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The UK has voted to leave the EU: What now?

The British public have voted that the UK should leave the EU.

The EU Referendum vote (the Leave Vote) does not by itself result in an automatic UK exit from the EU. The EU Treaty provides for a framework for a “Brexit” to become legally effective over a period of years. Until then, UK remains a member of the EU and continues to benefit from, and be bound by, EU Treaties.

BREXIT

How soon?

The framework for a Member State to withdraw from the EU is set out in Article 50 of the Treaty on the European Union (the Lisbon Treaty), under which the UK must give notice to the European Council (EC) of its intention to leave. This notice will commence the exit process and will be followed by a two-year negotiation period to agree the terms of a Brexit. It is unclear whether Article 50 requires parties to agree both terms for withdrawal and future relations with the EU, which may add to Brexit timing issues. Extension of the two-year period would require consent of all remaining 27 Member States.

Any terms agreed between the UK and the rest of the EU will have to be approved by a qualified majority of the EC (excluding the UK) and requires the consent of the European Parliament (arguably, including UK Members of Parliament). EU Treaties, and therefore secondary EU law, will cease to apply to the UK once the agreed Brexit terms enter into force or, if no terms are agreed within the two-year (or any agreed extended) period, automatically at the end of that period.

Whether the current UK government, which had previously indicated that it would commence the exit process immediately in the event of a vote to leave, can survive the Leave Vote is uncertain. The Vote Leave campaign, the leading group campaigning for Brexit, has indicated that they would want the UK to begin the withdrawal process immediately. Senior members of this group have indicated that they expect withdrawal to be completed by the end of 2019. They are not in favour of activating Article 50 (and being bound by the two-year deadline); they would prefer a more informal process to agree a trade deal and other exit details by late 2019. Any alternative Brexit negotiation models would require agreement from the other 27 Member States, some of which have indicated that they favour a quick Brexit negotiation.

The withdrawal process will therefore be decided only after consultations between a (current or future) UK government and the EC. In the meantime, political and market volatility as a result of the Leave Vote will undoubtedly push for speed and certainty.

How will it affect you?

The EU single market:
Access to the EU single market is critical for businesses in the UK that operate across the European Economic Area taking advantage of the EU single market directives. A loss of access to the EU single market as we know it today and absence of comparable access in any new UK-EU deal would be a setback for these businesses. Financial institutions like HSBC Bank Plc and JP Morgan have indicated in recent months that they would consider moving a significant portion of their activities away from UK in the absence of access to the EU single market. Similar issues arise for manufacturing industries in the UK that rely on seamless multi-country tariff and non-tariff barrier free chains of supply.

BREXIT

> "Commentators expect market, currency and possibly political volatility in and beyond the UK in the days, weeks and possibly months to come."

Managing risks:
International businesses with UK-EU wide operations will need to consider the effect of a Brexit on their operations. As a starting point, setting up an internal task force to look into these issues, and respond to concerns from employees, shareholders, customers and suppliers, would be sensible.

However, beyond this, companies with UK operations would need to understand how they would be affected if current EU regimes applicable to their operations (*e.g.*, pharmaceutical, airline, food, environmental regulations) would cease to apply following an automatic UK exit from the EU under Article 50, with uncertainty as to the replacement regimes.

See below for an overview of some of the issues to consider.

Managing business and operational risks:

ASSET VALUATIONS

Could market volatility affect value of collateral, especially on margin loans and other collateral value linked facilities?

CURRENCY FLUCTUATIONS

Do you have hedges in place to address Leave Vote related currency volatility?

EU TAX BENEFITS

Do you benefit from EU-negotiated tax and free trade agreements with non-EU countries?

EU-WIDE IP

Do you rely on EU-wide IP rights? Have you considered protective measures if EU rights cease to apply?

SINGLE MARKET ACCESS

Do you rely on EU passporting to access EU single market? Have you considered duplicating or moving existing operations (for UK and EU operations)? Would a new or existing subsidiary in the remaining EU fulfil the functions?

UK-EU SUPPLY CHAINS

Are you a UK manufacturer relying on borderless logistics to manage supply chain and just-in-time delivery between the UK and the remainder of the EU? Is "just in time" delivery viable with border controls, customs duties and no VAT remissions, and additional tariff clearance procedures?

BUDGET

Have you budgeted for review of Leave Vote related risks and contingency planning?

EU REGULATIONS AND APPROVALS

Is your business subject to EU-wide regulation or reliant on EU agency approvals (e.g., medicines and life sciences industries, energy, road transport and airlines)? Would you be affected if EU regimes ceased to apply (e.g., because no agency could give safety approvals as of a certain date)? What measures can you take to protect against gaps in interim legislation in the UK?

SCOTTISH REFERENDUM

Would any Scottish operations be impacted in the event of a new Scottish referendum in light of the Leave Vote and a possible Scotland/UK border for labour and goods?

STAFFING AND RECRUITMENT

Do you rely on EU work force based in the UK? Do you have UK workers based in EU offices? Have you considered need for work permits and family visas? Could this impact future staffing and recruitment?

WTO IMPACT

How would the absence of UK WTO rights affect your trade with EU and non-EU countries (automatic exit scenario until UK WTO accession)?

BREXIT

> "During the negotiation period, the UK remains a member of the EU and bound by existing EU treaties."

Managing legal risks:

BREXIT CLAUSES

Should you consider adding Brexit related termination events or grace periods (especially for new contracts)?

COVENANT COMPLIANCE

Could Leave Vote related market volatility affect your ability to comply with financial covenants and payment obligations or trigger market disruption events in contracts?

MAE

Could the Leave Vote trigger termination events or a force majeure or a material adverse effect (MAE) in your contracts? The English High Court has ruled it unlikely that circumstances known at the time of entry into a contract can give rise to an MAE. The Leave Vote therefore likely cannot trigger an MAE in documents entered into after the possibility of an EU Referendum became common knowledge.

CHOICE OF LAW AND COURTS

For new and old contracts, do you need to (re)consider the effect of choice of law and jurisdiction clauses if EU legislation and applicable law and courts cease to apply?

EU TERMS

Do your contracts refer to EU legislation or terms? Should you consider how these should be interpreted, for example by clarifying it refers to EU legislation as at the date of contract?

RATINGS

Could Leave Vote related market volatility affect credit ratings related undertakings?

RISK FACTORS

For new issuances, should you consider Brexit risk factors in prospectuses and information memoranda, in particular for regulated industries?

Key milestones to an Article 50 exit:

Notice under Article 50:
The UK government in charge of Brexit negotiations will, in principle, need to serve notice under Article 50 of the TFEU to start the process.

Effect of EU Treaties until Brexit:
EU Treaties will continue to be applied in the UK during any Article 50 negotiations, thereby ensuring at least a two year Article 50 period during which the current legal situation should remain unchanged (including effect of primary and secondary EU law on UK law and operations in the UK).

Effect of EU Treaties if Brexit agreement is reached:
If, at the end of the two-year period of Article 50 negotiations, an agreement is reached on the terms of a Brexit, one would expect a transition period to "decouple" EU law from UK law. A number of areas of current UK law (*e.g.*, financial services regulation, data protection, competition law, environmental law, listing regime, choice of courts, choice of law, recognition and enforcement of judgments and insolvency regimes), are derived from or harmonised pursuant to EU legislation. A key task would be to consider EU regulations (which have automatic effect) and directives (which are applied by domestic law) that need to be repealed or retained post-Brexit (according to some estimates, over 6,000 pieces of legislation, both EU and domestic), as well as reform of existing UK legislation to address references to EU references in those documents. One element of this would be to repeal the European Communities Act 1972 which gave EU law supremacy over UK national law.

BREXIT

Contingency planning for an automatic exit if no Brexit agreement is reached:
If no agreement is reached at the end of the two-year period of Article 50 negotiations, the UK government would need to consider a contingency plan for UK institutions and internal and external trade in the event of an automatic exit from the EU. At a minimum, the UK would need to put in place, in advance of an automatic exit, a set of interim legislation and related "shadow agencies" that would fulfil the role of EU agencies immediately on an exit.

Negotiating with non-EU countries:
The UK government would over time need to negotiate the new relationship of the UK with non-EU countries and it would have to accede to the WTO. There is no precedent for a major industrialised economy negotiating a full set of global trade agreements, and the negotiation of such agreements could therefore (according to some estimates, including HM Treasury) take a decade or more, during which trading relationships would likely need to be based on either interim arrangements or WTO principles, if agreeable to trading partners.

On what terms?

In a paper published in March 2016 ("*Alternatives to Membership: possible models for the United Kingdom outside the European Union*"), HM Treasury considered a few alternatives to current EU membership. Please see the table below for a snapshot of each of these alternatives in light of UK's current EU membership.

SUMMARY TABLE — MODELS OF RELATIONSHIP TO THE EUROPEAN UNION[1]

		Access to Single Market in Goods and Services								
	Votes on EU Law	Tariff-Free Trade	Customs Unions and External Trade	Level Playing Field for Businesses	'Ever Closer Union'	Justice and Home Affairs	Free Movement of People	Schengen Border Free Area	Contribution to EU Financing	Eurozone Membership
Current UK Membership of the EU	YES	YES	YES	YES	NO	P/V/SA[2]	YES	NO	P/V/SA	NO
Norway (Non-EU but Part of European Economic Area)	NO	P/V/SA	NO	P/V/SA	NO	P/V/SA	YES	YES	P/V/SA	NO
Bilateral Agreements										
— *Switzerland* [3]	NO	P/V/SA	NO	P/V/SA	NO	P/V/SA	YES	YES	P/V/SA	NO
— *Canada*	NO	P/V/SA	NO	P/V/SA	NO	NO	NO	NO	NO	NO
— *Turkey*	NO	P/V/SA	P/V/SA	P/V/SA	NO	NO	P/V/SA	NO	NO	NO
WTO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO

The HM Treasury paper did not give any indication as to a possible alternative membership model but noted that it would "*…be hard even to come close to replicating the level of access and influence from which the UK currently benefits as a result of our special status in the EU. … Negotiating exit from the EU, a new relationship for the UK with the EU, and then a new set of trade deals with third countries, would be at the most complicated end of the spectrum. We should expect this process to take up to a decade or more to complete.*"[4]

[1] Based on the table provided at page 14 of the HM Treasury Paper: "*Alternatives to Membership: possible models for the United Kingdom outside the European Union*", March 2016.

[2] This means the access is partial (P) or voluntary (V) or pursuant to special arrangements (SA).

[3] The EU and Switzerland are negotiating a new agreement under which the Court of Justice of the European Union oversight and more stringent rules (such as State aid control) will be imposed on Switzerland in return for access to the EU single market.

[4] See pages 41 and 42 of the HM Treasury Paper: "*Alternatives to Membership: possible models for the United Kingdom outside the European Union*", March 2016.

BREXIT

> "The UK government will need to serve formal notice to begin actual negotiations, which can last up to two years."

In the run up to the EU Referendum, the Vote Leave campaign claimed that the UK would be able to negotiate trade agreements with the EU comparable to arrangements currently in place without compromising on their case for Brexit (see box "*Vote Leave — The case for Brexit*").

Vote Leave — The case for Brexit:

EU IMMIGRATION

Take back control of UK's borders. Introduce a point-based non-discriminatory immigration system for all persons wishing to live and work in the UK (including from EU). In the event of a vote to leave and ahead of Brexit becoming legally effective, introduce "emergency" legislation, to restrict EU immigration (and prevent influx of migrants ahead of Brexit).

EU BUDGET

End contributions to EU budget. Focus on UK priorities like the National Health Service.

INFLUENCE OF EU LAW AND EU COURTS

End supremacy of EU law in the UK. Give the domestic legislator full control of UK laws. End oversight of EU courts in UK legal matters. In the event of a vote to leave and ahead of Brexit becoming legally effective, introduce "emergency" legislation to limit the role of EU judges on matters of UK law, notably on UK's powers to decide who it deports.

However, as illustrated by the table in the earlier section (see "S*ummary Table — Models of relationship to the European Union*"), there is no precedent where a country has been able to say no to free movement of people and obtain access to the EU single market and not have to comply with EU rules on single market, including EU court oversight on those matters.

Conclusion

A Brexit will not come into effect until, at the earliest, two years after an Article 50 notice. If a route outside of Article 50 were to be followed, negotiations could potentially be longer than two years.

We cannot assess when Brexit negotiations will start and end, or what aspects of the current relationship (for example, access to EU single market) will survive and if so, in what form. The resultant legal uncertainty as to timing and nature of the future UK-EU relationship will likely continue to cause market and currency volatility in and beyond the UK for some time.

Contacts

If you have questions about this *Briefing Note*, please contact the Latham lawyer with whom you normally consult.

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