



BREXIT ANALYSIS BULLETIN

May 2015



On 28 May 2015, the newly elected Conservative government published the EU Referendum Bill. This legislation paves the way for an in/out referendum on the UK's continued membership of the European Union to be held before the end of 2017. This will be the first time the UK has been asked whether it wishes to remain a part of the EU since 1975. In this bulletin, we look at some of the implications of an exit from the EU.

Businesses and individuals are already considering the potential impact of the UK leaving the EU, often referred to as a 'Brexit'. With negotiations among the UK government and EU representatives underway, the detail of any changes to the UK's existing EU membership is still awaited. Once new terms have been agreed, the UK will be asked whether it wishes to remain in the EU (on those new terms) or leave the EU completely.

What happens if the UK votes to leave?

What happens if the UK votes to leave is not clear. Potential options could involve a combination of free trade agreements with individual EU member states, bilateral deals or a customs union with the EU or membership of the European Economic Area (EEA) and the European Free Trade Association (EFTA). It has also been suggested that the UK's engagement with the World Trade Organisation (WTO) could become more significant in the event of a Brexit.

The impact for business and individuals depends on the terms which the UK is able to negotiate in respect of each option and lengthy negotiations after the referendum would be inevitable. This is likely to lead to the UK continuing to have to comply with EU legislation in order to benefit from some of the advantageous terms

and freedoms available under specific options.

In order to exit the EU, the UK will be required to give two years' notice and it is likely that numerous interim and transitional measures would be put in place during this time in order to ensure that the legal and regulatory framework is not removed overnight. The UK leaving the EU, however, would be unprecedented and the complexity of the negotiations as well the wider political background (eg. Eurozone matters) may have an impact on the time frame for a Brexit.

The Transatlantic Trade and Investment Partnership (TTIP), a bilateral trade agreement currently being negotiated between the EU and the US, brings an additional consideration to a potential Brexit.

For this bulletin we have identified some of the key areas where a Brexit would have significant implications on the current legal and regulatory framework. Our experts have summarised below the impact of a Brexit on their individual sectors, including an analysis of the implications of possible replacement arrangements, such as the EEA and free trade agreements.

As a UK firm, Shepherd and Wedderburn is committed



to providing UK and international clients with insightful advice on the legal and regulatory implications of the EU referendum and a potential 'Brexit'. We will issue further updates sector by sector as further information is made available and your usual Shepherd and Wedderburn contact will be happy to discuss at any time what a possible 'Brexit' means for you and your business.

Banking and financial services

The consequences of a Brexit would be wide-ranging and have a significant impact on the banking and financial services sector. With the City of London viewed by many as a bridge to the European single market, and the London Stock Exchange considered one of the top international listing platforms in the world for securities, it is clear that the outcome of the referendum could have far-reaching repercussions. The majority of UK legislation in the financial services and banking sector is derived from EU law and, as such, a Brexit would have a significant impact on the legislative backdrop for banking and financial services. These laws would need to be replaced or amended within the UK, though it is likely that they would be broadly similar to EU law.

Currently, a UK authorised investment firm under the Financial Services and Markets Act has the right to carry on business in another EEA state, with or without a branch, provided that it meets the requirements of the EU single market directive under which the activities will be carried out. This passporting right allows UK authorised firms free access to EU financial markets. Following a Brexit, the UK risks losing this right, the impact of which will vary depending on legislation in that particular sector.

A Brexit could also impact on existing contracts. Indeed, some contracts may contain obligations to comply with EU law. A Brexit could render such contracts impracticable and parties could attempt to alter or exit such contracts as a result. As such, it is possible that many contracts between now and the referendum will be drafted to include provisions regarding a Brexit. It is important for businesses to consider how a Brexit could change the reputation of the UK as a location to base their banks and financial institutions.

Banks and financial institutions are already turning their

attention to the issues arising from a potential Brexit, particularly in light of the General Election result and the confirmation that a referendum will take place. It is important to consider the possible implications now in order to take appropriate steps and minimise potential business disruption.

Competition

On the face of it, it may seem that a Brexit would mean that UK businesses would no longer be subject to EU competition law. That view, however, is too simplistic. EU competition law applies to undertakings (i.e. businesses) whose activities have an effect on trade between member states of the EU. Jurisdiction to enforce EU competition law does not depend upon a business being based in a country that is part of the EU. Therefore, if a UK business was to participate in a cartel which had an effect on trade between member states, this anti-competitive behaviour could still be the subject to enforcement action by the European Commission after a Brexit, as it is now.

Similarly, EU merger control rules would continue to apply where the jurisdictional tests were met. There would, however, be two key differences. First, the one-stop -shop rule would no longer apply, meaning that instead of the European Commission having exclusive jurisdiction over mergers with an EU dimension, companies could be faced with the prospect of having to obtain separate merger clearances from the UK and the EU competition authorities. This would increase transactional costs and regulatory uncertainty. Second, the UK would lose its entitlement to 'call in' a merger for UK consideration where the effects of an EU merger were expected to be experienced in the UK.

Finally, it is worth noting that UK competition law (the Competition Act 1998 and the Enterprise Act 2002) would still apply. However, if the current legal position was to be maintained some of the EU block exemptions which currently apply, such as for vertical agreements, would no longer apply to conduct or agreements which affect only UK markets, and those exemptions might need to be replaced in UK legislation. This could potentially lead to a significant alteration in the legal position in the UK if replacement provisions are not introduced.



Construction and infrastructure

Many of the key issues relating to a Brexit, such as changes in taxation and the effect of a Brexit on foreign investment (particularly in the real estate market) into the UK, would inevitably impact upon the construction sector. Restrictions on labour migration from EU states into the UK would potentially also affect the cost of construction projects if demand for labour outstrips supply.

In terms of current UK legislation in the construction industry, a Brexit would have little impact, at least in the short term, as most measures are already enshrined in UK law and there would need to be a specific move to change it. UK-based contractors seeking to work on projects in the EU would continue to have to comply with EU legislation. Changes to the procurement regulations, as referred to elsewhere in this bulletin, could also impact on contractors competing for projects both in the UK and elsewhere in the EU. Those supplying goods and materials to the construction sector would be affected by the terms of any new trade agreements which may be established.

Corporate Finance

UK businesses will await the in/out referendum with three key questions in mind:

1. Will the outcome make the UK more or less attractive to inward investors?
2. Could withdrawal from the EU reduce red tape?
3. How long will uncertainty linger about the impact of a Brexit?

A key point often overlooked is that any vote to leave the EU would trigger lengthy negotiations on the terms of the withdrawal. Some are concerned that this window of uncertainty might discourage investment in the UK. In the longer-term, concerns are focused on the potential impact on access to European markets, the financial dominance of the United Kingdom as a whole, and of London in particular, and the loss of the UK's voting rights in European matters.

Many UK businesses, particularly those in the funds and financial services sector, are currently governed by extensive EU directives and regulations which are

considered by some to be burdensome 'red tape'. It may be, however, that the impact of a Brexit would be broadly neutral in this regard. Notwithstanding the possibility that UK regulation could be relaxed following a Brexit, the UK has historically driven much of the financial regulation adopted by the EU and, at times, the UK has gone beyond the requirements of EU regulation in order to enhance investor confidence in the UK. The UK regime for market abuse is a good example of this.

Corporate Taxation

Leaving the EU is likely to affect the UK tax system in a number of ways. The most notable impact would be seen in relation to VAT. While VAT only applies to supplies made in the UK, the VAT framework is laid down in an EU directive and supplies made to and from other European countries are treated differently to those made in other parts of the world. While the VAT system is underpinned by EU law, a Brexit is not likely to lead to a withdrawal of VAT – it currently raises almost a sixth of government revenue. While that is the case, subject to the terms of the UK's future relationship with the EU, it is likely that, over time, changes to the VAT system would take place as the UK may no longer be constrained by the terms of EU VAT regulations and Directives.

UK membership of the EU has impacted on other areas of taxation with one example being various rules to ensure that taxpayers throughout the EU are treated equally by the UK tax system. If the UK was to leave the EU, it may be that these parts of the UK tax system will be amended to no longer offer such protections to citizens of EU countries. For example, UK personal allowances may no longer be available to EU citizens and other tax reliefs will no longer treat EU businesses in the same way as those based in the UK.

Court System

In the event of a Brexit, the highest courts in Scotland would remain the Inner House of the Court of Session and the High Court of the Justiciary (sitting as the Court of Criminal Appeal), with the UK Supreme Court retaining its existing jurisdiction over Scottish appellate matters. These courts can currently refer a question of EU law to the Court of Justice of the European Union (CJEU) in Luxembourg, with the CJEU ensuring the consistent interpretation and equal application of EU law across the



EU member states. EU law forms part of UK law, and any decision to leave the EU will require a process by which the UK can disentangle itself from EU law. Whilst the CJEU would no longer have jurisdiction to hear cases from the UK, to the extent elements of EU law remain following withdrawal from the EU, the UK courts would need to consider the mechanism by which such EU law is to be interpreted.

Electricity and downstream gas

For electricity and downstream gas companies, a Brexit would raise a range of significant questions. There are a range of European companies with interests across much of the EU. They transfer staff and capital freely across the EU. Their ability to do so is underpinned by the EU freedom of movement of goods and capital. The continued ability to transfer key personnel to and from UK operations, and transfer capital in and out of the UK after Brexit would be a key issue.

EU law now sets critical aspects of the UK regulatory framework for electricity and gas. EU law requires that regulators such as Ofgem/GEMA must be independent from political influence. Regulatory independence is a key protection for investors, in particular as energy has become much more political. It also requires that Member States do not unlawfully discriminate between companies, thus ensuring that foreign investors are not disadvantaged against “national champions”.

For investors in renewables, EU law provides a legally binding target for the UK. That target is much more difficult to change than UK law targets. EU targets underpin significant investments in renewables because investors know that the EU target makes it much more difficult for the UK to reduce its domestic targets and related support schemes.

The EU energy market is becoming much more integrated physically and economically. The UK now sources much of its gas via the interconnectors with Europe, and there is now a significant degree of electricity interconnection with Europe. The trend is for greater integration. This relies on a common set of rules against which large capital investments can be made. The rules also help promote security of supply. The EU is promoting more integration, and it is generally agreed that this is essential to promote energy security at an economical price. Against this background a Brexit is a significant issue for the UK energy sector.

Employee Share Schemes

Currently it is relatively easy for UK companies to extend their employee share schemes to those employees based in other EU member states. If the UK leaves the EU then operating international schemes may prove to be more complex and costly.

Employment

The free movement of workers between member states is a central pillar of the EU. If we were to leave the EU entirely, the UK would regain control of its borders and the current immigration system would need to be overhauled. EU nationals could potentially face the same visa restrictions as those from outside the EU. However, the extent of change would be dependent on the nature of any new relationship with Europe. If the UK were to join the EEA/EFTA, this would guarantee workers the right to free movement throughout the EU and other EEA nations so would not curb immigration. Alternatively, if the UK were to follow the Swiss model and enter into bilateral agreements with the EU, amendments to the current immigration system would still be needed.

The following EU directives underpin key aspects of UK employment law and apply to all members of the EEA: the European Acquired Rights Directive, which protects employees during business transfers and is embodied in UK law by the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE); European Working Time Directive, which regulates hours of work and notably holiday pay; European Collective Redundancies Directive; Equal Treatment Directive; Part-time Workers Directive; Posted Workers Directive; Parental Leave Directive; European Works Councils Directive and the Agency Workers Directive. As such, if there was a Brexit followed by an agreement to join the EEA, Britain would remain bound by many regulations and decisions that it was seeking to avoid by exiting the EU, but with less influence over the legislative process. In addition, the EFTA Court, which would have jurisdiction in these matters for EEA nations, is bound to follow decisions of the CJEU. Switzerland, with over 100 bilateral agreements with Europe, operates TUPE, collective redundancy and working time, and its courts treat CJEU decisions as persuasive.

Currently, UK legislation is in place to implement EU law so there will be no immediate change in the event of a vote to leave the EU. However, the impact over time on UK employment rights and working practices could



be significant, although the extent of any change will be dependent on the nature of any new relationship with Europe and/or membership of the EEA/EFTA.

Food and drink

Food and drink exports are particularly significant for Scotland – in 2012, food and drink exports from Scotland amounted to £5.3bn, with approximately 80% of that number relating to whisky exports.

In the event of a Brexit, food and drink producers would be exposed, at least potentially, to higher charges at all points in the supply chain when exporting to the EU. These charges could arise in two main areas:

- Tariffs on exports to EU member states.
- Increased administration incurred on goods crossing the Border of a customs union — likely to be true for all manufacturing sectors.

Some food and drink producers are no stranger to the difficulties of conducting business in high tariff jurisdictions. Scottish whisky currently faces a 150% tariff in India and the Scotch Whisky Association continues to lobby against this.

A potential Brexit cannot be viewed in isolation and it is necessary to consider what a post-Brexit trading landscape would look like. If the UK sought new free trade agreements, following the model of Norway, or bilateral deals, as adopted by Switzerland, there would still need to be compliance with EU law in order to continue exports into the EU. Given that so much recent food law on labelling, permitted additives, country of origin, etc, will still exist in the key export markets, UK producers and exporters would still have to comply with EU law in order to enjoy the benefits of continued sales in major European markets.

Current international free trade deals, for example, most recently with South Korea, were negotiated at an EU level and the UK would have to negotiate such deals afresh in the event of a Brexit. The high Indian tariffs on Scotch whisky continue to be the subject of debate in the context of an EU/India Free Trade Agreement.

In terms of food production, a Brexit would mean no

further Common Agricultural Payments, in relation to which the UK is currently a net contributor. The costs, benefits and consequences of this change cannot be fully determined at this stage without further details on what an alternative UK-based structure would look like. It is likely that food and drink suppliers would face uncertainty and, in common with other sectors, a likely downturn in foreign direct investment in the short-term alongside a potential period of paralysis.

Human rights

The UK Human Rights Act 1998 enshrines the European Convention on Human Rights into UK law. The European Convention on Human Rights is governed by the Council of Europe, which is a separate institution from the EU. As such, even if the UK were to vote to leave the EU, the European Convention on Human Rights would still be enshrined in domestic law and would continue to operate in the current manner. However, human rights law in the UK may be reformed in light of the Conservative government's proposal to replace the Human Rights Act with a UK Bill of Rights, subject to the consultation it has recently announced.

Insolvency

The European Insolvency Regulation (EUIR) established a regime for automatic mutual recognition within the EU of insolvency proceedings. The EUIR was put in place with a view to ensuring that a single insolvency procedure, commenced at the centre of main interests (COMI) of an entity, will operate throughout the EU. The EUIR provides uniform protections for security rights, employment rights and various other interests. It also allows some insolvency proceedings in relation to establishments in other member states to operate co-operatively with the main COMI proceedings. Further refinements of the EUIR are due to come into force shortly.

If the event of a Brexit, it is likely that the UK would seek to put in place arrangements with EU states which are similar to the EUIR. The key objectives for any new arrangement would be to preserve the stable environment which is currently available for business restructuring within the EU and to replicate the relatively predictable insolvency backdrop to lending and investment activity within the EU.

The Model Law on Cross-Border Insolvency, promoted by the United Nations Commission on International



Trade Law, has been enacted in the UK and various other states and provides COMI-based assistance to foreign insolvency representatives. It is, however, far less extensive than the EUIR and only operates between states which have both enacted the Model Law. EU directives relating to credit institutions and insurers which are parallel to the EUIR have been extended beyond the EU to EEA institutions and insurers. While this is linked to rules on financial regulation, it is possible that this could provide a model for a broader application of the EUIR preferable to the Model Law alone.

Intellectual property, data protection, freedom of information

While Freedom of Information is a Scottish matter, data protection legislation comes from the EU, currently by way of a Directive (enacted in the UK as the Data Protection Act 1998) and this is proposed to be covered by a Regulation in the near future. The Regulation is proposed to create certainty across the EU for businesses and a Brexit may mean that businesses would grapple with a regime that could differ between the UK and the EU.

The UK is part of the one-stop-shop European Trade Mark application and grant process and is supportive of the European unitary patent and unified patent court. While international conventions beyond the borders of the EU are key to intellectual property law, many of the developments in intellectual property law are driven by the EU and this allows UK companies to deal with broadly similar treatment of IP in many legal systems across the EU.

Pensions

The regulation of private pensions in the UK has traditionally been carried out at a UK-level, but recent trends have moved greater influence towards the EU. The EU's IORP Directive in 2003, for example, formed the basis for the UK's Pensions Act 2004.

With tax and funding issues, cross-border pension provision within the EU has remained relatively rare. The IORP regime is currently being revised and substantial changes have been proposed as part of that process. Key employment principles, enshrined in the EU treaties, have also had an impact on pensions in the UK – with many schemes continuing to grapple with the impact of

equalisation of benefits and age discrimination.

In the event of Brexit, it has been suggested that the UK may opt to join the EEA. Members of the EEA are required to adhere to EU rules, including the IORP regime, but are not traditionally involved in the rule-making process. The UK pension market is relatively unique compared to other European models and there is therefore a risk that the UK may become subject to rules which are inappropriate for the UK pension market or which are overly onerous.

Planning and environment

Since the UK joined the European Community, environmental legislation made at EU level has increasingly shaped domestic environmental legislation across the UK. The constituent parts of the UK have transposed various EU directives relating to the environment into domestic law, and in many cases, domestic legislation has gone further than what is required by the Directives. In the event of a Brexit, it is unlikely that domestic legislation originally deriving from EU law would significantly change.

There is recent EU legislation relating to the environment that the UK must now implement into domestic law. Some of this legislation could have far reaching consequences. For example, the new Directive on environmental impact assessment includes new monitoring obligations and timeframes relating to environmental impact assessment. Depending on the outcome of the referendum and the timing of this, the UK may not be required to implement those changes into domestic legislation.

In the event of a Brexit, the UK may be required to have in place levels of environmental protection equivalent to the rest of the EU if it wishes to maintain trade relationships with Europe.

Private client

The EU has generally only taken limited action in relation to trusts, succession and personal taxation and even where measures have been adopted, the UK has often chosen not to adopt those measures. It might, therefore, be thought that a Brexit would have little or no impact on private client issues. While that is true to some extent, a Brexit could mean a number of changes to the UK tax code, such as the removal of agricultural property relief



in relation to farmland in EU countries and the removal of tax relief to charities located in the EU. In addition, UK-based individuals holding assets in EU countries could find themselves subject to a more punitive taxation regime as compared to that which applies to EU nationals.

Property

The UK and the EU are major markets for each other, and the many UK businesses, including investors, retailers and developers, with property interests in Europe, will be concerned about the regulatory and fiscal implications of a Brexit. Any changes to freedom of movement provisions could have repercussions for the property industry.

Funds which invest across different jurisdictions are likely to want to continue to invest across their desired locations regardless of the extent of the EU, but as this is often a matter governed by the internal constitution of a fund, scrutiny of their constitutional documents will be required to ensure investment in the UK could continue following a Brexit.

Inward cross-border investment is likely to be affected by a Brexit, and lower foreign direct investment in property is likely to result. The occupier market is likely to suffer, as global organisations and major corporates, especially in financial services, seek to cut back their UK operations and take them back to their traditional bases.

A Brexit is likely to affect the ease with which supply chains work across Europe, since property owners, developers and occupiers, in common with other businesses, are heavily reliant on goods and services that come from outside and through the EU.

Having just gone through the latest round of reforms to the Common Agricultural Policy and the system of

entitlements, farmers and estate owners will be anxious to understand how a vote to leave the EU would affect them. The system which emanates from the EU, but is administered locally within EU countries, could be replicated, but how it would be funded will be of concern.

Much of the UK legislation affecting property which emanates from the EU, such as energy efficiency and energy performance of buildings, is likely to be retained, certainly in the immediate aftermath of a Brexit, and in line with the UK's commitment to carbon emissions reduction.

Public Sector

There are a number of public sector issues that would be impacted in the event of a Brexit, many of which are dealt with in other areas of this note. A Brexit would clearly impact regulated activities, such as public procurement.

In the short term, as the implementing legislation is governed by Scots and English law, there would be no immediate change. The UK would, however, have a greater ability to vary or revoke that legislation where it is no longer bound to comply with EU directives. This could mean greater flexibility in terms of restricting competitions to UK entities. Likewise, however, it could also mean that UK entities which currently bid for contract opportunities outside the UK may lose the ability to bid for those contracts.

The UK would no longer be subject to EU rules on state aid. It is also possible that the public sector could be impacted by a change in accounting standards as the public sector is currently subject to the internationally agreed European System of Accounts 2010.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with your usual Shepherd and Wedderburn contact.