Economic Area (although recent estimates suggest that the percentage of annual premium income linked to passporting rights may be nearer to 5%).

If passporting rights terminate, UK financial services businesses will no longer be able to provide services into EEA states under the supervision of the UK regulator and without establishing a local branch or subsidiary. As passporting rights are reciprocal, financial services businesses in other EEA states wishing to access the UK market after Brexit will face similar issues. The loss of passporting rights will also affect non-EEA firms who access the European market through a single European subsidiary. Whether transitional arrangements can provide continued rights of access to the EU (without local licensing) will depend on the overall dynamic of the UK's withdrawal negotiations.

Separately from any transitional arrangements that may be put in place, some EU directives enable companies from third country jurisdictions deemed "equivalent" to provide services into the EEA without a licence in the EEA. For example, under MiFID2, third country companies registered with the European Securities and Markets Authority (if the firm's home jurisdiction is considered equivalent) will be able to provide cross-border services, including in relation to derivatives and securities, to certain professional clients and counterparties.

Crucially, however, there is no equivalence regime in the directive governing banking, nor in the directive governing retail funds. The passport available since 1989 under the banking directives has played a key role in enabling UK-

authorised deposit-taking banks to engage in activities with counterparties in the EU, including broker-dealer activities. In order for UK-based firms to remain competitive, new equivalence regimes may need to be formulated.

For UK insurers, while equivalence would allow them to continue the group supervision and capital structure model they currently have (and to provide reinsurance on an equivalent basis to EU reinsurers), it will not provide the full rights of establishment cross-border services that passporting currently offers.

Equivalence, therefore, is simply not "equivalent" to the passporting rights available under the single market directives. While the UK may initiate the process of applying for equivalence as soon as practicable, especially for sectors such as central clearing, there is no guarantee of successfully negotiating acceptable terms by March 2019. Even if negotiated, equivalence is a political decision that can be withdrawn or amended at the discretion of the EU.

A possible alternative to equivalence would be a bespoke agreement, similar to the existing agreement between the EU and Switzerland, to preserve some access to the single market. Such an agreement would inevitably take time to negotiate and may not be concluded within the two-year period envisaged under Article 50. However, on the basis of the Prime Minister's speech, bespoke agreements appear to be the government's preferred option.

The Prime Minister's confirmation of a hard Brexit comes when the EU and the U.S. have concluded an important trade deal which could significantly boost transatlantic insurance business. The so-called "Covered Agreement" on reinsurance, group supervision and information exchange demonstrates the increasingly global nature of insurance regulation.

Whether the UK can negotiate a similar agreement to cover other important financial sectors will depend on what the UK can offer to the EU by way of access to the UK market. The UK is currently a key supplier of financial services to EU businesses and consumers and a major market for many EU-based industries such as manufacturing. It is possible that a bespoke trade deal in which the interests of the EU and the UK are protected, with the EU gaining access to the UK market in sectors of importance to it (such as manufacturing) and the UK enjoying in return access to various EU services markets (such as financial services) would be acceptable to both sides.

COMPETITION LAW

The underlying fundamentals of competition law enforcement in the UK are unlikely to change materially in the short term. At the same time, there are immediate issues that will need to be addressed if the UK leaves the single market and is no longer a member of the EEA.

In a merger control context, the end of the European Commission's jurisdiction as a 'one-stop shop' for mergers meeting the EU thresholds means the UK would have competence over a number of transactions that it would not have had previously. This would have some important consequences.

First, some form of transitional arrangement will be necessary to deal with cases where the parties have already engaged with the European Commission or are partway through a review. That should ensure that the companies involved are not prejudiced in their rights of defence and appeal, or the enforcement of any remedy.

Second, from whatever cut-off date is agreed, companies will need to factor in the costs and timing implications of a parallel review by the UK competition authority (the CMA) at the same time as notifying at an EU level. In turn, the CMA will face an increased workload and a number of those cases will be large and complex, as they would previously have been handled by the European Commission. That has implications for government in terms of funding and resourcing the UK review process.

Third, continued close procedural cooperation between the EU and UK authorities will be necessary in order to provide legal certainty for business and to avoid conflicting decisions being taken in the context of multi-jurisdictional reviews or complications around suitable remedy proposals.

In the longer term, the end of the 'one-stop shop' could well result in significant changes being made to the current UK merger regime to deal with more large, multi-national deals.

TAX

The Prime Minister's speech provided two big hints as to the post-Brexit UK tax landscape, although, as with all areas discussed in this paper, the final layout will depend on negotiations.

First, it is now confirmed that the UK will seek to leave the European Customs Union, meaning that EU imports to the UK could become subject to customs

duties. Similarly, UK exports to the EU may become subject to customs or other duties. The Prime Minister also talked of her desire for the UK and EU to trade easily, which suggests that a new raft of customs duties is not contemplated. We know that the EU can be flexible when it comes to the Customs Union - Norway and Turkey are such examples - yet the Prime Minister's message was that the UK would not seek to adopt a model already enjoyed by another country, so it remains unknown what form the UK's trade with the EU outside of the Customs Union would take.

Second, the Prime Minister made it clear that Britain is not afraid to use its tax system as a bargaining chip—with both the headline rate and general tax policy as tools to "attract the world's best companies and biggest investors to Britain". Tax rates are always a somewhat controversial issue. Aggressive tax planning has been very much in the spotlight recently with the release of the OECD recommendations to tackle base erosion and profits shifting (BEPS). The UK already has the lowest corporation tax rate in the G20. While it is difficult to imagine the UK emulating its neighbours in the Channel Islands to become a tax haven, the Prime Minister did suggest that the UK could "change the basis of Britain's economic model".

Perhaps the more interesting point here is around the use of tax policy to encourage inward investment. This will likely anger those EU states who are currently subjected to increased EU interference with their domestic tax policy through State Aid regulation - the recent Apple-Ireland ruling is perhaps just the tip of the iceberg. The EU's recent spate of State Aid decisions means there are disgruntled multinationals operating in the EU; the UK could, in theory, offer them a home.

DISPUTE RESOLUTION

Prime Minister May made it clear the UK will aim to pursue free trade agreements with the EU and with countries outside the EU. This raises the question as to whether these agreements will provide for a mechanism for resolving investment disputes and what form this would take.

One option would be through Investor-State Dispute Settlement, as with most Bilateral Investment Treaties. An alternative would be through a standing Investment Court, such as the one set up in the Canada-EU Comprehensive and Economic Trade Agreement. Either option would likely allow investors an alternative to litigating in the domestic courts.

Many businesses will have entered into longer-term contracts premised on continued free access to EU markets. Whether, as a matter of law, the UK's withdrawal from the single market and Customs Union will allow a business to terminate an uneconomical contract will be a matter for negotiation and potentially determination by the courts.

In this regard, force majeure and material adverse change clauses are likely to be of particular significance. To address the post-Brexit risk of a contract becoming commercially unviable, parties might seek to amend them preemptively. Although Brexit could present an opportunity to withdraw from contracts, caution needs to be exercised to reduce the wrongful termination risk.

Jurisdiction and applicable law in respect of civil and commercial matters are presently governed by EU regulations. Post-Brexit, these regulations will no longer apply and no guidance has yet been provided as to what might replace them. There would appear to be two main options:

- Reverting to the previous system of English private international law rules. This would allow greater flexibility and allow courts to have regard to the appropriateness of England as a venue for resolving a particular dispute, although at the price of certainty. Additionally, the present regime for mutual recognition and enforcement of EU judgments in the UK, and UK judgments in the EU, in civil and commercial matters would cease, which means recognition and enforcement of such judgments in the EU would become significantly more complicated.
- Maintaining the effect of the existing EU regulations through transitional arrangements as part of a separate treaty with the EU member states.

As to arbitration, it seems likely London will remain a safe, effective, and successful seat for arbitration post-Brexit. The UK is and will remain a party to the New York Convention. English courts will continue to respect arbitral awards, and England has a highly qualified legal profession and judiciary well versed in arbitration law.

WHITE COLLAR AND REGULATORY ENFORCEMENT

Recognising the challenges of transnational criminality, Prime Minister May stated that "*a global Britain will continue to co-operate with its European partners in important areas such as crime, terrorism and foreign affairs. … I therefore want our future relationship with the European Union to include practical arrangements on matters of law enforcement and the sharing of intelligence material with our EU allies*".

This is an area the Prime Minister knows well, having, as Home Secretary, considered and exercised the UK's right to opt-in to important EU measures improving co-operation between the various EU criminal justice systems. The Government's preference is likely to be to retain as much of the EU co-operation framework as possible.

In the early 2000s, the UK was the driving force behind the principle of mutual recognition of national judicial orders across the EU. The UK successfully sought the EU's adoption of the principle of mutual recognition to facilitate cooperation. Ironically, this success may now be a significant roadblock to achieving the UK government's Brexit objectives as the EU's firm stance has hitherto been that mutual recognition is not available for non-member states.

Some of the main areas in which new forms of co-operation will need to be established include:

Data protection: In theory, current EU legislation provides for the free flow of data subject to the protection of the rights of the data subjects within the European Economic Area. In reality, however, member states have adopted very differing interpretations of how data is to be protected which means that, in practice, intra-EU sharing of personal data remains fraught with difficulty.

Post-Brexit individual multinational corporations will still be able to protect themselves by adopting appropriate Binding Corporate Rules to enable intra-company, EU/UK transfers of personal data, and having them authorised by an appropriate EU data protection authority. Absent such rules, the ease with which EU/UK personal data transfers can be effected will depend on whether the UK can obtain an Adequacy Decision from the European Commission. What is already a complex area for multinationals with operations in the EU and the UK (and beyond) will become even more complex following Brexit.

From the enforcement side, the current rules on the sharing of personal data between EU law enforcement authorities will cease to apply to the UK and new arrangements would need to be negotiated.

Evidence gathering: A material improvement in intra-EU cross-border evidence gathering is on the horizon with the advent of the European Investigation Order (EIO), to be implemented across the EU by 22 May 2017. Replacing and repealing previous, more limited provisions, the EIO significantly includes provisions on cross-border testimony as well as surveillance. Post-Brexit, UK law enforcement will not benefit from the EIO and whether the UK will need to revert to cumbersome letters of request transmitted through diplomatic channels or whether a new arrangement can be agreed remains to be seen.

Extradition: With the European Arrest Warrant no longer available, and in the absence of new arrangements being negotiated, extradition between the UK and the individual EU member states would revert to the previous regime governed by the 1957 European Convention on Extradition. This means that proceedings to return suspects or convicts which currently would have concluded within weeks or days, would go back to taking months (or even years).

SANCTIONS

The UK's future sanctions policy, and the impact this will have on UK and international businesses, is far from clear.

As a starting point, regardless of Brexit, the UK will be bound to transpose UN Security Council sanctions regimes into UK law. Many of the current EU sanctions regimes are themselves based on or substantively overlap with the UN Security Council regimes, including those relating to North Korea, Libya, and South Sudan. In practice, this means that sanctions restrictions relating to such jurisdictions will likely remain the same after Brexit.

More nuanced is the question of how the UK will treat non-UN Security Council based EU sanctions regimes, such as those relating to Russia and Ukraine. At one extreme, the UK may agree to continue implementing existing and future EU sanctions regimes through domestic legislation. While this is likely to create some legal uncertainties (such as the extent to which EU law interpretations of those sanctions regimes would be followed by UK courts), it would have the benefit of giving businesses certainty when dealing in the EU and the UK. A similar approach is already taken by British Crown dependencies such as

Guernsey and Jersey, which are not full members of the European Union but voluntarily implement EU sanctions legislation as a matter of local law. Alternatively, the UK may take a more selective approach, in a similar manner to Norway and Switzerland, which have agreed to follow some EU sanctions programmes, but do not automatically adopt every regime. At the other end of the spectrum, a post-Brexit UK may decide to design its own, bespoke sanctions policy or to align itself wholly with the U.S.

Assuming that the UK elects not to follow EU sanctions policy wholesale, international businesses are likely to be faced with a new challenge of ensuring that their sanctions compliance systems and controls not only comply with U.S. and EU regimes, but also with those of the UK. If the UK's sanctions regimes begin to diverge materially from those of the EU, this may lead to businesses needing to consider how to separate their EU and UK operations. Similarly, consideration may need to be given as to how to organise back office functions, such as accounts processing or server hosting, between UK and EU operations, if different regimes sanctions regimes apply.

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There will be many twists and turns in the path the UK has decided to follow, but the first steps leading toward the UK's post-Brexit future can now be discerned.

Please do not hesitate to contact us with any questions.