

ALLEN & OVERY

Brexit Law – contingency planning for corporates

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On 23 June the UK voted to leave the European Union, the first step in a process that is likely to lead to the biggest demerger in history: the world's fifth largest economy (the UK) leaving the world's largest economic grouping (the EU). The vote to exit the EU has caused significant market volatility and there will be continuing uncertainty during the lengthy period in which post-exit arrangements are negotiated. Although it is not yet clear what form the UK's post-Brexit relationship with the EU might take, many companies with a presence in the UK have begun contingency planning. In this note we cover the issues that corporates should be thinking about **now**, and assess the likely impact of Brexit on different aspects of business.

Identify (or re-affirm) which aspects of your business will be most affected by Brexit

If you have not already done so, consider putting in place a team, reporting to senior management, to assess, or re-affirm, the potential impact of Brexit on your business, and including Brexit on the agenda of up-coming board meetings. Because of uncertainty over the post-Brexit regime, detailed long-term planning is not yet feasible. But knowing where the issues may lie will give you a head-start on planning as the picture becomes clearer. We have outlined some of the potential implications on the next page, grading their impact from high to low.

Consider contributing to government or industry consultations

If you conclude that your corporate best interests require the UK government or the EU to act in particular ways, you may wish to consider your options for lobbying – whether in London or Brussels, or elsewhere. Should you lobby alone, or as part of a larger group (such as an industry lobby group), you will need to comply with applicable rules in the UK, Europe and beyond. And there are other issues to consider, particularly if you are paying someone to lobby a government minister on your behalf, or contemplating co-operating with competitors to get your voice heard.

Reassure employees

Your employees are likely to be nervous about where the vote leaves them, particularly if they are currently working under an overseas assignment arrangement. Will they be required to return to their home country? If so, how long will they have to sort out their affairs in the host country,

and will there be a job for them to return to in their home country?

Employees may also be wondering what the company's plans are in terms of continuing to do business in the UK or Europe – will you be scaling back operations and, if so, what impact will there be on jobs? In the short term, we suggest you do what you can to alleviate employees' concerns, whether that is through engaging with those on overseas assignments individually, or through a collective announcement to the whole workforce. FAQ documents may also be helpful, even if the answers at this stage are inconclusive.

The Brexit camp has talked about an immigration control bill to restrict EU nationals entering the UK. In light of this, you may wish to consider whether it is worth bringing workers into the UK now or taking steps to secure their immigration status or citizenship rights pending immigration changes once the two-year period for the UK to negotiate its exit has passed.

Plan your response to stakeholder or media queries

Consider how you will respond to any stakeholder enquiries or press coverage, and whether to appoint a spokesperson and internal PR manager to run this process.

Consider timing of annual report and AGM

Consider the timing of your next annual report and whether it may need to address Brexit, and the date of your next AGM. Are shareholders likely to ask questions about the impact on your business?

Implications for business

High impact

Imports and exports

Trade and single market access is a key element of the UK's relationship with the EU – the EU takes almost half the UK's exports. How this relationship is redefined will be one of the main areas of focus, with future trading relationships dependent entirely on the nature of any agreements reached. In the medium-term this will result in significant uncertainty for UK businesses.

An EU/UK trade agreement may not overcome tariff barriers, and the other models proposed also have drawbacks. For example, a Norwegian model would require the UK to continue to observe many of the EU's regulations, and a Swiss model would provide access to the single market for the UK's goods, but not its services.

Brexit will also leave UK businesses without the benefit of the 53 free trade deals which the EU has obtained. While some of these agreements may be replicated bilaterally by the UK, this will undoubtedly take time. Whether the UK can obtain deals as favourable as those granted to the EU also remains highly uncertain.

In the short to medium-term, fluctuations in exchange rates may also impact UK trade.

EU funding

Businesses that benefit (directly or indirectly) from EU grants or subsidies, for example for research, may find that it is difficult to obtain funding for new projects following the vote to leave the EU. Transitional arrangements for on-going projects will have to be agreed, and the UK will need to decide what it will continue to fund post-Brexit, at which point it will no longer be constrained by the EU state aid regime. In the short-term, there have been suggestions that politically it might be considered expedient for the UK government to ignore state aid rules prior to any formal exit. That is speculative but, if it becomes reality, affected corporates should carefully consider any implications and take advice.

Employees

Depending on the post-Brexit model, it might become more difficult to recruit, retain or move employees from the UK to the EU and vice versa, which could give rise to skills gaps, an inability to service customers in relevant countries and a loss of talent. In the worst case scenario, UK nationals currently based in the EU, and EU nationals currently employed in the UK, could have to return to their home countries, potentially on short notice (although that is unlikely).

There may be an impact on EU-wide recognition of qualifications, which could present another barrier to staff mobility. This may extend beyond the EU if recognition of qualifications, or the ability to operate in particular countries, derives from free trade agreements entered into by the EU rather than the UK.

Brexit may also impact absolute staffing numbers if it affects customer demand for, or your ability to provide, your product or services. There is likely to be a need to look at existing agreements with works councils and other employee representative bodies if there is a significant change in the size of the workforce as a result of Brexit.

Tax

When the UK leaves the EU, it will probably cease to be a part of the customs union. Exports between the UK and the EU would then need to go through customs procedures. However, we would hope that the UK and the EU enter into a free trade agreement with no or very low customs duties.

Following Brexit, the UK will sit outside the territorial scope of EU VAT. It could therefore change how VAT is charged in the UK or even replace it with an entirely different tax. Over time there could be some divergence from EU VAT, although the risk of double taxation or double non-taxation may incentivise the UK to keep its VAT system materially aligned with the EU's. The most tangible consequence of Brexit will likely be the imposition of 'import' VAT when goods enter the EU from the UK and vice versa. The VAT will often be recoverable, but there may be an unwelcome cash flow cost for the period between import and recovery.

EU directives prohibit withholding taxes on intra group interest, dividends and royalty payments made within the EU. Following Brexit, EU subsidiaries will not be able to rely on the directives to make these payments to their UK holding companies free from withholding taxes. Relief under bilateral double tax treaties will be an alternative, and in many cases will eliminate withholding taxes entirely.

At some point after Brexit we may see the UK reintroduce UK tax rules that have been held contrary to EU law. The 1.5% stamp duty charge on UK shares issued into clearing systems such as Euroclear, Clearstream and DTC is one example. The UK will also have more scope to adopt competitive tax regimes that would currently be contrary to state aid rules. Conversely, we may see anti-avoidance rules applying to arrangements with UK businesses that previously would have been exempt.

For the UK, Brexit will mean the retention of sovereignty over fiscal matters. For the rest of the EU, Brexit could accelerate the harmonisation of corporate income taxes. This will not necessarily be the case; other Member States are against further harmonisation. However, the loss of a large and influential opponent could be decisive.

Medium impact

Finance

For some borrowers or issuers, uncertainty around Brexit and resulting financial market volatility may impact the availability or cost of some types of finance. However, the impact on the loan market will probably be limited, at least in the short to medium-term, and relationship-driven lending is unlikely to be significantly affected. The impact may be greater in the bond market.

Those with businesses that will be adversely affected by Brexit may find their access to finance is reduced or their borrowing costs rise (through increased margins or coupons on new transactions or step-up provisions on existing ones). In the longer term, the availability or cost of finance could be affected by the regulatory landscape post-Brexit (eg through loss of the ability to 'passport' prospectuses, or changes in regulatory capital rules or their application). However, much will depend on the UK's post-Brexit relationship with the EU.

Derivatives

The terms of existing derivatives transactions are unlikely to be significantly impacted by the "leave" vote, although movements in underlying markets might result in margin calls, actions may be required to mitigate rating downgrades and defaults could ensue. Standard illegality and force majeure termination events should not be triggered by the vote. Until the terms and timing of Brexit are clearer, there is not a great deal that can be done from a documentation perspective. Indeed, there is a risk that any changes made could conflict with any legislation designed to ensure continuity of contracts. However, when exit terms become clearer it may make sense to undertake limited due diligence to check for unexpected consequences.

Pension schemes

Any pensions impact will vary depending on the structure of the scheme and the degree to which a particular sponsor is detrimentally affected by changes to trading conditions post-Brexit. Trustees of defined benefit schemes may seek increased contingent security to mitigate funding risk where there is a strong perceived threat to the sponsor. More generally, corporates should consider whether detrimental changes could trigger any reporting or funding requirements under existing pension scheme contingent security arrangements. Trustees will also need to review investment and hedging arrangements in relation to scheme assets; for defined benefit schemes this could increase funding requirements.

Public procurement

In a contract award subject to EU procurement rules, the party awarding the contract may not usually discriminate against a tenderer just because it is from outside the EU,

although EU utilities do have a limited ability to discriminate against a tenderer supplying from outside the EU. These rules are quite likely to be replaced: the European Commission has proposed a new regime under which it could impose a price adjustment measure (of up to 20%) on procurement of goods or services originating in a non-EU country if it concludes that country does not itself operate an open public procurement regime.

In practice, application of procurement rules is likely to form part of the negotiations around internal market access. Assuming the UK wants to maintain full access to procurement in the EU internal market for UK businesses, it is likely to need to agree to reciprocal access for EU businesses to UK processes.

Companies with an interest in public procurement should monitor the public debate for calls to allow UK public entities and utilities to discriminate in favour of UK suppliers. If this becomes an issue, the UK government may be more likely to advocate restrictions on UK/EU procurement in Brexit negotiations.

Intellectual property

The most immediate impact of Brexit will be on unitary, pan-European, intellectual property rights such as Community Trade Marks and Community Registered Designs. These will not cover the UK post-exit, although they will continue to cover the rest of the EU as before. It is widely expected that the UK government will provide for right-holders who lose protection in the UK in this way to be granted an equivalent UK national registered trade mark or design right preserving their priority rights, so they should not lose out in the long run.

The position for unregistered Community Design Rights is less clear, so companies operating in fields where designs are important, including consumer goods and mobile devices, will need to consider registering design rights wherever possible. In the patents field, the UK will not be able to participate in the new European Unitary Patent or Unified Patent Court. However, 'classic' European patents protecting inventions in the UK will continue to be available through the European Patent Office as before.

Data protection

Personal data is permitted to flow around the EEA without specific restriction on cross-border transfers. Following Brexit, the UK might put in place data protection laws which the European Commission recognises as adequate, thereby enabling cross-border transfer of personal data from the EU to the UK. However, unless and until the Commission recognises the adequacy of UK data protection law by way of a formal adequacy decision, companies that move personal data from the EU to the UK would need to implement other mechanisms (eg standard contractual clauses approved by the Commission, or Binding Corporate Rules for intra-group transfers).

Low impact

UK-incorporated group entities

If group structures have been created for specific reasons (eg for tax purposes or to take advantage of EU-wide arrangements) they should be reviewed to ensure they will continue to have their desired effect following Brexit. Where issues are identified, corporate relocations might form part of the solution.

Contracts

Neither the vote in favour of Brexit, nor Brexit itself, is likely to have a significant impact on existing or new contracts, save in any exceptional situations where a counterparty's business is severely affected. Contracts will remain in force, the parties' rights and obligations will be largely unaffected and specific Brexit-related provisions in new contracts are unlikely to be needed. Material adverse change provisions, for example in M&A and debt finance documents, are unlikely to be triggered. Brexit should not affect the approach that parties take to including English governing law clauses in their contracts or, in most cases, to including English jurisdiction clauses (save in the limited category of cases where enforcement of English judgments becomes more difficult post-Brexit).

Some contracts (eg IP or IT licences and distribution or franchise agreements) may contain territorial restrictions that refer to the EU. These will likely need to be amended following Brexit, as will references to EU legislation to the extent it is no longer applicable.

Insurance

We expect regularly renewed insurance policies to be renewed on terms that cater for Brexit. Historic policies that still provide cover (eg occurrence-based policies) will need to be reviewed for provisions referring to the EU which, following Brexit, would exclude the UK.

Law and regulation

We have entered a period of uncertainty as to the post-Brexit application of EU laws in the UK. This will need to be clarified as part of the exit arrangements. In the meantime, it is possible that the UK's implementation of new EU legislation may be delayed or put on hold in the run-up to Brexit.

It may, in practice, be that much of the existing law will remain in place post-Brexit (amended to reflect the EU break). For instance, there is a considerable amount of European law concerning the packaging and labelling of products. To continue to export products to Europe, businesses will still need to comply with these requirements even though they may not be driven by national law.

In some areas, eg antitrust, there will probably be an added layer of complexity, uncertainty and cost resulting from dual-regulation or parallel investigations following Brexit. But for companies whose businesses or dealings are not subject to EU-wide regulatory or passporting regimes, the impact should be limited.

Product safety

Much of the UK's law on product safety and regulation derives from European law. The vote to leave has not triggered the unravelling of those laws overnight. However, decisions will have to be taken as to which laws to retain and whether any need to be adapted. EU product standards may well ultimately continue to apply to UK imports, and the UK's exporters may have little choice but to meet safety and design standards if they want to continue their exports into Europe.

Environment and climate change

The vote to exit the EU does not have an immediate impact on rules implementing EU environmental or climate change law. However, the extent of any transition to a purely domestic regime will be key. Much of the UK's environmental law is EU-derived. Decisions will have to be taken over which areas of law and policy the UK government will retain or replicate. Politically, there may be calls for many of these laws to be repealed and a lighter touch form of environmental regulation applied. It is likely that, over time, we will see a patchwork of EU and UK-derived law in place.

In the case of climate change driven laws, the UK has its own climate change ambitions and initiatives. This may be an area where the UK government finds it easier to press on with its own policies, which will largely be in keeping with EU policy. Difficult questions will still arise, such as how the UK links (if at all) to the EU emissions trading scheme.

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