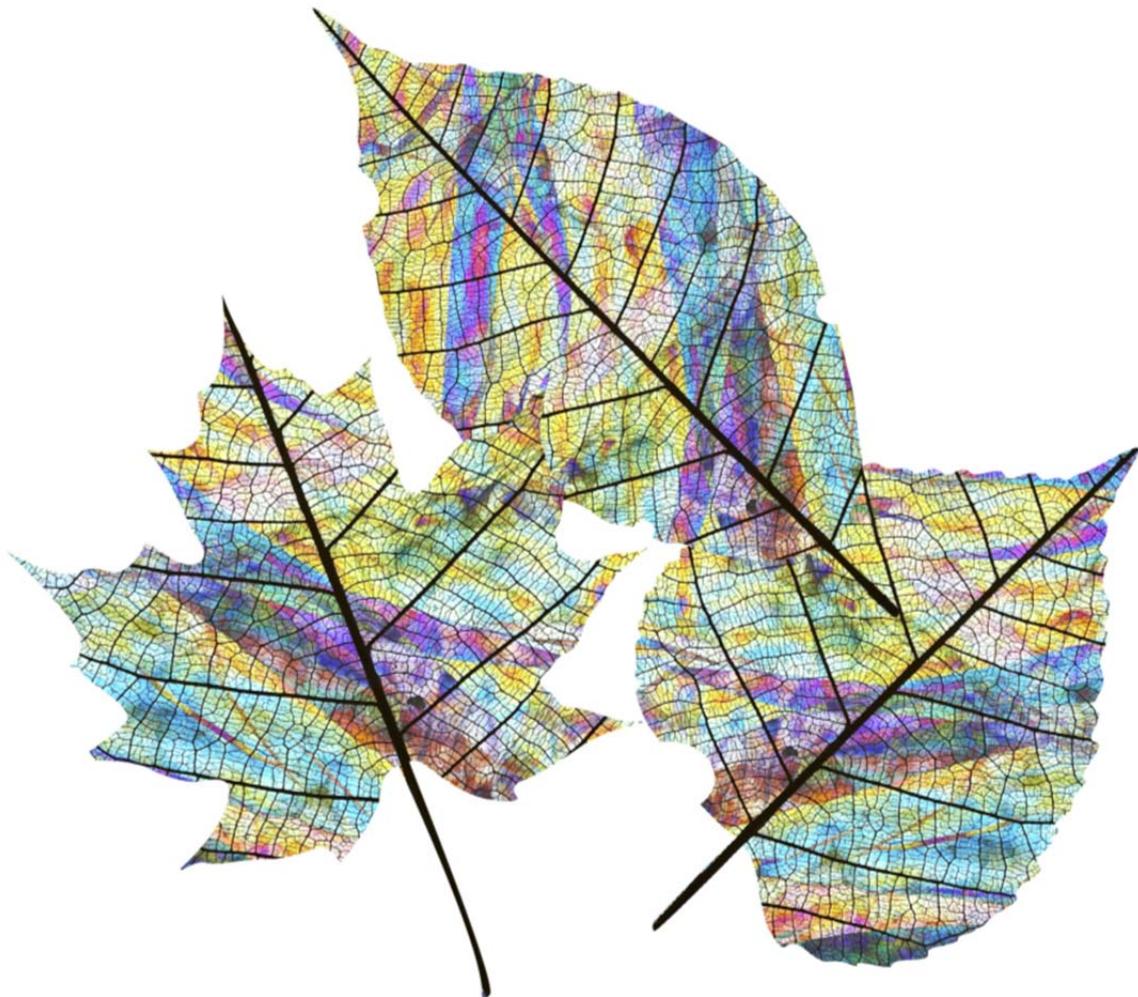


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ALLEN & OVERY GLOBAL LAW INTELLIGENCE UNIT



A lawyer's view on Brexit

5 February 2016

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The A&O Global Law Intelligence Unit is a think-tank led by Philip Wood CBE, QC (Hon) which expresses independent views which are not necessarily the views of the firm.

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What this paper is about

The UK government proposes a referendum in which the ballot question is “Should the United Kingdom remain a member of the European Union or leave the European Union?” The referendum is to be held no later than 31 December 2017. It is likely to be held sometime between Spring 2016 and Autumn 2017. The potential exit of Britain is often called “Brexit”.

In reviewing the issues, people naturally want to know what they should be doing now. But we believe that we should also take a medium term view, i.e. not six months from now or a year from now but ten years from now, even 25 years from now.

The UK could lift anchor and float out alone into the North Atlantic. Or else the UK could remain with the crowd in a much bigger ship and sail forward in the open oceans. To some people, that is the choice. To others the grand ship is a battered barge with its fractious passengers sitting at separate tables. Whatever view you take, we believe that the choice is a fundamental one for the UK and will have far-reaching consequences for the future of the country.

This paper is a lawyer's view of Brexit. This angle is relevant for a number of reasons. The issues are ultimately expressed through the law, for example: how much legal sovereignty should the UK transfer to the EU (constitutional law)? What should be the rules about freedom of trade or services or immigration? How much law should there be? How much regulation should there be? What should the law say about currency or welfare entitlements or employee rights or offering circulars or the capital of banks or the governing law of contracts?

Further, law is the most important ideology underpinning our societies. Societies may decide they can do without other ideologies, such as their religions or their philosophies of life, and that is up to them. But there is no question that societies cannot do without law. The law is the one universal ideology which practically everybody believes in and is fundamental to our survival and prosperity. The law is potent as to whether it restricts us or liberates us – or restricts us so as to liberate us.

Laws can be good or bad. You measure the morality of a society, its credentials, its civilisation, by its laws.

What should you do now?

Taking concrete steps to anticipate the outcome of the Brexit referendum is difficult at this stage. However contingency planning and working out the options make sense. If you think that Brexit is a perceptible risk, the following might be some aspects worth exploring:

- Businesses should evaluate their dependence on the free internal market, for example, EU free trade and free employment, on their ability to passport their banking, insurance or other businesses throughout Europe without barriers, and on their own ability to raise capital in a free capital market and the like. They should consider the possible impact on their own financial condition and credit ratings.
- Businesses should evaluate their exposure to the potential financial health of their counterparties and indeed the future financial health of Britain and its credit rating.
- Businesses can plan what the options are for an investment or merger or disposal or joint venture – for example, whether it should be in the UK, in the continental EU or in Eire.
- They could review their financial covenants, material adverse change clauses, credit rating triggers and other break, termination or ratchet clauses in their own loan agreements, leases, note programmes, share purchase agreements and other contracts.
- They could debate whether their new contracts with counterparties should contain Brexit triggers or termination clauses relating to the counterparty, or should exclude Brexit from material adverse change or force majeure clauses. It could often prove difficult to negotiate suitable clauses.
- They could consider governing law and jurisdiction clauses in contracts. At present, we do not on balance see a compelling case for reviewing English governing law and jurisdiction clauses in contracts if in normal form, but there might be special cases. We do not anticipate that Brexit would prejudice English contract predictability

or that English law and courts would vanish forever down a black hole.

- Some agreements may contain territorial definitions, e.g. to the EU, which may have to be amended. This might include, for example, intellectual property licences, distribution and franchise agreements or insurance policies, as well as other non-compete clauses.
- They could assess their exposures to currencies, to shares and bonds, to interest rates, to commodities and to derivatives and, if appropriate, consider hedging. The impact of Brexit on the value of collateral should be considered. Markets might be volatile in the run-up to the referendum and immediately after any Brexit vote.
- They should consider whether their own special exposures are material enough to warrant disclosure in offering circulars or to investors generally. In ordinary cases, it would probably not be possible to say anything meaningful at present because of the uncertainties.
- Do they depend on grants from the EU?
- They should consider what will happen to a particular sector they are in, for example, energy or transport or pharmaceuticals or telecommunications or real estate or construction. Practically every sector would be affected by Brexit either directly or by the economic climate resulting from Brexit.
- If they plan to lobby or participate in the referendum process itself, they need to understand the relevant electoral laws.

Those in continental EU would investigate these questions in reverse, e.g. how would their relations with UK counterparties be affected?

But contingency planning is significantly hindered by the obscurity of not only the outcome of the referendum (where the main indicator is the vagaries of opinion polls) but also what form a post-Brexit regime would take so far as Britain is concerned. Would it be like the Euro-lite countries, such as Norway (free market and some of the EU regulatory regimes but substantially not the rest) or Switzerland (a nightmare of nearly 130 bilateral treaties) or even Turkey (mainly trade in goods and alignment with some EU laws)? Or would it be like South Korea with its one big free trade agreement? Or would Britain end up completely on its own and have the

same links with Europe as it has with the United States? Further, the disentanglement after an exit vote could take at least two years, possibly closer to five. So, although people should work out the options at this stage, moves now run the risk of getting it wrong. One recalls that in relation to the Greek crisis in 2012 and the recent Scottish referendum, many similar contingency plans were debated, but there was more talk than action.

This is not to say that investors who take positions in equities, bonds or derivatives or the like should not go ahead with their bets, for better or for worse.

Hopefully this paper will help with thinking about some of the specific questions and about the future generally. First, to get a grip on the issues, we need to focus on what the European Union is and what it does. Later we comment on the transition process if the Brexit vote is to leave.

Allen & Overy will be publishing a series of papers on many aspects of the above and of the points in the rest of this paper, including on conflicts of law and contract issues.

What is the European Union?

When you join a club, you join it because of what it does and how much it costs.

The main reason that countries join and stay in the European Union is that it offers a bundle of freedoms. These freedoms are not just economic or functional or utilitarian. They are freedoms which seek higher philosophic values which seek to fulfil more fundamental aspirations.

At the base are some very obvious freedoms which are universal in their spirit, namely the freedom to live where you want, to move where you want, to do business where you want, to set up your business establishments or companies anywhere you wish, to move your money around with you and to spend it where you want, to be employed where you want, to vote where you want and to take your family with you.

If you do not have these things, then you are a slave or serf, tied to your patch of land, fenced-in and fettered.

All countries allow their citizens to exercise the above freedoms internally except those countries which are chaotic or despotic. It must come as a surprise to foreigners that so many Europeans dispute things which seem at first sight to be so normal.

The freedoms are announced in the EU treaty references to freedom of trade and services, freedom of movement of people and establishment and freedom of capital movement and payments. It is true that these freedoms are hedged about with qualifications and ifs and buts, the result of decades of compromise and bitter arguments. Nevertheless, they are substantially there. They are greater by a large margin than those which exist between independent countries in the world which still live behind their own fortress walls.

On top of these freedoms – which are often demoted to the level of pure economic or utilitarian freedoms – there are more profound freedoms which are fundamental to how we live and which are also fundamental to our prosperity and economies. These freedoms are therefore both functional and philosophic, our way of living. They are the liberal values of democracy and the rule of law. There is no question that the European Union has been a major force in the world in promoting these ideas and influencing the outcomes. Examples are Spain and Portugal in the 1980s, the central and eastern European countries after the collapse of the Soviet empire, and the pressures the EU can bring to bear internally.

People who have never lived in a despotic country can hardly imagine how awful it is. Quants can't put a metric on this so they leave it out. But the rest of us know that these things are valuable.

What countries are in the European Union?

The European Union comprises practically the whole of western Europe and central and eastern Europe. There is a list in the data set out in the appendix, numbering 28 countries in all. The biggest countries are Germany, the United Kingdom, France and Italy. The smallest is Malta. The latest is Croatia.

Candidate countries to join the EU are Macedonia, Montenegro, Turkey, Serbia and Albania. Potential

candidate countries are Bosnia and Kosovo. Maybe there will be others in the future. Applicants have to show that not only will they be able to put in place the accumulation of existing EU law and practice (a dossier of about 80,000 pages), but also that they have stable institutions guaranteeing the rule of law and human rights. Hence the political pressure on new members.

The European Free Trade Association countries are Iceland, Liechtenstein, Norway and Switzerland. The European Economic Area comprises the EU and EFTA, except for Switzerland. The EFTA countries have various degrees of euro-litensness.

The EU could be a very different place at the end of the next two decades. A major issue for the UK is whether it aims to be part of the decision as to what happens to the future membership of the EU.

How are EU laws made?

The European Constitution is contained in two separate documents – the Treaty on European Union and the Treaty on the Functioning of the EU. The division arose because of constitutional problems when the relevant Treaty of Lisbon was agreed.

The main government institutions of the EU are as follows:

- **European Commission** This is the EU executive, the bureaucracy, the civil service. Its main job is to propose legislation. Each member state sends one Commissioner to Brussels. The president is elected by a consensus of the heads of government of member states and approved by the European Parliament.
- **Council of Ministers** Together with the European Parliament, the Council is responsible for passing legislation. It is composed of ministers from the national governments of member states. There is a permanent President of the Council elected by the heads of government of the member states. Currently this is Donald Tusk of Poland. One member state holds a Chair or Presidency position. The Presidency rotates between the member states every six months. Voting is via a qualified majority except on entrenched matters which require unanimity, e.g. defence, tax, social security,

immigration. The qualified majority voting requires (1) 55% of the members of the Council, (2) that 55% comprises at least 15 of those members and (3) those Council members represent member states comprising at least 65% of the population of the EU (over 500 million). There are rules about blocking minorities. Each member state has a national delegation in Brussels. In practice, the Council tends not to override a member state which strongly objects.

- **European Parliament** This has 736 members arranged in formal parties and directly elected every five years by all EU citizens according to their country, e.g. 99 members for Germany, 72 for the UK and five for Malta. The quotas are based on population. Elections are based on a system of proportional representation, not the British “first past the post”. The Parliament delivers formal opinions on legislative proposals from the Council of Ministers and so, with the Council, it passes legislation. The Parliament ultimately has rights of veto, including in relation to the EU budget.
- **European Council** This is the summit of heads of member state governments who meet at least twice (usually four times) a year to discuss policies. It has no legislative role.
- **Court of Justice of the European Union** This court is the ultimate arbiter of what EU law is. National courts may refer matters to it. The court has 28 judges, one from each member state and is assisted by advisory advocates-general. There is also a General Court which for some purposes is a court of first instance.
- **European Investment Bank** This is the EU financial institution which provides loans and other finance to firms in member states and sometimes non-member states.
- **Others** There are numerous other institutions and agencies, including a Court of Auditors which audits the revenues and expenditures of the EU and bodies set up by the EU, a European Economic and Social Committee, which includes representatives of employers, workers and others, and a High Representative for Foreign Affairs and Security Policies.

EU LEGISLATION

This comprises (1) **regulations** which are directly applicable in all member states automatically, (2) **directives** which set out the result to be achieved and which member states implement by their own legislation within a specified period, and (3) **decisions** binding on their addressee, e.g. parties violating competition laws. There are also various non-binding opinions, recommendations and other guidelines. EU laws override national laws. Various general principles of EU law have been developed by the EU in relation to law-making. These include:

- the principle of “subsidiarity”, to the effect that the EU shall take action only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the member states and can therefore, by reason of the scale or effect of the proposed action, be better achieved by the Community. The effect is to reduce the scope of EU competency over member state sovereignty.
- proportionality, that is, a public authority may not impose obligations on a citizen except to the extent to which they are strictly necessary in the public interest to attain the purposes of the measure.
- various protections of fundamental rights on the lines of those in the Charter of Fundamental Rights which has legal force under the Treaties. The European Convention on Human Rights, drafted in the late 1940s with major input from the UK and legislated into law by the UK in 1998, is not an EU code, but has its own court, a court which has sometimes irked the British public. A withdrawal from the EU would not include a withdrawal from this convention, although the UK government has separate plans to modify this area.

On Brexit the UK would not participate in the EU institutions mentioned earlier and would not participate in decisions on future members or exits or laws. There is a procedure for exiting unilaterally in the relevant treaty after two years but any exit is likely to be on an agreed basis. There are independence movements in many EU member states of varying degrees of strength, but at present the EU seems stable in nearly all its member states.

National sovereignty and the EU

The transfer of sovereignty by member states to the EU is much less pronounced than is commonly thought.

The national member states retain (unless they unanimously agree otherwise) the core functions of modern governments. These include defence and the military, the power to tax, the management of the national currency (except for the Eurozone countries), most aspects of the welfare state, including state pensions and unemployment benefit, housing, health services and education. The welfare state is typically nearly three-quarters of the UK budget.

In practice, although the EU does borrow on international capital markets, the member states finance themselves in the capital markets on their own and have to pay principal and interest on their own. Member states are responsible for their own solvency and, even in the Eurozone, are not entitled to relief from the central bank of the Eurozone. Member states are in effect responsible for their own banks including deposit protection, even though other regulation is EU-centralised to a high degree.

Member states build their own roads and railways, their own power stations and electricity grids, their own ports and airports, their own broadband networks, radio and television stations, their own schools, universities and hospitals. The EU supplies some funding and coordination. They run their own police forces and courts.

Foreign policy is almost wholly for national member states. Free trade treaties and some other external commercial policies are within the EU's control.

The EU subsidises agriculture – around a third of its budget.

There is some erosion of these exclusive national powers, e.g. in relation to banking, employment, the environment, consumer protection and limited areas of tax, but these do not derogate from the basic proposition that the loss of sovereignty is relatively small at present. And many of the erosions have been unanimously agreed.

Hence in the UK the country probably retains nearly all of its sovereignty measured in terms of expenditure. Its contribution to the EU budget is less than one per cent of GDP. Accordingly, the assertion that the EU emasculates UK sovereignty and control of its own affairs is incorrect. This myth probably feeds on the intrusiveness and noise of EU regulation, amongst other things, so that the EU presence seems larger than it really is. There is the reality that no developed state (other than arguably the U.S.) has complete sovereignty in a world caught in invisible nets and chains of trade and treaties, science and security. The projects carried out by the EU are substantial but the cost of these projects is not large in relation to the size of the EU.

There is another aspect of sovereignty. Continued trade by the UK with the EU, continued use of EU capital markets, continued provision of banking, fund management insurance, settlement services and investment business from the UK into the EU would require compliance with EU regulation, as in the case of Norway. Thus you could not sell a car into the EU without complying with their pollution rules or accept deposits without complying with their banking rules. So effectively the EU would impose its regulatory standards on the UK, take it or leave it. The UK would not have had a vote on what the regulation said. The UK would be disenfranchised.

Financing the EU: what do they spend it on?

A useful way to understand the EU is to work through a typical EU budget (in this case the 2014 budget) to see where the money goes.

The total of the annual EU budget in terms of payments is now typically around EUR150 billion. This is less than one per cent of the total GNI (Gross National Income) of member states. This is not a large amount considering that the EU is running major governmental tasks in relation to 28 member states. For example, the annual budget of the UK is around GBP750bn (EUR975bn), which is more than six times that of the whole of the EU.

The **revenue** of the EU comes from four main sources:

- Member state contributions, around 0.6% of GNI: **70%**
- Part (0.3%) of national VAT: about **12%**
- Customs duties, mostly the external common tariff (member states deduct 25% for collection costs): about **11%**
- Other revenues such as fines for violations of EU law: **6%**

In 2014 the German contribution was around EUR26 (22%), the French contribution about EUR20 (17%), the Italian contribution EUR14 (12%) and the UK fourth with about EUR11.3 net, around 1% of the typical relevant UK budget. The UK contribution to the EU budget works out at less than 40p per day per person in the UK.

As to **expenditure**, typically around 6% is devoted to administration and bureaucracy, e.g. running the European Commission, the European Parliament, the Council of Ministers, and the Court of Justice.

Accordingly, typically 94% of the budget goes into the activities of the EU for its citizens. These activities are divided into about five big areas (we use our own headings):

- **Agriculture** The biggest expenditure is on agriculture, which absorbs about **40%** of the budget. Almost half of this is direct payments to farmers to maintain their income. There are more than eight million farmers in Europe. The average income support to each farmer is about half that of the U.S. Another big slug goes towards supporting typical agricultural prices and a third slug to promoting rural development, such as knowledge and information. Maritime and fisheries end up with a tiny amount of under EUR100 million. The subsidy is intended to ensure that enough farmers remain on the land to ensure food security. The EU in effect takes the whole burden of this in place of member states.
- **Development of lessor-developed EU regions (cohesion)** The next largest item in the budget, absorbing nearly **40%**, covers finance to reduce regional disparities in less well-developed parts of the EU, especially by funding communication technology such as broadband, building road and

rail links, promoting renewable energy, and enhancing education and health.

- **Internal market** The third main area, aimed at internal competitiveness, growth and employment, absorbs about **7%** of the budget. At the heavy end are the navigation satellites and an experimental fusion reactor. Then there is infrastructure – the building of missing links in road and rail transport systems, energy projects such as cross border pipelines and grids, and digital networks. Small and medium-sized businesses benefit from loans and grants – over 99% of EU businesses fall in this category. This heading also includes Erasmus, which is a programme for funding EU citizens to study abroad.
- **International** This absorbs about **5%** of the budget and covers international affairs, armed conflicts, aid and development cooperation. The EU is the world's largest humanitarian aid donor. Funds also finance responding to humanitarian crises, e.g. in Syria, Ukraine, South Sudan and the Central African Republic, and the fight against Ebola. Dealing with the crisis in Mali is another example.
- **Security and citizenship** This absorbs a rather small amount of the budget, typically less than **2%**. It covers such matters as justice and home affairs, border protection, immigration and asylum, public health, consumer protection, culture, young people, information and communications and aid for disasters, e.g. from floods. Given the current migration crisis, this looks seriously imbalanced.

The lion's share of the budget, therefore (nearly 80%) is spent on agriculture and on developing less well developed regions. On Brexit, the UK would have to fund its own agricultural support and regional grants which currently come from the EU.

BORROWING AND LENDING

Unlike, say the United States and member state governments, the EU borrows only small amounts in the international capital markets, most usually to finance a financial crisis such as loans to Ireland and Portugal or neighbouring countries, e.g. Tunisia. Currently the EU has an EUR80bn note programme on which it draws from time to time.

Hence the EU does not borrow for balance of payment purposes, but rather for macro-financial assistance. Note also borrowings by the European Investment Bank in the capital markets to finance their operations. The EIB also makes substantial loans to finance projects in neighbouring countries and pre-accession countries.

The EU, the U.S. and China

The fact that China, with a population of 1,400 million and the U.S. with a population of nearly 320 million, can successfully run a common government for all the provinces and internal states shows that the forging of a union is not blocked by the size of the population – the EU has a population of just over 500 million, including about 220 million workers and 20 million entrepreneurs. The U.S. has five times the population of the UK, and China more than 20 times.

In terms of territory, the EU occupies 4,400,000 square kilometres, which is less than half the size of the U.S. and China which both occupy about 9,500,000 square kilometres. China and the U.S. are each nearly 40 times bigger than the UK.

The GDP of the EU is about USD17,700bn (about 24% of the world), of the U.S. USD16,300bn (about 22%) and of China USD8,300bn (about 11%). These are the three economic superpowers. The per capita GDPs are EU USD36,400, U.S. USD52,000 and China USD9,100. So China is a long way behind and the EU lags behind the U.S. in wealth per person. But the EU is the largest economic bloc.

China has had a union (with some quite severe intermissions) since 221 BC and the U.S. since roughly the Declaration of Independence in 1776, although neither union was complete until quite some time after inception.

The union of Europe has no such record of continuity. There were various attempts by European states to assert hegemony by force. The most successful was by Rome which had a mainly southern European empire lasting for three or four hundred years. The attempt by France in the decades around 1800 lasted only around 15 years. Charlemagne in 800 and the

Holy Roman Emperor Charles V in the early 1500s forged partial unions by dynastic inheritance and force, although in both cases the bonds were soon broken.

Apart from these, there have been various raids by external powers, for example, by Attila the Hun, the raid by Arabs from Spain up to Poitiers in 732 AD, by the Ottoman Turks in 1687 when their siege of Vienna failed, and by the USSR in 1945 which snapped off most of central and eastern Europe for about 44 years. Italy unified only in the 1860s and Germany in the 1870s.

It was only in 1957 that the six original members of the EU agreed what was basically a customs union. This was subsequently expanded to cover 28 states.

There are many explanations for the European reluctance to form a union on the lines of China and the U.S. One of the most obvious barriers is language. China and the U.S. each have substantially a common language. The EU however has 23 official languages, which reinforces their idea of national identities.

History is a major source of identity. The following pan-European examples are hard to beat:

- The laws of about 280 of the 320 jurisdictions in the world are based on a Western European system of law, namely English common law championed by England, Napoleonic law championed by France and Roman-Germanic law championed mainly by Germany. The ratio of jurisdictions is roughly 40% English, 30% Napoleonic and 20% Roman-Germanic, with the rest, including Islamic law, taking up the remaining 10%.
- European scientific inventions are the foundation of modern science and technology.
- The historical richness of European music, art and architecture and an extraordinary set of geniuses – Mozart and Beethoven, Michelangelo and Picasso, the builders of Chartres Cathedral, and founders of literature of the calibre of Shakespeare, Dante, Goethe, Molière and Cervantes.
- A large range of exceptionally charismatic products – consider just in the case of cars, Rolls Royce, Ferrari and Porsche, never mind wines, perfumes and fashion.
- A proliferation of profound philosophy, beginning with the Greeks.

Notwithstanding the above, people in the EU do not have a common patriotism or sense of allegiance to Europe of anything like the intensity that citizens of the United States and China have to their own countries. Most only have allegiances to their national state. This absence of common purpose unquestionably prevents the concept of a federal Europe. For now, at least.

People in the UK should speculate as to what the power relationships in the world will be over the next few decades.

UK proposed reforms

Britain's proposals to reform the EU were set out in a letter from Prime Minister David Cameron to the President of the Council Donald Tusk in November 2015. Since negotiations are likely to overtake the position quite quickly, we summarise very broadly as follows:

EUROZONE

There should be no discrimination against any business on the basis of the currency of their country. Eurozone changes, such as the creation of a banking union, must be voluntary for non-Euro countries. Non-Euro countries should never be financially liable for operations to support the euro. Non-euro central banks must control their own financial stability and supervision.

COMPETITION AND REGULATION

The burden from existing regulation is too high and a burden on business. The EU should do more to fulfil its commitment to the free flow of capital, goods and services.

SOVEREIGNTY

There are three proposals on sovereignty (1) to end Britain's obligation to work towards an "ever closer union"; (2) to give a threshold number of national parliaments a veto; and (3) to ensure there is no EU legislation unless necessary ("subsidiarity"). Also national security is the sole responsibility of member states unless otherwise agreed.

IMMIGRATION

The UK government believes that immigration brings too many pressures on schools, hospitals and public services. Britain's population is already expanding: the population is set to reach over 70 million in the next few decades and the UK is forecast to become the most populous country in the EU by 2050. At the same time, UK net migration is running at over 300,000 a year.

The UK wishes to reduce the current very high level of population flows from within the EU into the UK, e.g. no free movement from undeveloped new members until economic convergence, a time lapse before eligibility for certain social benefits for EU immigrants, and crackdowns on abuses of free movement.

Summary of pros and cons of Brexit

Those who favour the departure of Britain from the EU are sceptical of claims about the economic benefits of free trade in goods and services, object to what they see is a wasteful agricultural policy, think that the EU costs too much and wastes too much, oppose the burden of EU regulation, insist that Britain should be able to make all its own decisions and want to control immigration from EU member states.

Those who favour the maintenance of Britain's membership of the EU base their arguments on the economic importance of the free trade in goods and banking, insurance and other services and the free movement of people. They say that Britain would not be able to participate in the development of EU policies, such as product standards, passporting rules for businesses or regulation, and yet would still be subject to them in order to carry on business in Europe.

They refer to the potential loss of skills by not being able to hire across Europe and the erection of barriers not just to trade but also to activities as various as capital markets and students, scientific research and security. They stress the adverse impact of Brexit on the City and fear political splintering and fracturing, e.g. Scotland and greater impetus towards a potential EU breakup, which could make things even worse for the UK.

They allude to the possible impact on UK finances from prolonged uncertainty, from the unravelling and cutting of the ropes, and draw attention to the possibility of lost investment (which moves to continental Europe), of an increase in the current account trade deficit and of a need for excessive borrowing to shore up UK finances. They fear that the UK may dwindle when it should be a potent financial power.

They also believe that Britain might be more exposed to security threats, lose a great deal of its influence in a world where crucial decisions are taken by Beijing, Brussels, Washington and Moscow but not London, and that the UK might become marginalised, isolated and ignored at a time when the UK should be strong and at the centre of affairs, a leader not an onlooker.

Those in continental Europe would no doubt consider these arguments but in reverse. For some, the departure of the UK market might be adverse. For others the elimination of a competitor might open up new opportunities to fill the gaps left by the UK.

We examine some of these factors.

Free trade in goods

FREE TRADE IN GOODS

The European Union is now the largest trading group in the world, accounting for just over 20% of total world trade in goods.

One of the biggest advantages of the EU is free trade between member states. Firms in member states can sell and buy goods from other member states without having to pay custom duties, irrespective of the country of origin of the goods. There are virtually no administrative or compliance processes and there are significant reductions in non-tariff barriers to trade between member states, e.g. restrictions on quantity, quotas, licences, requirements to appoint a local representative, inspections, quality, and certificates of origin or price controls. About half of the UK's trade is with the EU.

In return for free trade EU member states must comply with the EU trading rules. EU member states must adhere to common custom tariffs with third countries because otherwise trade from third countries would

be deflected to the member state having the lowest external tariffs.

FREE TRADE AGREEMENTS

EU member states also benefit from free trade agreements with numerous other countries. These include Albania, Bosnia, Chile, Colombia, Egypt, the Faroe Islands, Iceland, Israel, Korea, Mexico, Morocco, Norway, Peru, South Africa, Switzerland and Turkey.

Free trade agreements are being negotiated or ratified with the U.S. (Transatlantic Trade and Investment Partnership), Canada and Japan.

The ability of EU member states to trade with the UK would depend upon new, to be agreed, agreements.

Opponents of Brexit maintain that:

- In the event of Brexit, the UK might be damaging its relationship with the buyers of around 50% of its exports. The UK has had a persistent trade deficit for decades. Unless otherwise agreed with the EU, the UK would be left with the basic WTO rules and be subject to EU tariffs. Free trade increases competition and reduces the cost of goods to the consumer.
- Whatever agreement with the EU were negotiated, the UK would lose influence over the formation of EU trade rules. If the UK did negotiate free trade rules with the EU, it would then still have to contribute to EU budget, although in a lesser amount.
- Firms in third party countries might seek to avoid uncertainties and a subordinate position by moving their production facilities or head offices into the EU.
- There can be no guarantee that the UK would be able to negotiate equivalent free trade treaties.

Banking, insurance and other services

PASSPORTING

Under EU directives, financial services firms authorised in one member state can conduct business in any other member state without any additional authorisation from the host state, either through a local branch or directly. This is called passporting. This, for example, enables financial firms from third countries to set up a subsidiary (not a branch) in a member state and then to passport that business throughout the EU. It also allows UK headquartered firms to passport throughout Europe and for EU headquartered firms to carry out business in the UK through a branch rather than having to establish a subsidiary. Subject to qualifications, this applies, for example, to banking, financial leasing, money transmission, credit cards, underwriting securities, portfolio and management advice, custodianship, dealings in securities, derivatives and a number of other financial areas. Passporting also applies to insurance and to a lesser extent to collective investment schemes and in some respects to alternative investment funds.

In order for firms to have the benefit of passporting, the firms must comply with EU rules concerning such things as capital, liquidity, ownership, conduct of business and other matters. In the case of Brexit passporting would be up in the air.

CAPITAL MARKETS

As to the raising of capital, companies in member states can offer bonds or shares to the public throughout the EEA or list them on an EEA regulated market with a prospectus complying with common EEA rules, e.g. as to content and summary, if the prospectus is approved by the home state authority. It does not have to meet separate requirements in each member state. The prospectus is also passported under a somewhat messy regime for allowing prospectuses from countries with an equivalent regime. EEA member states cannot impose additional requirements other than translation. The prospectus legislation could interfere with capital market bond issues out of London to sophisticated investors.

In addition, the EU has common rules about continuing disclosure in relation to listing securities and transparency, such as financial reporting, general information requirements and the notification of major shareholdings. In effect there is a single capital market in the EEA, which significantly reduces costs and enlarges capital-raising.

LONDON AS A FINANCIAL CENTRE

Financial services are a major part of the UK economy. The country hosts one of the largest financial centres in the world, which produces taxable revenues, attracting investment and both soft and hard power. It is unquestionably the EU's premier financial centre. Brexit would prejudice the location of foreign financial firms in London and potentially the loss of the passport into the EU. The effect might therefore be that foreign firms might locate their head offices in Frankfurt or Paris, thus diminishing the liquidity of London markets, depriving London of investment and the UK of tax revenues and weakening London as a financial centre to the detriment of the UK as a whole.

English law and courts (along with New York) are an international public utility for major international financial and other contracts. Their status is strong but not impregnable – not impregnable because choice of law is often associated with the size of the target market of investors.

The above could be bad news for accountants, law firms, risk management consultants and the like, who generate significant tax revenues for the UK.

NON-FINANCIAL SERVICES

The treaty provides that restrictions on the freedom of establishment of nationals and EU companies in the territory of another member state are prohibited. The prohibition also applies to restrictions on the setting up of agencies, branches or subsidiaries, by nationals of a member state established in the territory of another member state. The freedom includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings on the same conditions that apply to nationals of the member state of establishment. Restrictions on the freedom to provide services within the EU are also prohibited. Brexit would imply a loss of these freedoms unless otherwise agreed.

Employment, professions and immigration

One of the basic principles of the EU is freedom of movement, that is, both individuals and companies should have the freedom to move from one member state to another. The main objectives are to remove controls on persons, whatever their nationality when crossing internal borders, carrying out checks for the crossing of external borders and establishing policies on asylum and immigration from third countries.

Generally, EU citizens have a right to reside in another member state (1) for up to three months without any conditions and (2) for a period of longer than three months if (a) they are workers or self-employed persons, or (b) have sufficient resources not to become an unreasonable burden on the social assistance system of the host state and have comprehensive sickness insurance, or (c) are enrolled students with sufficient resources, or (d) are family members of the above. Citizens who have resided in a host member state for five years are entitled to permanent residence.

EU citizens and their family members also have the right to move freely around the EU to work and to look for work within another member state and must benefit from the same working conditions, social and tax advantages as host state nationals.

This freedom of movement and residence right is subject to public policy, public security and public health. An example is where a citizen of another member state is deported for conviction of drug offences. Another exclusion permits member states to reserve some public sector positions for their own nationals.

Member states must recognise certain professional qualifications acquired in another member state e.g. medical doctors, dentists, vets, midwives, architects and, subject to limitations, lawyers. Professionals cannot be excluded because of nationality.

In return, EU member states have to comply with EU employee protection rules.

The effect of Brexit would be likely to prejudice labour mobility and the ability to hire from a much bigger pool, including professionals and secondees from Europe. It might also inhibit working abroad by the British and hence close off one of their options.

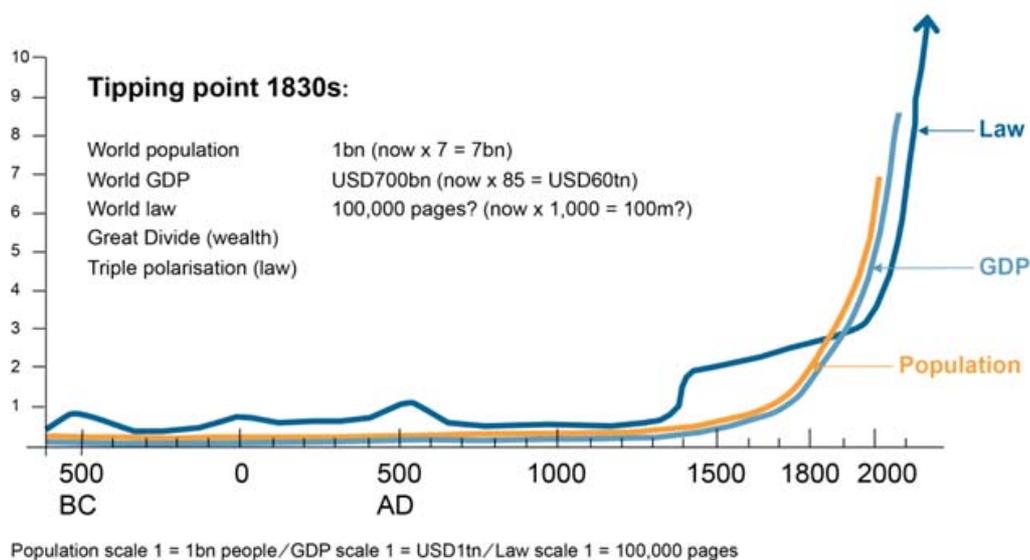
EU law and regulation: how we got here

One of the most pervasive complaints about the EU is the expansion of law and regulation.

We have already said that the law is the most important ideology underpinning our societies. The EU combined is currently the greatest force of law in the world. This has happened in part because, as mentioned, countries in the EU have been the source of the law in nearly 90% of the world's jurisdictions for historical reasons.

Before we embark on these topics, it is worth taking a longer historical view and also a peek at the future.

Growth of law: 500 BC to 2015 AD



This chart shows a close correlation between the growth of population (a billion is added every few years), the growth of GDP (a rough metric for wealth) and the growth of law – which has been colossal.

Until quite recently most people worked on the land. Now in the EU and other advanced countries, only about 1-2% are engaged in agriculture. Typically the contribution of agriculture to GDP now is about 1% in the leading industrialised countries. Even manufacturing and industry is typically around only 25%. But services are typically around 75%, for example, banking, insurance, construction, retail.

The huge growth of GDP plus the resulting importance of finance and the credit economy, plus factories, machinery and industrialisation, plus the fact that most

people in the world now live in cities, all these things produced more risk, more danger, more bankruptcies, more conflicts. In turn, all these complications have fed the leap ahead of the law, a leap which has been felt in virtually all countries, especially developed states including EU member states. That is why there is so much regulation. So the world has changed. We cannot go back. Hence our next chart – the football fields of GDP.

GDP football fields (USD10 trillion)

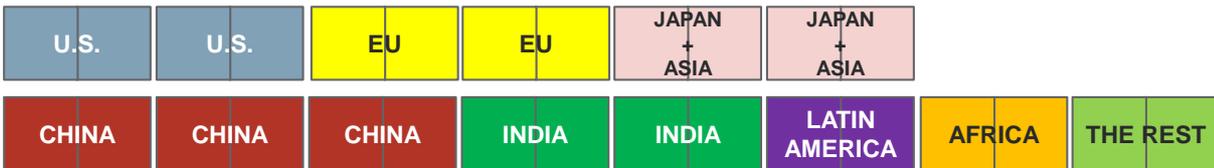
1995



2010



2035



This chart shows football fields where one football field is USD10 trillion of GDP in 2000 U.S. dollars. In 1995 there were three football fields of which one was the U.S., the second was Europe and the third was the rest, half of which was Japan. That was the result of the Great Divide in wealth which started around 1830 and before, when the West pulled away from the rest, a process which is now being reversed. In around 2010 there were about five football fields, with several emerging countries coming up, including China. In around 2030 there could be ten, 12 or 15 football fields, absent some terrible disruption in the meantime. That means more food, more health, more hospitals, longer lives. But if five football fields could produce the mayhem of the recent financial crisis, imagine what mayhem might be produced by 15 football fields. All that GDP is not going to go under the mattress. It is going to go sloshing around into banks, capital markets, corporations, tax coffers. The result could be greater competition between states, more conflicts, more risks. And more law and regulation to cope with the situation (often more than is necessary). Steadiness is needed in order to prevent an even greater explosive burst of law in the future. The UK could make a contribution to that. It would have to do this from the inside.

EU regulation

Notwithstanding the historical force, there is no doubt in our view that the growth of regulation in Europe and elsewhere needs to be controlled. The UK is therefore right to request a brake on regulation.

Nevertheless, it would be wrong to regard regulation as a purely Brussels phenomenon. In the first place, as shown, regulation is a distinctive feature of all advanced societies, including the United States. Financial regulation in the U.S. is particularly zealous. In the second place, it seems likely that Britain would itself have had similar regulatory systems even in the absence of the EU. Indeed many of the regulatory initiatives in the EU have been led by the UK, e.g. the regulation of banks, the resolution of banks, environmental regulation and consumer protection. The UK also has its fair share of regulatory enthusiasts. Thus, Britain was one of the first countries in Europe to develop a mass of financial regulation in the 1980s and the first main country (in the 1970s) to develop consumer credit and other consumer protection laws on a large scale. These were both initiated under both left wing and right wing governments. Hence the growth of law and regulation is

a feature of advanced states generally, including Britain, and would be likely to remain, with or without Brussels.

Further, whatever one may say about the intensity and disproportion of regulation, it is often hard to question some of the basic principles which we need. For example, a free market must have some rules about the capital adequacy of banks and insurers to mitigate the insolvency risk, it must have stringent rules preventing cartels and the abuse of a dominant position, there must be detailed rules to protect the environment and it is not unreasonable to have rules strengthening the privacy of our data. Clean beaches and car seat belts are not unreasonable, nor is the interoperability of railways.

Brexit may also lead to less efficient enforcement of the UK's own regulatory regimes because of the loss of mutuality.

The main fields of regulation in the EU are the following:

- **Regulation of financial services** Fields include authorisation of firms, capital adequacy, liquidity, ownership, fair conduct of business and misselling, conflicts of interest, market abuse (including market manipulation and insider dealing), money laundering and terrorist financing. The UK firms may on Brexit lose the passport into the EU and hence the attraction of third country firms locating in London. The UK would still in practice have to take into account soft law from BaseL.
- **Public procurement** The volume of public procurement contracts represents about 16% of the GDP of the EU or EUR1,500bn. EU firms have access to EU public procurement without discrimination. Foreign bidders from third countries can be excluded in a few cases, e.g. telecoms, post, water, energy and defence, but otherwise there are no EU rules on exclusion of foreign bidders. Typically EU companies can access procurement elsewhere through numerous international treaties. Aggrieved contractors and interested parties generally have remedies in the event of illegal or wrongful award decisions.
- **Telecoms and media.** There is an extensive regulatory framework for electronic communications, including network access by operators, and universal service and users rights.
- **Competition law**, such as cartels, abuse of a dominant position, examination of large mergers and state aid. Third party damages claims are possible. The UK permits certain class actions in this field. On Brexit, the UK might have more flexibility to allow state aid. But it would still be necessary to notify Brussels if EU merger thresholds are met (as U.S., Japanese and other companies from around the world must do, wherever they are based) and, as the law is extraterritorial pursuant to the doctrine that you are caught if your conduct has effects within the EU, effectively large companies would have to conform to EU standards. Companies, wherever they are based, are liable for large fines if they infringe EU competition rules.
- **Environmental law** There are more than 300 EU legislative acts. The major areas of protection include water, atmospheric pollution, prevention of noise, the conservation of wild flora and fauna, waste management, the control of chemicals and energy policy (e.g. specifications for fuels,) environmental impact assessments for large projects, the monitoring and reduction of greenhouse gas emissions and a system of trading carbon emissions. There are proposals for widening liability for damage caused by environmental violations.
- **Data protection.** A general data protection regulation, to be in force in the first half of 2018 will afford a higher degree of harmonisation in relation to the protection of privacy. This builds on current rules but extends the territorial scope, applies a new sanctions regime and introduces many more onerous obligations on those handling personal data. An area of particular contention currently is the rules on transfers of data outside the EEA as the EU seeks to protect personal data.
- **Immigration.** Examples include rules on long-term visas and residence permits, work and study permits and family member rights. However, the UK participates selectively in EU immigration law and has chosen not to adopt most directives. We expect that a just British government would honour existing residence rights and secondments.
- Detail on the qualifications to the **free carrying on of trade and professions** in other member states.

- **Public health and safety**, including medicinal products, medical devices, biotechnology, dangerous substances, pesticides, the quality of drinking and bathing water, bans on smoking and health warnings on tobacco packages and labelling. A basic principle is that no medicinal product may be placed on the market without a prior authorisation either from a member state or the European Commission. Controls on pricing are national. In the case of Brexit, the need to go through two regulators instead of one would increase the expense. Pharmaceutical companies may lose interest in the UK as a base.
- **Employee protection** Examples are a prohibition on age, sex and race discrimination, equality for men and women (equal pay for equal work and equal treatment in relation to e.g. access to employment, training, promotion, working conditions and dismissal), rights to maternity and parental leave and information and consultation, protection in the event of the transfer of an undertaking or employer insolvency, and rules on health and safety and working time.
- **Occupational and personal pension provision** A substantial proportion of the legislation and regulation governing the provision of occupational and personal pension flows from EU directives, which cover everything from how pensions are funded, how pension arrangements are governed, how individuals' rights are preserved, and how they are protected in the event of employer failure.
- **Consumer protection**. For example, there are directives on health and safety, misleading advertisements, unfair commercial practices, cooling off periods for contracts negotiated away from business premises, distance contracts, electronic commerce, consumer credit, product liability, unfair terms in consumer contracts, package tours and combatting late payment in commercial transactions.
- **Transport, roads, rail, air, sea, waterways**. A mass of regulation, including access to the market, interoperability, safety and qualifications. Road is the biggest sector.
- **Energy**. A crucial policy area. The regulation facilitates such matters as access, rights of transit and the ideal of a single European network.

- **Taxation**. The founding fathers of the EU would not have anticipated that the EU would impinge on member state tax policy, but the principle of freedom of movement without discrimination and an activist court have resulted in a significant erosion of member state freedom of manoeuvre in setting tax policy, particularly in the international context. Brexit would restore this freedom, but it may well be that the UK would not change the current EU regime.

In most of these areas we doubt that they would all vanish with a single defiant strike on the delete key. It seems more likely that the UK would retain the bedrock of the regulatory regimes, subject to some tinkering. In some cases, e.g. competition law, the UK already has its own well-established regime. This would also be driven by the need to comply with EU standards in order to deal with the EU, e.g. environmental standards for cars. It might invite improved access to the EU market.

The potential absence of state aid rules and the like could give a post Brexit UK government more scope for anti-competitive conduct. European laws generally can be a source of good governance imposing judicial control on national governments.

The potential exclusion of the UK from EU initiatives in the various fields is a matter of conjecture, for example, transport, energy, telecoms and media, student exchanges, research, space satellites and nuclear programmes.

It is obvious that single country regulation of all these fields would be a nightmare. Each field, already large, would be multiplied by the number of separate regimes resulting in a multiplication of compliance – a uncontrolled monster of our own making.

Harmonisation of law

The efforts by the EU to harmonise the law is of major importance, not only for the EU, but in the world at large. Harmonisation is a key source of simplification and hence reduction in volume and cost. The cost of legal investigation in the world is now colossal.

The fact that most of the jurisdictions of the world are influenced by basic European private and commercial law and also by its regulatory systems means that what Europe does may have a very significant impact elsewhere, especially in developing countries who owe their legal origins to one or other European countries (because of former imperialism and emulation). The effect could therefore be felt by people everywhere. Leadership by the EU could therefore produce significant international benefits – if the EU accepts that what we now need most of all is brevity.

The United States has completed a very large programme of harmonisation of law, particularly the Uniform Commercial Code. In addition, some of its most important laws are federal and are therefore centralised, e.g. bankruptcy law. In China, statutes regarding private and commercial law have universal applications throughout the country.

The main fields in which the EU has harmonised large portions of private and commercial law include:

- all the above **regulatory fields**
- the **governing law of contracts and non-contractual obligations (Rome I and II)**. In contract, a choice of law is generally valid.
- **the jurisdiction of member state courts in civil and commercial cases and the mutual recognition of member state judgements**. The regulation generally upholds an express choice of courts and the enforcement of a complying judgment throughout the EU is virtually automatic.
- **prospectuses for offerings of securities**
- **company law generally**, including the harmonisation of rules applying to public takeovers, and measures to facilitate domestic and cross-border transactions, as well as requirements on shareholder rights, capital, financial reporting and disclosure, and for listed entities to apply international accounting standards.
- **disclosure of large shareholdings**
- **finality in settlement systems for money and securities**
- **financial collateral and its legal strengthening**
- **intellectual property, including EU-wide rights**
- **conflicts of law for insolvency**. The regulation (which does not apply to Denmark) generally gives

insolvency jurisdiction to the member state where the debtor's centre of main interests is located although parallel secondary proceedings in other member states are permitted, though limited. The applicable law is generally that of the opening state, subject to important exceptions.

– **aspects of family law**

There are proposals to harmonise contract law.

However, the EU has hesitated on the really difficult legal harmonisation projects, for example, trusts, bankruptcy set-off and other parts of property law such as land registration and the transfer of title to assets.

In the event of Brexit, we suggest that most of the above fields would probably remain substantially in place, subject to necessary adaptations.

The EU project to develop EU-wide intellectual property rights might exclude the UK.

Multilateral projects

There are other things which the British cannot do as well on their own, which are necessarily multinational. They include activities like transport, energy and its delivery, telecommunications and satellites such as the European Galileo programme, space research, research into alternatives to fossil fuels, large physics projects, the fight against terrorism, even judicial cooperation and arrest warrants – all this prodigious multitude of sometimes little efforts which together advance the tide up the beach. These are all things which to one degree or another member states pool in the EU, and which they rightly pool in the EU.

Defence and security

The world remains a dangerous place, easily tilted over into savagery. This is not just because of conflicting ambitions and cultures, but also because of the fearful power of violence that modern technology provides. There are many old fault lines such as between China and Japan, between India and Pakistan, between Iran and other Arab countries, between Russia and its neighbours, including Europe, and the threat of terrorism mainly

from the Middle East. A key to security is being at the leading edge of military technology including space. The EU has an important space programme, in particular Galileo relating to satellites. It sponsors major research projects into such fields as nuclear stations and radiation protection.

The size of nuclear arsenals is a good measure of military might and danger. The following are estimates of operational nuclear missiles in 2015 [source: *The Economist*]:

U.S. – 4,764
 Russia – 4,300
 France – 300
 China – 250
 Britain – 225
 Pakistan – 120
 India – 110
 Israel – 80
 North Korea – 10?

Britain does not design its own nuclear weapons but uses U.S. Trident missiles.

The North Atlantic Treaty Organisation is the main defence alliance, apart from the individual capacity of each member state. NATO comprises 28 countries, namely, all EU member states (except Austria, Cyprus, Finland, Malta and Sweden) plus Albania, Canada, Turkey and the United States. Decisions are taken by consensus. A clause provides for a common response to aggression.

Britain and France have the largest conventional forces. Defence is exclusively a matter for national member states. Member states have however agreed on a nascent Common Foreign and Security Policy and an effective multinational police and security force. International sanctions have much great persuasive power if they are imposed by the EU, not a single state.

Eurozone: the common currency

The euro currency was established in 1999. The Eurozone comprises the countries in bold listed in the appendix. The largest members of the Eurozone are

France, Germany, Italy and Spain. The largest members outside the Eurozone are Poland, Sweden and the UK.

The euro has a central bank – the European Central Bank which has exclusive rights to issue legal tender within the territory with exclusive control of the money supply and with intervention powers on interest rates. The European Central Bank is independent of political authority. There is a body called the European Stability Mechanism which can borrow in order to finance Eurozone member states who are in financial difficulties.

Many have argued that, because banks are vital to the operation of a currency and to the financial condition of their territories, a common currency also requires a banking union. Whatever the merits of this argument, the Eurozone is moving towards the common supervision of banks (the ECB supervises over 5,000 Eurozone banks) and a common rule book. There is also a common set of rules for the “resolution” of banks (i.e. the restructuring or liquidation of banks on insolvency) pursuant to an EU directive which effectively nationalises bankruptcy law for banks. This applies to the whole of the EU, not just the Eurozone. The third limb is common deposit insurance, unlikely to be realised at present.

The euro is the world's second biggest currency after the U.S. dollar. The main future competitor is probably the renminbi. The opt-out of the United Kingdom and Sweden undoubtedly weakens the euro as a competitor.

In principle, one might suspect that a single currency is better than 28 currencies being manipulated by 28 separate central banks.

Theorists of optimal currency areas say that all parts of a currency union should be at the same economic level in order to prevent transfers from rich to poor regions and to enable the central bank to tailor its monetary policies, for example, on inflation rates, credit supply and interest rates, to the state of one economy. Nevertheless there are very poor and very rich provinces in the United States, in India, in China, in Italy and indeed in just about all single currency countries including the UK, except those that are very small, such as Luxembourg or Singapore. Equalisation of the availability of public services in poor regions involves vastly larger transfers than those by the EU in favour of less well-developed regions.

Contrary to the angst at the time of the bankruptcy of Greece in 2012, it is clear that the bankruptcy of a province or the like within a single currency area is not fatal to the currency (compare, for example, California and New York), but the bankruptcy of a significant proportion of the region in a currency union could potentially have a catastrophic effect on the currency, leading in turn to enormous pressures on the solvent countries to bail out the bankrupts.

If the UK were not part of the EU, the EU would have no reason to authorise euro settlements or clearings or even dealings in euro denominated securities by UK institutions.

Currency is a major source of both soft and hard power. Consider the way in which the U.S. used denial of access to U.S. dollar clearing to extract settlements from allegedly errant foreign banks or to promote the impact of sanctions.

Currency is also a source of identity: money is our means of exchange, it connects us to our future, it connects us to other countries through trade. It is therefore a major factor in drawing the currency union together and excluding isolated outsiders.

In the end, national control of monetary policy and the avoidance of entanglements with any travails of Eurozone countries are presently unshakeable UK policies. But when we look into the future the key issue remains – where will the UK be on the currency question 25 years from now?

Transition after Brexit

Article 50 of the relevant treaty provides in effect that a member state can withdraw from the EU by agreement. The agreement is concluded by the Council of Ministers acting by a qualified majority after obtaining the consent of the European Parliament. A state can leave unilaterally after two years if agreement is not reached. It seems most likely that the departure of the UK would be dealt with by treaty between the EU and the UK.

We imagine that most of the existing EU law, such as EU regulations having direct effect, would be transposed into or matched in UK law by appropriate legislation. The degree of pruning could be highly political since the

electorate might be saying they wanted to leave the EU, not take it with them. EU directives have already been implemented by UK statute. It would be necessary to expunge references to the European Court of Justice (and indicate the extent to which UK courts could still have regard to its decisions, past and future) and references to other EU institutions. The UK would have to decide which parts of EU law it wished to keep and which to jettison. Anti-trust, financial regulation and pensions would be only examples of numerous complex areas.

Legislation would have to deal with the continuation or otherwise of continuing authorisations, permits and licences, as well as any grandfathering, e.g. of existing EU immigrants.

It would be necessary to deal with those areas which are covered by the EU but not the UK, such as the agricultural support regime, anti-dumping and trade defence. As regards anti-dumping and trade defence the UK would have to replicate in respect of the UK something resembling the EU apparatus for ensuring trade defence and to deal with anti-dumping. This would involve inter alia the creation of a large inspectorate to carry out all the verification work currently handled by the European Commission.

In addition, it may be desirable for the UK to enter into a treaty with the EU confirming reciprocity in the case of EU legislation on court jurisdiction and the recognition of judgments and the insolvency of individuals, companies, banks and insurers, as well as bank resolution. It does not follow that agreement would be forthcoming.

Further the UK would have to negotiate a large number of free trade agreements entered into by the EU if the UK wanted to keep them and also renegotiate a huge number of international agreements, such as those relating to air transport.

The above unravelling would require a massive legislative and negotiating programme on just about everything. The precedents set by Algeria on independence from metropolitan France in 1962 and the withdrawal of Greenland in 1985 are not very helpful. On the other hand more than 150 of the current near-200 sovereign states are the result of independence or secessions over the last 250 years. Some of these are very recent – for example, the break-up of the USSR and

Yugoslavia, the split of the Czechs and Slovaks (all in the 1990s), and the independence of East Timor, Montenegro and South Sudan. These were very different from Brexit, but some of the techniques, e.g. preserving the previous law, are similar. There is a large body of international law on the subject of state succession to help deal with lacuna, such as the interpretation of references in a contract to a split territory, such as the European Union. It is not common for secession legislation specifically to interfere in current contracts e.g. by neutering “material adverse change” or other termination clauses.

On Brexit, UK interests would no longer be represented by the extensive EU diplomatic representations around the world and so the UK would have to take on this responsibility.

We envisage that there would be a transition period so that there was no gap and also to permit the various countries to readjust. We suspect that the whole process could take between two and possibly five years.

In our judgment any transition period might involve significant governmental costs and also a period of uncertainty.

EU views on the UK

The UK is the sixth largest economy in the world after the US, China, Japan, Germany and France. It is one of the big four in Europe with Germany, France and Italy. It has a large population of consumers which would then potentially be lost to the EU. The departure of the UK could destabilise the EU as a whole which in turn could have serious adverse effects on the UK.

The UK enriches the EU by reason of its extraordinarily strong reputation in the world, its aptitudes, its resourcefulness, its energy and spirit. The country has made an enormous contribution in terms of democracy and freedom, beginning as far back as Magna Carta in 1215, the striking advances it made in the development of science (for example, Newton, Darwin, Faraday, Rutherford, Crick), its language and literature (for example, Chaucer, Shakespeare, Charles Dickens), its legal system which has been an inspiration to many other countries, its contribution to economic theory and practice (for example, Adam Smith, David Ricardo, John

Maynard Keynes), its financial prowess since the 17th century and its historical economic success – in the 19th century, Britain was the super-power of the world. It is no longer a super-power but the country could still be a major part of a super-power.

We suspect that many people on the European continent would prefer that the UK stayed in the EU, not just for economic reasons but also because of bonds of history and mutual esteem and because mainland Europeans and the British share a common sense of justice and an underlying idealism and hope.

Conclusion

It is an open question whether the EU will or will not move to closer union and a federal Europe. If the UK is an outsider it cannot be part of the debate.

Winston Churchill said in 1946: “We must build a kind of United States of Europe. The structure of the United States of Europe, if well and truly built, will be such as to make the material strength of single states less important....”

The United Kingdom has sometimes convinced itself that it is part of Europe, sometimes not. This time it should make up its mind once and for all.

Appendix

Date of accession after name

Eurozone members in bold

	Population (m)	GDP USDbn	GDP per head USD	Area sq km (*000)	Median age
Germany 1957	82.0	3,428.1	42,700	357	45.5
France 1957	63.5	2,612.9	36,790	549	40.6
United Kingdom 1973	62.8	2,475.8	35,720	244	40.2
Italy 1957	61.0	2,014.7	34,930	301	44.3
Spain 1986	46.8	1,323.0	32,130	506	41.4
Poland 2004	38.3	489.8	22,780	313	38.8
Romania 2007	21.4	169.4	18,060	238	39.4
Netherlands 1957	16.7	770.6	43,340	42	41.8
Belgium 1957	10.8	483.3	40,570	31	41.6
Greece 1981	11.4	249.1	26,040	132	42.8
Czech Republic 2004	10.6	196.4	27,520	79	40.3
Portugal 1986	10.7	212.3	25,960	92	42.2
Hungary 2004	9.9	124.6	22,640	93	40.6
Sweden 1986	9.5	523.9	42,870	450	41.0
Austria 1995	8.4	394.7	44,120	84	42.7
Bulgaria 2007	7.4	51.0	16,040	111	43.0
Denmark 1973	5.6	315.2	42,780	43	41.1
Slovakia 2004	5.5	91.1	25,840	49	38.2
Finland 1986	5.4	247.5	39,200	338	42.3
Ireland 1973	4.6	210.8	43,830	70	35.3
Croatia 2013	4.4	59.2	20,960	57	42.6
Lithuania 2004	3.3	42.3	24,360	65	39.3
Latvia 2004	2.2	28.4	21,810	64	41.5
Slovenia 2004	2.0	45.3	28,480	20	42.4
Estonia 2004	1.3	22.4	24,450	45	40.9
Cyprus 2004	1.1	22.8	30,770	9	35.2
Luxembourg 1957	0.5	55.2	89,510	3	39.0
Malta 2004	0.4	8.7	28,960	0.3	40.9

Total EU GDP: USD17,685bn

Note: Whether or not foreign dependencies of member states are included is complex – usually not in the case of the UK (e.g. not Cayman or Bermuda or the Channel Islands) but Gibraltar is in a special position.

Source: Mainly *The Economist*, *Pocket World in Figures 2016*.

	Population (m)	GDP USDbn	GDP per head USD	Area sq km (‘000)	Median age
China	1,353.6	8,227.1	9,080	9,600	35.4
U.S.	315.8	16,244.6	51,750	9,832	37.4

Acknowledgements

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