

ALLEN & OVERY

PERSPECTIVES ON BREXIT

*The impact on business,
law and everything in between*



BREXIT – HOW MUCH HAS CHANGED IN A YEAR?

Well, we have an end date, 29 March 2019 (we think at least); but otherwise the imponderables from last year remain. Aside from the intense political, social and popular debate, what does the future hold for Europe, we scan the horizon...

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Wim Dejonghe
 Senior Partner, Allen & Overy

PERSPECTIVES ON BREXIT

As I travel around our network, the questions I'm most often asked are: what's the impact of the UK's decision to leave the EU and what does the trend for increasing protectionism mean for internationally operating businesses and service firms alike?

Our global clients will continue to run global businesses. At the same time, they know they have to adapt the way they run these global businesses to the increasing call for protectionism. With our global reach, local depth strategy, we are best placed to help them.

The work we have done in recent years to build our network across the world not only means we have an unrivalled footprint in all the key economies where our clients are working, but provides us with a powerful hedge against volatility in any one region. That hedge is re-enforced by the strength of our practice groups and their superb record of working across borders to meet our clients' needs.

So regardless of where our clients need high quality legal advice and whether or not we do see a sharp resurgence in national regulation in the years to come, we are better placed to serve them through our international network than any of our competitors. This is the new normal and I believe the uncertainty we're currently seeing could last a decade or longer.

Our mantra is "global reach, local depth" – never one or the other; always both, together – and I believe recent developments across the world reinforce this as the right strategy. We remain focused on our clients wherever their challenges arise.

While building U.S. law capability remains a top priority for A&O, I believe the importance of English law and the English Courts will continue to give us an advantage as it will in many cases remain the governing law of choice for international deals.

I'm also convinced London will continue its role as a leading global financial centre. And where any movement does occur over time, our international network is ideally placed to support our clients very effectively as we have large teams in jurisdictions such as New York, Washington D.C., the Middle East, Singapore, Hong Kong, Germany, France, Luxembourg, the Netherlands, Spain and Belgium.

Our objective since the Referendum has been to ensure that we are there to advise our clients on Brexit risks and opportunities in areas such as scenario planning, advising on issues such as relocation and reorganisation and helping clients ensure their voices are heard during the negotiations. We've published over 25 specialist papers, run more than 200 seminars and meetings globally and contributed to more than 30 governmental and trade association fact-finding initiatives.

We have already secured a good number of significant Brexit-related mandates for banks, insurers, asset managers and corporates, and expect there will be many additional opportunities to win further work as the Brexit deadline approaches. To date, instructions have mainly involved regulatory advisory and reorganisation work, but these are expected to lead to implementation work offering scope for A&O to use its unparalleled sophisticated delivery capabilities.

So, as we did a year ago in the immediate aftermath of the Referendum result, we've compiled a number of thought-provoking articles and external perspectives with the aim of demystifying some of the key Brexit-related issues and assisting our clients to chart a course through this unprecedented period of uncertainty.

With the negotiations now kicking off in earnest, we've focused this report on three main issues: the future of EU/UK trade, the role of the European Court of Justice and the English courts after Brexit and the effect of Brexit on the development of global legal systems. We also feature expert independent political commentary on the negotiations from Charles Grant of the Centre for European Reform.

I hope you find the content informative.

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Charles Grant
Director of the Centre for European Reform

THE POLITICS OF THE UK'S DEAL ON BREXIT

The final shape of the Brexit deal will depend less on economic considerations or the views of the 27 EU governments than on the complexities of UK domestic politics.

When Theresa May lost her parliamentary majority on 8 June 2017, the hard version of Brexit that she had been seeking probably became unviable. She had wanted a significant drop in the numbers of EU immigrants, the exclusion of the European Court of Justice from the UK and an exit from both the Single Market and the customs union. But there is probably no longer a majority in Parliament for that model of Brexit.

The final deal will probably be softer, but how much softer and in what ways is far from clear. Big business and a newly emboldened Treasury, led by Chancellor Philip Hammond, are pushing for a less hard outcome. The extent to which they succeed will depend largely on the internal politics of the Conservative and Labour parties over the next year.

A softer Brexit would mean some or all of five things:

- A transitional period of several years between when the UK leaves the EU in March 2019 and when a future free trade agreement (FTA) takes effect.
- Only modest restrictions on free movement post-Brexit.
- Remaining in some EU regulatory agencies, certainly during the transition, and perhaps afterwards.
- Accepting some future role, though probably indirect, for the European Court of Justice (ECJ).
- Staying in a customs union with the EU.

This list does not include staying in the Single Market, since it is inconceivable that Britain's political class could accept – beyond the transition – the EU's conditions: free movement, budget payments, the ECJ and all single market laws (with no vote on them). The first of the five things has already been achieved. Mrs May now accepts what she did not accept before the election, namely that the future relationship cannot be negotiated before Britain leaves the EU. So there has to be a transition, which will resemble the current terms of membership and will give businesses some time to

prepare for the major changes that Brexit will entail. The second attribute of a soft Brexit – also important to businesses – looks viable, since Brexiteer ministers such as David Davis and Boris Johnson do not want draconian cuts in the numbers of EU migrants.

The third, fourth and fifth characteristics are more problematic. There is a strong case to be made for staying in some regulatory agencies, since leaving them would mean the UK having to devote time and money to building up national replacements. But the EU will insist that, if the UK stays involved, the ECJ must play a role. The EU also makes the general point that if, in the future relationship, the UK wants anything approaching Single Market membership – whether in aviation, data flows, equivalence in financial services or other areas – the UK must accept ECJ rulings. If the UK wants pure judicial sovereignty, it will face barriers to trade.

As for staying in a customs union with the EU, the economic benefits would be manifold: combined with the mutual recognition of standards, a customs union would eliminate the need for controls on borders, as well as all tariffs on trade with EU partners. It would take away the need for customs posts on the border between Northern Ireland and the Republic. But it would deprive the UK of the ability to negotiate FTAs in goods with third countries, which is central to the 'global Britain' narrative pushed by leading Brexiteers like Boris Johnson and Liam Fox.

In free votes in the House of Commons, there would probably be a majority for all these elements of softer Brexit. But both the main parties will whip their MPs, which means that the hard-Brexiteers could still win on regulatory agencies, the ECJ and the customs union.

The key questions are how many Tory MPs are ready to rebel against a whip, and what line the Labour Party takes. The government has a majority of 13, thanks to the support of the Democratic Unionist Party.

That means that if Labour joins the other opposition parties in voting against a law, seven Tory rebels would suffice to defeat the government (however, a few Labour Eurosceptics may vote with the government, which means that more Tory rebels would be required). There probably are enough pro-EU Tories to defeat the government, at least on some issues. But is Labour capable of taking a unified line? The party is currently divided on key issues like membership of the Single Market and the customs union, though it may be moving towards a policy of staying in a customs union.

If Labour gets its act together, and if about ten Tories are willing to rebel, the Commons will vote down some of the legislation required for a hard

Brexit. The House of Lords will also vote in favour of a softer Brexit, though it may be reluctant to defeat the government unless the Commons gives a lead. In such circumstances, Mrs May will find that in order to survive, she will need to reach out to opposition parties and work with them on Brexit strategy. That would almost certainly mean breaking with her own right wing on issues like the ECJ and the customs union – and suffering ministerial resignations. But if she is unwilling to do that, her government may fall. And her successor as Tory prime minister would discover that the only way to push through the Brexit legislation and survive would be to work with the opposition to achieve a softer outcome.



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CREATING A NEW TRADING RELATIONSHIP BETWEEN THE EU AND THE UK

Following more than four decades of political, economic and social integration, the UK's decision to leave the EU presents the EU-27 and the UK with an unprecedented challenge.

Do they resist calls for a shift to a more protectionist relationship, as witnessed in other parts of the world, or look to establish a new economic framework built on open and free trade? To many, international trade negotiations are all about politics and much less about the law. If true, does this make it less likely that the UK's departure from the EU is both orderly and avoids the rise of protectionist behaviours?

Perhaps Liam Fox, the UK's Secretary of State for International Trade, and a leading Brexiteer, was rather optimistic in his comment that settling a free trade agreement between the UK and EU should be "one of the easiest in human history". However, given that the UK's and EU's economic interests will remain highly interwoven even after 29 March 2019, a recalibration of the economic relationship through some form of trade and/or customs arrangements should be achievable in the medium to long term. Dr. Fox was perhaps more realistic in his observation that "the only reason that we wouldn't come to a free and open agreement is because politics gets in the way of economics". Welcome to the world of trade negotiations.

It's important to put the UK's relationship with the EU in context when seeking to understand the shape of future trade. The EU, taken as a whole, is the UK's largest trading partner accounting for 44% of all UK exports and 53% of imports. In 2016, the UK carried a trade deficit with the EU of GBP71 billion – a surplus of GBP24bn on services was outweighed by a GBP96bn deficit on goods. Germany, France and the Netherlands remain significant destinations for UK goods and services although the U.S. is, by some distance, the UK's largest export market.

The numbers clearly tell us that some form of free trade between the UK and EU should be beneficial to all (even recognising this will fall short of the benefits of being a member of the Single Market). However, there are numerous other dynamics at play that will influence the economic debate.

The level of future co-operation over issues of collective security will have a key part to play. Not only does this touch upon issues such as the Irish border question but also the EU's position vis-à-vis Russia and indeed the U.S. Another central theme concerns the extent to which there should be regulatory convergence between the UK and the EU-27 going forward (in legal terms often referred to as equivalence). There remain strong political voices in the UK calling for a low tax and lightly regulated business environment. This is potentially at odds with the terms on which the rest of the EU would be willing to keep its doors fully open to UK trade. A third dynamic arises from how ambitious the EU-27 and UK wish to be in framing any future trade agreement (FTA). There has been an emergence of new forms of FTAs over recent years that touch upon issues wider than trade (as witnessed with respect to environmental issues in the TTIP negotiations). These agreements can be used for far wider purposes. In the near-term, the UK's interests clearly lie in an FTA-lite model which focuses on the core essentials. The EU-27 may not see it that way.

Amid the uncertainty and speculation, one of the few seemingly accepted principles in the Brexit debate has been that, absent an FTA, the UK will default to the WTO rules (principally, GATT and GATS) as the basis for trade with both the EU-27 and third countries which currently have FTAs with the EU.

It appears to have been generally accepted that the current absence of any UK specific schedules of commitments for goods and services is a mere bump in the road that will eventually be sorted out. This is, again, where the politics of international trade will come into play. The UK is currently a WTO member in its own right. It does not, however, have any schedules of commitments for either goods or services. It has traded on the basis of the EU's schedules. It is anticipated that the UK will merely 'adopt' the EU schedules in the short term in order to regularise its position under the WTO rules. This is

not without difficulty given that there is no current mechanism under the WTO framework which deals with this situation. The precise routes under GATT/GATS through which this will be addressed have still to be agreed. Aside from procedural questions, close attention will also have to be paid as to how the UK and EU approach the split of quantitative commitments currently in the EU's schedule. All of this will require a political willingness among key WTO members to regularise a unique set of circumstances.

There also appears to be a growing acceptance that some form of transitional arrangement will need to be in place to ensure an orderly Brexit. This seems a sensible step (at least commercially). At the very least, this should provide a roadmap towards a full FTA and may even go further in preserving the status-quo of the existing trading relationship for a short period despite the UK's exit from membership of the Single Market. In principle, this is permissible under WTO rules. Part of this deal should also address the immediate regulatory issues that would otherwise present themselves on 30 March 2019 (such as the grandfathering of EU product licences and customs/border requirements). It remains too early to predict how far reaching any such agreement will be. The UK will also leave the EU's customs union on 29 March 2019 (despite some reports that the UK could 'stay in' the Union). We would regard the settlement of

customs formalities (including rules of origin for goods) as an essential part of any transitional arrangement given that businesses will need time to adapt their supply chains to the new practicalities. Much has been said on Turkey's customs union with the EU. This would appear to be politically challenging given the constraints it would impose on the UK's international trade policy post-Brexit. A more bespoke model will probably be needed.

That being said, nothing apart from the terms of the divorce are likely to be in place by 30 March 2019 if the approval of all Member States is required. The challenges that CETA faced remain fresh in the mind (and CETA has yet to be approved by many Member States). A potential short-term fix could be to wrap any transitional arrangement into the Article 50 withdrawal agreement rather than construct it on a stand-alone basis.

With a fair wind and the German Parliamentary elections behind them, it remains firmly within the grasp of the EU and UK negotiating teams to secure a deal which allows the benefits of a trading relationship to endure while recognising that the UK has left the EU. We all understand the unprecedented legal complexities of what needs to be done. Ultimately, however, it will be politics, rather than the law, that will define the terms of any new trade deal the effects of which will be felt for many generations to come.




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BREXIT AND THE COURTS

What role will the Court of Justice have in determining private party disputes in the UK after Brexit?

One of the few things that UK Prime Minister Theresa May committed to at the outset of the Brexit process was ending the jurisdiction of the Court of Justice of the EU in the UK. It is a point Mrs May made when setting out the UK's 12 negotiating objectives on Brexit in January 2017 and one that she has reiterated repeatedly since then, including in the UK Government's consultation paper on legislating for Brexit, published in March. That commitment has now been reflected in the European Union (Withdrawal) Bill which, if enacted in its current form, would result in the Court of Justice having no continuing adjudicative role in the UK legal system in relation to cases arising after Brexit.

That is not to say that the UK intends that the influence of the Court will no longer be felt, however. The Bill does provide that UK courts will generally continue to be bound by pre-Brexit Court of Justice case law when interpreting "retained EU law" (EU law incorporated into UK law on Brexit) and it also contemplates that they may "have regard" to post-Brexit decisions if they consider it "appropriate" to do so. The UK's position paper on ongoing Union judicial proceedings also contemplates a continued role for the Court in relation to cases involving private parties that are "pending" on exit day, although the UK's position on when a case should be deemed to be pending is unclear. The EU-27 takes a wider view – its position is that the Court of Justice should retain jurisdiction both over cases pending on exit day and cases involving "facts that occurred before the withdrawal date".

What does this mean for the business community? It is clear that the role that the Court of Justice will have in private party disputes in the UK after Brexit is of huge symbolic significance on a political level on both sides of the negotiating table, but does it have the same significance at a legal and practical level for commercial parties?

In answering that question, it is important to distinguish between the jurisdiction of the Court of Justice and its jurisprudence. From a jurisprudential perspective, the Court does have a significant role in defining the scope of private law rights and obligations derived from EU law.

The UK government's proposal that pre-Brexit decisions of the Court of Justice must generally be applied by the English courts after Brexit in relation

to "retained EU law" implicitly recognises this and is eminently sensible and in the interests of clarity, certainty and legal continuity. Absent such a provision, businesses could not be sure whether their current understanding of EU law, informed by Court of Justice case law, would still stand in relation to retained EU law and the common understanding developed through many years of clarificatory decision-making by the Court would be lost. Over time there may be divergence, but this is likely to be gradual and well sign posted. From a jurisdictional perspective, it would clearly make no sense for references to the Court of Justice to continue indefinitely in areas where reciprocity between the EU-27 and the UK falls away.

But the UK courts make relatively few references up to the Court of Justice and the Court has a reasonable track record in the quality of its decision making (albeit subject to certain notable exceptions). This means that businesses can be relatively relaxed about where the two sides come out on pending cases. What is more important is that the position is clear and certain, so that there is no room to dispute whether a particular case falls within or outside the scope of any power to refer to the Court of Justice.

In areas where there may be agreement to continue a reciprocal relationship, whether under a transitional deal, free trade agreement or otherwise, it is unlikely to be politically palatable from a UK perspective to agree that the Court of Justice should have a continued role in hearing references from the English courts. Presumably, however, this will be the preferred position of the EU-27 and, from a business perspective, it would not be hugely problematic provided the UK retained its procedural rights, eg to appoint judges to the Court, for such matters. At the least, it should be possible for the UK to agree that its courts will have to have regard to the decisions of the Court of Justice (and vice versa) in areas where a continuing reciprocal relationship is agreed. This may serve to mitigate the risk of divergent outcomes and so help to maintain the equivalence which is likely to form the basis of negotiating any continuing reciprocal relationship, but it is unclear whether it would be seen to be enough from an EU-27 perspective. The EU-27 is certainly likely to see any transitional arrangement as being part of EU law and therefore subject to the Court's jurisdiction on questions of interpretation.

A separate question arises of course as to how any disputes involving the UK, individual EU-27 states and/or the EU itself will be dealt with after Brexit, whether those disputes arise under a withdrawal agreement, transitional arrangement, free trade agreement or otherwise. We do not consider this issue here but it is, of course, likely to raise many similar questions about the role and jurisdiction of the Court of Justice. Politically, the negotiations in this area are likely to be difficult on both sides of the table.

What about the role of the English courts?

In our 2016 Annual Review we said that we did not think the prospect of Brexit would make a significant difference to the popularity of the English courts as a forum for resolving international commercial disputes. This is because it should still be possible in most cases to enforce English judgments under national law (or, where relevant, the Hague Convention on Choice of Court Agreements) if the current reciprocal regime for enforcing English judgments in the EU falls away, although it will be more time-consuming and costly to do so (and as discussed below could be improved in the negotiations). We also said that a choice of English law would remain popular, because English law in this context will be largely unaffected by Brexit and will continue to be predictable and commercial and because EU courts will still give effect to a choice of English law.

Our view on both of these points remains unchanged. We have also not seen any significant market move away from English law and the English courts in commercial contracts in practice. There have been some developments in this area, however, including the publication in June 2017 of the EU Commission's position paper on ongoing judicial co-operation in civil and commercial matters. Among other things, the paper proposes that jurisdiction clauses agreed prior to exit day should continue to be assessed by reference to EU law after Brexit. This proposal on jurisdiction clauses is a helpful one from a business

perspective, although the EU's position on enforcement of judgments rendered pursuant to such clauses remains unclear. Also in our view it would be still more helpful to businesses and citizens both in the EU-27 and the UK if a continuation of the existing reciprocal regime could be agreed (as proposed by the UK's position paper, published on 22 August). Wherever the parties end up on these points, however, one thing that will be important is that there is clarity on the detail of how any new regime would operate in practice.

We have also seen continuing competition from courts around the EU for international commercial disputes work. Initiatives are under way in France and Germany to make it easier for parties to refer disputes governed by English law to their courts and a new Netherlands Commercial Court is due to open its doors on 1 January 2018. This new court will be able to hear international commercial disputes governed by any law and will hear proceedings and give judgments in English. The English courts have similarly introduced a range of initiatives to retain their competitive edge, while arbitration continues to grow in popularity as an alternative to court litigation among parties to international deals (and it is our view that there is no reason why Brexit should have any impact on the popularity of London as a centre for international arbitration). It will be some time before it is possible to work out whether any of the new court initiatives will be a success, but increased competitiveness and choice can only be a good thing for commercial parties.

Where does this leave us?

Stepping back from the detail, our view at Allen & Overy is that maintaining legal continuity and cross-border judicial co-operation after Brexit is a vital part of the framework for facilitating ongoing global trade. If the UK and the EU can reach agreement on continued reciprocity in this area, it will be to the benefit of businesses and citizens in all 28 jurisdictions trading across the UK/EU border.



Philip Wood CBE QC (Hons)
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THE EU: THE BIGGEST LEGAL HARMONISATION FACTORY IN THE WORLD

There is no question that the European Union has over many decades been conducting the biggest legal harmonisation project that the world has ever seen.

So one of the big issues is the future of this project in the light of Brexit. The issue is not unimportant because certain countries in Western Europe have also been the most prolific law-givers the world has even seen, even more prolific than the Romans, and the UK is one of those. Brexit is a prodigiously chunky break-up – the biggest single de-merger in sovereign history. At its heart are the laws. I make the point because in my view the law is the most important ideology underpinning our societies. Societies may decide that 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 everyone believes in and is fundamental to our survival and prosperity.

By law I mean the whole of law, not just the basic ten bullet points delivered on the mountain with the burning bush. I mean not only law about sex or murder but law about money, banks and corporations, about capital markets, about governing law and jurisdiction, about bankruptcy, about collateral, about tax and about settlement and payment systems. They are among the many classes of wholesale law we specialise in. Without these things, there would be nothing on the plate for breakfast.

All these domains of law are drenched with moral choices. Laws can be good or bad. You measure the morality of a society, its credentials and its civilization, by its laws. Should the law restrict us, or restrict us so as to liberate us? All of these fields of law, and a huge number of other subjects as well, have been the subject of EU harmonisation programmes, programmes so vast as to be almost impossible for one person to grasp. Altogether, one can count between 40 and 50 major areas of harmonisation among the 28 existing member states. Thousands upon thousands of pages. Some say far too much.

The laws of about 280 of the 320 jurisdictions in the world are for historical reasons based on a European system of law, mainly English common law (including the US) championed by England (about 40% of jurisdictions), Napoleonic law championed by France (30%, sometimes via Belgium, Portugal or Spain) and Roman-Germanic law championed mainly by Germany and the Netherlands (20%). Probably the most potent original influence at the beginning was Roman law. The rest (including transition and Islamic law) take up the remaining 10%.

Now the UK has to make choices about its laws. English law as a governing law of major contracts is effectively an international public utility. Should the UK on Brexit take over all 40 to 50 harmonised areas of law by packing them in its suitcases as the ship pulls out of the continental harbour? It might do this in order to preserve trade and City access to the European continent or because advanced economies consider they need these gigantic libraries of law anyway or the UK thinks that continuity is essential. Or the UK may decide that the harmonisation is going in the wrong direction and that what is needed is more competition. In each case there is the question as to what happens to the core project of the European ocean of law, the ocean which has so far been fed by the potent pulses of the three great rivers of legal ideology. Will they continue to merge, or will the diversion of one giant tributary to some other sea alter the waters of that giant tributary as well as the other two and the ocean itself? Since these three flowed out to the rest of the world, what happens in Europe matters to the rest of the world too. For law is the ultimate fount.

Will the region of Europe, whatever may be its future political shape, build the legal future as precociously as it built the past and the present?



Brexit Law

[allenoverly.com/Brexit-Law](https://www.allenoverly.com/Brexit-Law)

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The implications of the UK vote to leave the EU are changing on a daily basis; the content of this publication was prepared on the basis of the legal, political and economic situation in mid-August 2017.

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