

Brexit

approaching a year on





Nearly a year after the outcome of the referendum of the UK electorate became known, Article 50 has been triggered and an election called but uncertainties remain.

Markets have now recovered strongly (with a notable improvement when the UK general election was called) and the pound is the best performing G10 currency this year against the US dollar. Interest rates remain low. Indications seem to be that the UK is faring well with a strong and growing economy.

The UK Government has acted to increase the focus on international trade. The assumption is that the importance of international trade will continue to be emphasised if, as widely anticipated, Theresa May forms a new government post-election.

Commentators suggest that now a large majority of the UK public support Brexit with a new category – Re-leavers – being identified who voted to remain but now believe that leaving is both inevitable and, in all the current circumstances, the correct thing for the UK to do. The FT has reported that 68% of the UK electorate are either Leavers or Re-Leavers.

What form will Brexit take?

It is clear that the UK Government will not be rushed into hasty decisions on the form which Brexit will take. While there are precedent models which could be followed, it appears increasingly likely that the final exit arrangements will be bespoke, reflecting the importance of the UK as a trading partner with Europe, and reflecting also the key political importance of the alliance between the UK and the EU member states.

There are five precedent models which have been used to date:

- EEA and EFTA (model adopted by Norway and Iceland) - the UK could become a member of the European Economic Area and the European Free

Trade Association. This model would permit the UK to retain access to the EU internal market and for EU businesses to continue to have access to the UK market. The position on immigration would remain unchanged; the UK would not be able to restrict EU immigration rules and would be obliged to permit the free movement of EU workers. The UK would also be obliged to continue to contribute to the EU financially and adopt EU legislation. The UK would not be part of the EU common agricultural, fisheries, transport energy and commercial policies or foreign and security policy.

- Bilateral trade agreements and EFTA (model adopted by Switzerland) - the UK would be obliged to agree specific sector-based treaties with the EU and trade agreements with individual countries outside the EU. This model would restrict the UK's access to the internal market but would not require the UK to implement EU legislation.
- Customs union - Turkey is an example of a country which has a customs union for goods (not services) with the EU. This would permit the export of goods to the EU without the requirement to comply with customs restrictions or tariffs. In such a scenario the UK would not be obliged to contribute to the EU budget but would have to comply with a large part of EU trade policy, and there are downsides on the right to provide financial and professional services on equal terms with other EU members.
- Free Trade Agreements – the UK could negotiate its own Free Trade Agreement with the EU, similar to the Swiss model except that there would be one agreement with the whole EU rather than sector-by-sector specific agreements. This would give the UK total freedom but would cause the UK to lose its internal market rights.
- World Trade Organisation - for the UK, this would be the purest form of exit model as it does not involve negotiated agreements with the EU or individual EU countries. Under the existing WTO rules, the UK



would have absolute control over its trade policy and borders and would not be required to contribute to the EU budget. Under this model the UK would lose its influence on EU law and regulation but would not have to adopt EU legislation. All UK exports to the EU would be subject to EU tariffs, duties and regulations.

Corporate

For corporates operating outside of financial services, Brexit represents opportunities as well as threats. The fluctuation in the sterling exchange rate against currencies (particularly the euro and the dollar) for some businesses is a good thing but not for others. Those businesses that generate a majority of their income from exports benefit from a weaker pound as do business with overseas operations who receive income in foreign currencies. Corporates in the tourist and leisure sectors who rely on visitors from overseas are also seeing short term benefits. However, for those businesses that generate the majority of their income domestically, the future is less clear. We have seen an increase in foreign interest in buying UK businesses partly due to the exchange rate but we have also heard of investors pausing on consideration of UK opportunities. Some of the diligence we are seeing will be opportunistic and may not result in completed deals, but others where there are genuine synergies and business drivers are likely to proceed. While the UK stock markets have so far seemed to hold their own, it remains to be seen whether London can remain the capital market of choice for many overseas companies looking to list and sell their shares.

Litigation and arbitration

Many international businesses chose English law for their investments and deals. Except in certain limited respects, Brexit will not affect the substantive law of England. Accordingly, the terms of contracts governed by English law will not be interpreted differently post Brexit. There is therefore no reason to think that - market uncertainty aside

- Brexit will cause commercial disputes to occur.

Many of the international rules regulating commercial disputes will also remain unaffected. The EU Rome I Regulation which regulates choice of law applies to EU and non-EU states alike. There is therefore no reason why Brexit would cause a court in another EU state not to respect the choice of English law in a contract.

International arbitration is outside the EU rules and governed by the New York Convention 1958, which most countries worldwide have ratified. LCIA and other international arbitration seated in England is therefore not expected to be affected.

There will be one significant change, however. Post Brexit, England will be outside the Brussels regime which enables the service of legal proceedings, stays of parallel proceedings and enforcement of court judgments within the EU.

At the end of March 2017, the House of Commons Justice Committee recommended that, following Brexit, the Government should aim to replicate the Brussels regime as closely as possible, perhaps using the EU-Denmark agreement as a blueprint. Another option was to secure membership of the Lugano Convention, which extends a regime similar to Brussels to the EFTA states (Switzerland, Norway and Iceland).

This will be the subject of negotiations during the Brexit process. However, even if an agreement modelled on Brussels or Lugano is not achieved, we do not expect EU states to refuse to allow service of English court proceedings and enforcement of English court judgments, or vice versa. This is generally possible without specific international agreements. For example, the UK has no bilateral jurisdiction treaty with its largest trading partner, the USA, and this does not cause any major issues.

Nevertheless, this is an area where there is a degree of uncertainty and you may wish to obtain specific guidance when negotiating contracts with a cross-border dimension.



Projects & Construction

Although there is still much speculation as to the likely effect of Brexit on the UK construction industry, the main areas of concern are beginning to emerge:

- the exacerbation of skills and labour shortages;
- the rising cost of goods and materials;
- the status of current construction standards and regulations;
- the availability of finance (currently facilitated by the European Investment Bank or other European funds) for large infrastructure projects; and
- single market and tariff free access.

The first three of which have been the biggest concerns for our clients.

A chronic shortage of labour and a widening skills gap, not yet affected by Brexit, is already being felt by many in the industry. Even if part of the fallout from Brexit results in a downturn in demand, there remains the problem of the EU workforce (currently estimated to be 8% of the UK's construction workforce) leaving the UK with no home grown solution to plug the gap.

A weaker currency caused by Brexit uncertainties will add to the difficulty of delivering current and future projects as more expensive goods and materials will be added to the extra expense of labour as a scarce resource. An increase in or the addition of, cross border tariffs will not assist.

If a Brexit deal does not provide for the regulation of both voluntary and mandatory construction standards, including codes of practice, this could leave the UK out of step with the EU, possibly preventing UK companies from bidding for international construction projects.

How can this and the other issues be anticipated (in so far as this is possible) to ensure that even a hard Brexit will result in a relatively soft landing for construction

professionals? New projects will require carefully negotiated contracts which clearly allocate particular Brexit risk such as delays or increased costs. The possibility of fluctuations in currency or changes in standards should be discussed up front. Construction agreements for existing projects should be reviewed to check where there is possible exposure to avoid disputes later on.

Construction Litigation

With the increased risk of construction disputes following the EU Referendum, effective contract management will become increasingly important, and understanding where disputes are likely to arise in the next couple of months will be crucial.

One of the areas that may see a rise in disputes is in the termination of contracts. Parties may look to terminate contracts where there is a concern about profitability, which may now be compounded by shortages of labour and fluctuations in the value of the sterling. In a more uncertain market, contractor insolvency is also more likely to cause disputes in respect of outstanding monies to the insolvent party, or recovery of any loss incurred by the solvent party as a result of the insolvency. Payment disputes have already been in the spotlight for some time, but this is likely to give rise to further disputes as parties are eager to get paid as soon as possible to keep up cash flow. We may therefore see a rise in 'smash and grab' adjudications and enforcement proceedings.

Parties should review their contracts to ensure they are aware of their rights and obligations and how to exercise them, so that disputes may be avoided from the outset.



Immigration

Article 50 was triggered on 29 March 2017. According to the Treaty invoking article 50 sets a two year clock which means the UK automatically ceases to be a member in April 2019.

At this point the UK will no longer be bound by EU treaties and laws and therefore any EU migrants exercising treaty rights in the UK automatically lose the right to remain in the UK. That is of course if another deal is not reached or transitional arrangements are not put in place.

While no official guarantee has been given, the Government has given strong indication that EU nationals currently living in the UK will be allowed to stay. All negotiating parties are eager to guarantee the rights and a deal is likely to be reached before the two year deadline comes into play. In the worst case scenario some form transitional arrangements are likely to be put in to place which raises the possibility that current free movement rules could extend beyond April 2019.

What to do now?

Whether a deal is reached or transitional arrangements are put in place at some point EU nationals living and working in the UK will have to prove their right to remain in the UK and that is probably one of the biggest challenges that EU nationals will face.

Depending on the amount of time they have spent in the UK as Qualified Persons (workers, self-employed, self-sufficient, students or job seekers) they could apply for a Registration Certificate or a Permanent Residence card. Both of these applications require the applicant to keep a record of their residence in the UK (in the form of utility bills, bank statements and other correspondence) as well as evidence of how they are qualified (such as payslips, P60's etc.).

Employers should encourage their employees to keep as many records as possible and dig out historic records of their employment and residence in the UK to ascertain their eligibility to apply. Employers should also encourage their workers to make applications as soon as possible in

order to obtain some form security moving forward.

At the moment the only way to completely guarantee a worker's continued right to live and work in the UK would be to apply for British Nationality and applying for a permanent residence card first is a prerequisite.

Employment

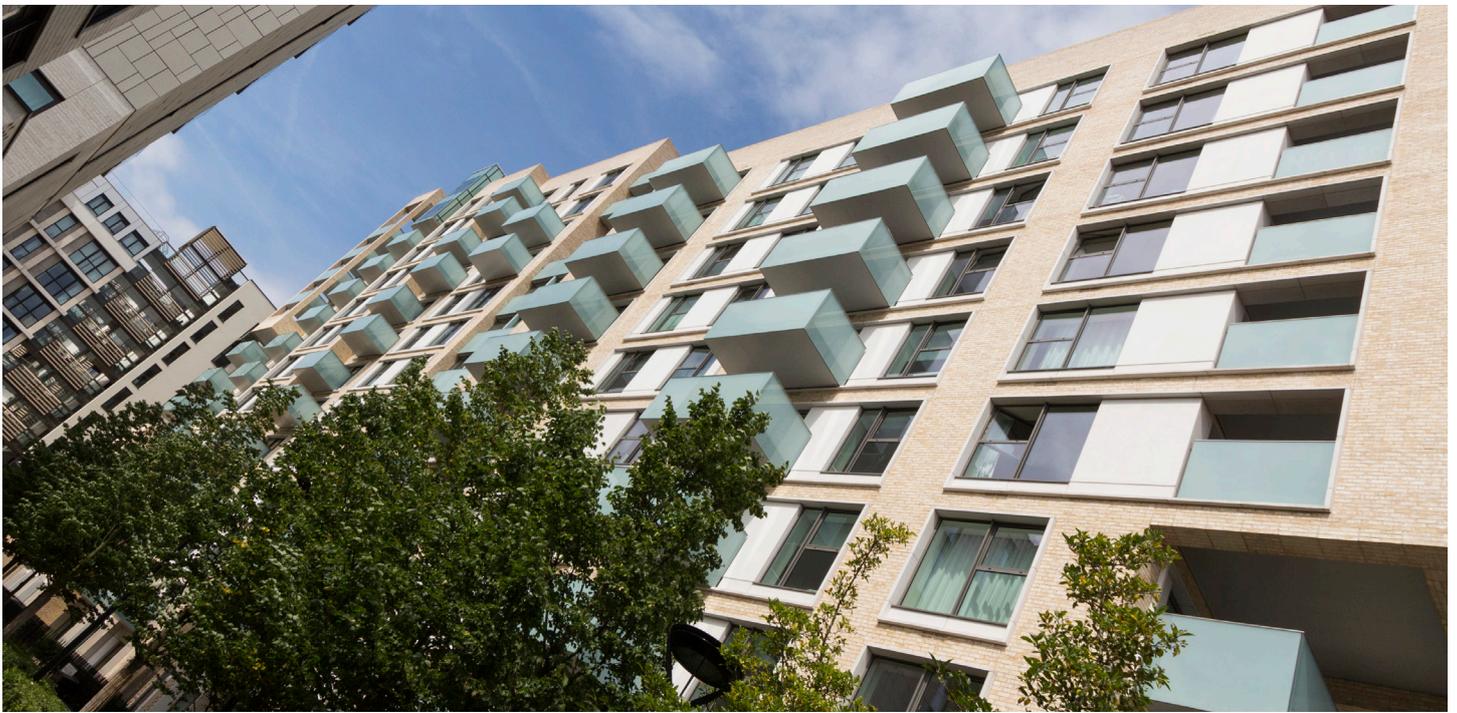
The uncertainty following Brexit has affected employment. We are advising employers to revisit their people strategy to ensure that it is sustainable in the short to medium term, that the business is attracting the right people, retaining its key people and limiting risks when employees leave. As the talent pool may decrease, the competition increases making all areas of the employment relationship more challenging.

Despite no legal challenges yet, employers in sectors with a high proportion of EU workers such as social care, leisure and hospitality are beginning to anecdotally report higher staff turnover and difficulties recruiting. We continue to see an increase in applications for citizenship being made by citizens of the EU resident in the UK who had previously believed such an application to be unnecessary.

What happens to employment law will naturally depend on the outcome of the negotiations with the EU and its members.

This is likely to affect whether the UK can ultimately maintain or regain its position as the jurisdiction of choice for non EU investors wanting to expand into Europe, and for those already basing their European headquarters in the UK. These factors will influence employment and immigration. We are seeing businesses expand into other European countries which could ultimately lead to a relocation of headquarters. We are also seeing redundancies being made due to the uncertainty in the market.

If the UK does enter into competitive trade agreements with EU members, it is likely that it will need to retain



the main social framework laws as a condition. It is likely therefore that the essence of TUPE, holiday rights, discrimination laws will remain.

Employment laws in the UK are mostly now domestic laws deriving from the EU rather than being EU laws. In addition, the 'Great Repeal Bill' will codify the remaining EU laws into UK law, with powers for ministers going forward. Brexit does not mean, therefore, that these laws and protections fall away automatically. It may mean, however, that over time, the government will liberalise employment law further by removing red tape such as Working Time protection, collective redundancy rights and agency workers rights.

Real Estate

Since Brexit the UK property market has become more attractive to inward investors due to falls in the value of sterling. Investors from the Asia and Middle East (where currencies are pegged to the dollar) continue to increase their investment further. The rental returns offered by commercial property continue to look attractive given the low interest rate regime and nominal yield on some government bonds.

Some Real Estate funds had to respond to initial nervousness by investors immediately after the referendum results by placing suspension on withdrawals, but these have now been largely lifted and there has been a marked increase in activity so far this year as funds come back to the market across a variety of sectors.

Longer term Brexit is likely to have implications on the investment, regulatory and environmental frameworks which surround the UK's real estate investment market. Particularly given London's success in the real estate investment market, Brexit could have real impact on the property industry if it affects how investors access the property market, or adversely impacts on demand. At present however, the perception of overseas investors is that London remains a safe place to invest and also a

place where people want to continue to live and work. Some large businesses are considering a relocation of some staff from London but not as yet in substantial numbers.

Historically changing markets offer opportunity and the robust English legal system and the transparency of the UK property market are unlikely to be affected by Brexit. The long term state of the market will however inevitably be influenced by how quickly and decisively the government strikes a deal with Europe.

Impact on procurement rules

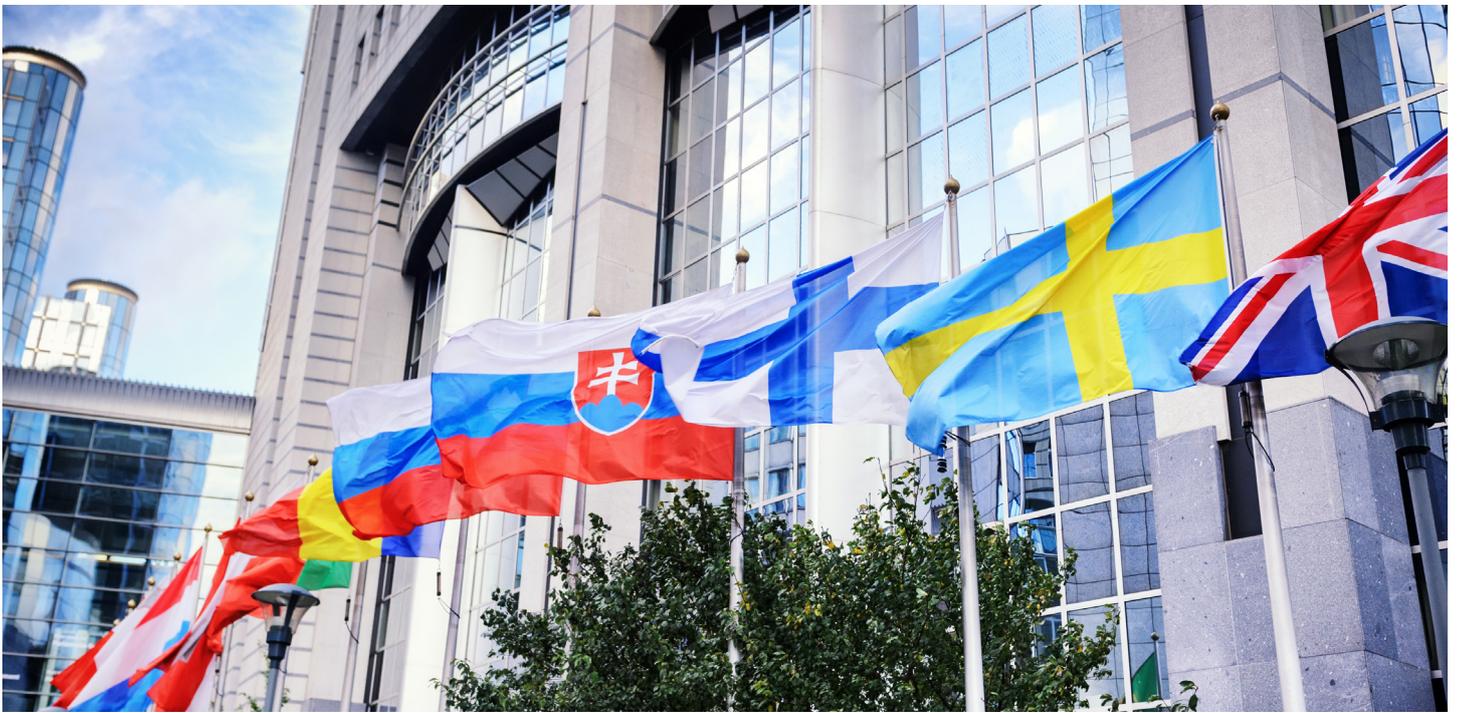
A number of our clients have asked us our view of the impact of Brexit on EU procurement rules as applicable in the UK.

The Conservative Party's policy means that, if they are re-elected, the UK appears destined to cease to be a member of either the EU single market or its customs union.

The Great Repeal Bill White Paper proposes incorporation of most existing EU law into domestic legislation with subsequent wholesale changes being left to the discretion of Parliament. In our view, in all likelihood therefore, the substantive obligations of the Public Contracts Regulations 2015 to procure competitively and transparently would remain in place.

If after Brexit, the UK were part of European Economic Area with access to the single market, then very similar rules would need to be implemented. If, however, the UK negotiated trade treaties with different countries then another form of public procurement rules would apply - possibly modelled on the World Trade Organisation's Government Procurement Agreement and giving the relevant countries access to the UK market.

The White Paper is not clear whether competition law (including state aid) will be incorporated on the same basis as other EU law. State aid law is currently very



dependent on the role of the EU Commission. If a form of state aid law is adopted, it will be interesting to see whether competition law/state aid will be overseen by arm's-length regulator or placed in a government department.

Labour, the Liberal Democrats, SNP and the Greens are advocating that the UK should remain in both the EU single market and customs union. If any of those parties form the next government then much of EU law and the EU courts' role will be retained.

Therefore, we believe that there will be no dramatic change to the current position regarding procurement rules in the short term. Although, the position should become clearer after the UK government has set out its preferred option for life outside the EU.

Taxation including VAT

Until the UK leaves the EU, there will be no impact on the UK tax system. In any event, large parts of the UK tax regime are broadly outside the jurisdiction of EU legislation and therefore the impact of Brexit may be minimal on those taxes, such as corporation tax, income tax, inheritance tax and stamp duty land tax. So far as cross border tax issues are concerned, for example, withholding tax on interest payments, the UK may need to look to its extensive double tax treaty network in dealings with EU states.

However, some UK taxes are to an extent dictated by or closely associated with the EU. The main examples are VAT and customs duties. So, for example, the UK will need to introduce its own customs duty regime.

Although VAT, which contributes 20% of UK tax revenues, will undoubtedly continue post-Brexit, the regime may be subject to some change, for example extension of the zero rate of VAT to more goods and services. However, there may be additional compliance and a possible cost burden for businesses making supplies across the EU.

Ready or not?

Businesses need now to be considering the risks, the impacts on their business of Brexit and their options.

We are looking at the legal, regulatory and commercial implications of Brexit across all of our practice areas. We can help you to prepare by considering the implications of Brexit for you.

For further information please contact: brexit@trowers.com

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