Brexit starts today – how will you respond?

29th March 2017

A little more than 9 months on from the momentous referendum decision on 23 June 2016, the UK government has today given notice of the United Kingdom's intention to leave the European Union and in doing so triggered the two year period under Article 50 of the Lisbon Treaty to negotiate an agreement to leave the European Union. Negotiating principles have been drawn up by both sides and negotiating teams are tooling up for something unprecedented. Something for which there is little legal certainty, both in the UK and under international law. Those who drafted Article 50 have freely admitted that they did not expect a member state to actually to trigger the provision and that is reflected in the lack of detail prescribed for the exiting process.

Expect to see many leaks over the coming months, robust positions and much political posturing. This is, after all, a commercial negotiation, albeit one under intense political supervision. While much speculation, recrimination, even gesticulation can be expected, it is important to remember that this is the beginning of the process by which certainty will begin to emerge and the clock is ticking. How hard will Michel Barnier and the EU27 hold fast to their position *of pour décourager les autres* and just how bright is the UK's stated red line of not accepting free movement of labour in exchange for a favourable trade deal? Political rhetoric is about to be tempered by the fires of pragmatism, which may be no bad thing.

While it is clear that this will be a task of Herculean proportions, there is also a huge amount for both parties to lose and therefore a very real incentive for a workable, fair compromise to be agreed. Recent messaging on both sides has been more measured than it was in 2016, as a result. How a deal covering all trade can be agreed within the period available under Article 50, before the UK General Election due in 2019 and key European elections in 2017 - is even more of a challenge. Article 50 does not help here – it governs the exit but only nods to replacement trade terms, leading the EU to argue that exit terms must be agreed before a new trade deal.

While the UK Prime Minister will not want to go into a general election without at least an interim arrangement agreed (which is likely to look a lot like the status quo), the degree of complexity of negotiating a comprehensive trade deal across all sectors, and factoring in global integrated supply chains, will almost certainly be left until after the terms of divorce have been agreed. Whether that is 'CETA on steroids' or a uniquely British solution remains to be seen. Another profound question to ask, as the Scottish parliament has voted this week to move for another referendum on independence, is what 'UK' will remain to ratify the agreement? A third is whether the British parliament has the stomach to walk away from a "bad deal", with all that entails.

What a "no deal" scenario entails is, like most things related to Brexit, uncertain. In theory, it would mean that the UK would trade with the EU on unfavourable WTO terms. But that pre-supposes political stability and longevity that may not exist; faced with that "cliff edge", would the British electorate still favour Brexit and a government that had by then failed to secure a trade deal and jeopardised the UK's own union, or would a new government perhaps be mandated to seek to withdraw the Article 50 notice – jurists are split about whether or not that is permissible, but question how the EU would respond to a change of British heart, whatever the Treaty says? Ironically, these determinative issues could fall to the European Court of Justice to determine.

So much for the risks and uncertainties. What of the opportunities?

One thing Brexit has shown is its capacity to prove many of the pessimists, naysayers and experts wrong. The threatened financial cliff-edge has not materialised and economic forecasts for the UK have been repeatedly reforecast upwards. The pound fell against the euro, but only to levels seen as recently as Q1 2013; against the dollar, the fall is sharper, but in part this is because the US economy is strong. The FTSE has risen to record highs and, though it has fallen, the more representative FTSE local index is not substantially down. UK GDP growth has remained steady at a creditable and resilient level (0.7% in Q4 2016, the same as the pre-referendum Q4 2015). Inflation is forecast in the UK Budget to outstrip earnings growth for the first half of 2017. House prices continue to grow.

The wheels of commerce turn, British businesses continue to see and grasp opportunities to expand within the EU and elsewhere and many international companies are, if not all confirming growth in the UK, certainly confirming their intention to maintain the strength of their existing investments. Some have seen the opportunities and announced major new investment. The UK government's green paper on its industrial strategy is a roadmap for growth regionally and, in particular, in the technology, life science and infrastructure sectors to name but a few.

The City will lose some financial services jobs to continental Europe. Some have been announced already. But so have some major re-commitments of global players to London. It is true that, absent certainty about passporting and equivalence, London-based financial institutions (and professional services firms) will need to have a material base in the EU. But where? No single other city has or could within the foreseeable future replicate London's vast business infrastructure – everything from the size of its huge professional services infrastructure and pool of labour (London is far bigger than other European cities, so more IT workers, office cleaners, lunch stops etc.) to the availability of office space, people to fit out office space with technology etc. None has such a huge housing stock or a native population whose first language is the world's business language or a time zone that is able to trade in normal business hours with as much of the rest of the world for so many hours a day. Few are as cosmopolitan as London and celebrate that fact as enthusiastically. Finally, but not least, there is English law, a legal framework and courts chosen by many global investors to transact their business.

The costs and risks associated with relocating to the wrong European location or of the fragmentation of the City's hub are beginning to be seen as outweighing Brexit trade risks. We are helping many financial institutions plan interim measures that allow them to maintain EU trading while keeping the majority of their operations in London for precisely all of these reasons. The offer of favourable tax treatment and scrapping of the banking levy by the British government, 2 years ago inconceivable politically, are now a possibility as the government looks to protect this important part of the economy.

The UK's political focus is necessarily on the short term need to engage with the EU on Brexit and what follows it. But for inward investors, rarely have there been changes that offer such potential opportunities in a major western economy. A consequence of the UK leaving the EU for non-EU investors is that the barriers to entry are likely in the short-medium term to fall and in particular to fall relative to new investment in the EU. This is because the restrictions that apply to the UK's trade with the rest of the world by virtue of its EU membership will fall away, unless retained as part of a new trade deal with the EU.

There are two types of restriction. One is the terms of trade applicable now, the other is the freedom to agree new trade terms with non-EU states. These two in combination offer rich pickings for non-EU investors, particularly those whose own governments secure early-mover advantage by negotiating favourable new trade terms with the UK.

Take US investors. TTIP seems to be dead in the water, at least for the duration of a Trump administration; so US:EU investment terms will likely remain static for at least four years (plus however long it takes to resuscitate TTIP). The potential for an early trade deal with the US, on the other hand, coupled with a devalued Pound, mean a soon-to-be post Brexit Britain presents some real growth opportunities for US businesses and the prospect of political needs on the UK side of the pond delivering investor-friendly terms. Other deals will follow hot on the heels of the US (or so Liam Fox hopes). Canada, China, India, Australia…the list of trade partners to whom the UK, unfettered by EU membership, is attractive is long. And doing a deal with post-Brexit Britain will be quicker and easier than dealing with the necessarily less nimble collective bargaining EU.

So, a real question for those with capital to invest globally and a willingness to tolerate a degree of uncertainty, is which other politically stable, mature economies offer investment prospects as changed for the positive as the UK?

Two years is not a long time. The EU negotiating team will need to throw out its playbook if it has any hope of agreeing a workable interim arrangement and framework for a free trade agreement within that time. Blink and it will be 2018. So now is the time to start your Brexit risk planning in earnest if you have not already done so. And for non-EU investors looking for a home for capital, you may want to buy now before others get the best deals!

Dentons' Brexit Toolkit

As the world's largest law firm, with experts on international trade law, WTO rules, investment, corporate restructuring, regulation and risk across the world, Dentons is ideally placed to help you with your Brexit risk planning and to help you invest in Britain. We have developed an innovative suite of technology solutions designed to help clients plan for Brexit.

RAVN – Applied Cognitive Engine Robot

Working with Nextlaw Labs, Dentons' venture development company launched in 2015 to develop, deploy and invest in new technologies, we are working with Artificial Intelligence software experts RAVN Systems to develop a cognitive search engine tool that can be used for Brexit-related contract reviews. Using RAVN's Applied Cognitive Engine (ACE) Robot and an algorithm developed by them with input from Dentons' subject matter experts, high volumes of contract documentation can be processed through the tool to identify provisions that could potentially be impacted by Brexit, creating a report highlighting areas that should be further reviewed and possibly require expert legal advice.

BRIT – Brexit Risk Implementation Tool

Separately, Dentons has developed a software application that automatically creates a "Brexit Action Plan" for clients based on their key areas of risk exposure. Clients can log into a secure website that will ask them to select the key issues their businesses are primarily concerned with, such as data protection, the environment, immigration, and more. Based on this information an action plan will be produced that identifies concrete steps clients need to take in order to understand their exposure and plan an appropriate response. This can be managed and updated by Dentons, giving clients access to industry trends and intelligence. Targeted updates relevant to particular projects will be delivered to those responsible (goodbye general Brexit updates) and an integrated "ask Dentons" functionality will allow clients working on Brexit issues to access Dentons' experts on those topics quickly and easily.

Brexit Connect

Shortly after the Brexit vote, Dentons launched "Brexit Connect", a secure online portal enabling clients to access useful Brexit-related information such as: briefing notes on the impact of Brexit across different sectors; materials from the Firm's internal "Brexit Bootcamp" fee earner training sessions; recordings of webinars that have been delivered to clients across North America, Europe, Asia and the UK; third party source material; an events calendar and an "Expert Locator" of key partner contacts. Clients can benefit from having a constantly updated source of Brexit advice and thought leadership at their fingertips, from which they can choose what is most directly applicable to their businesses.

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