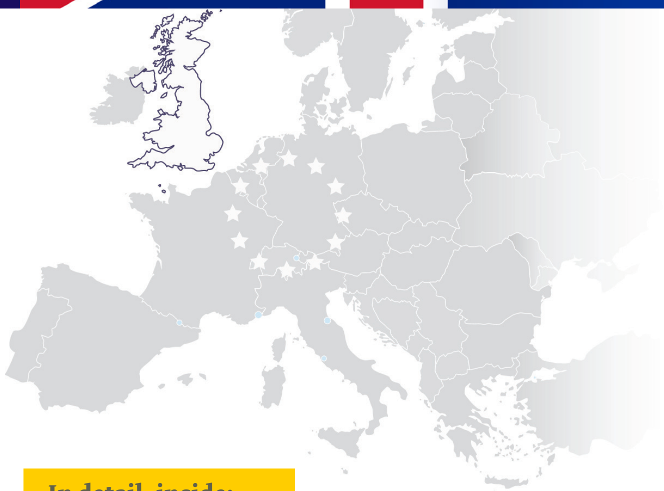
McCann FitzGerald

Brexit

A LEGAL PERSPECTIVE



In detail, inside:

12 February 2016

Referendum

> “The UK’s relationship with the EU is a relationship of the head not of the heart.”
>
> - Martin Wolf, Financial Times

The referendum on the United Kingdom’s continued membership of the European Union must take place before the end of December 2017 but is likely to be held much earlier and, perhaps, as early as June 2016. The right to vote in the referendum will apply to UK residents who are British, Irish and Commonwealth citizens over 18. In addition, UK citizens living in Ireland, and Irish citizens who have lived in the UK during the past 15 years and registered to vote, can cast a ballot in the referendum.

The question on the ballot paper will be: “*Should the United Kingdom remain a member of the European Union or leave the European Union?*”. The responses will be “remain a member of the European Union” or “leave the European Union”. The outcome of the referendum will have a major impact on domestic politics throughout the UK and will influence profoundly the UK’s role in Europe and rest of the world.

> “...if agreement can be reached, David Cameron will campaign with all his ‘*heart and soul*’ to keep the UK inside a reformed EU.”

David Cameron, the British prime minister, has sought proposals for reform in four areas: economic governance; competitiveness; sovereignty, and immigration. And if agreement on these four areas can be reached, he has said that he will campaign “with all my heart and soul” to keep the UK inside a reformed European Union.

Will the United Kingdom remain or leave?

> “To be, or not to be, together, that is the question.”
>
> - Donald Tusk, President of European Council

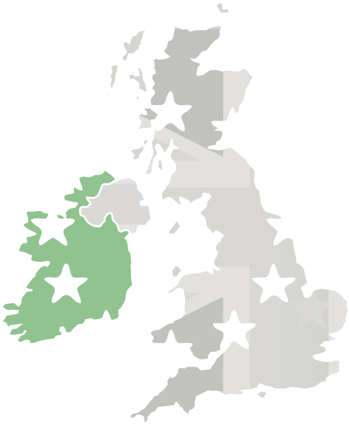
The outcome of Mr Cameron’s negotiations cannot be predicted. Donald Tusk, President of the European Council, has put forward a proposal for a “new settlement of the UK within the EU” which he believes goes “really far” in addressing all the concerns raised. Mr Cameron appears to have endorsed this proposal although its final terms are subject to further negotiation and approval by the European Council. “To be, or not to be, together, that is the question which must be answered not only by the British people in a referendum, but also by the other 27 members of the EU” – says Mr Tusk.

Whatever the outcome of the negotiations, it is also not possible to predict the outcome of the referendum. Most significantly, alternative legal or political treaties and arrangements will not be put to the voting public in the referendum itself nor even known at the time of the referendum. Thus, a vote to leave would immediately lead to political, economic, legal and regulatory uncertainty.

If a decision is taken to leave the European Union, the procedure for voluntary withdrawal will be as set out in article 50 of the Treaty on European Union. The timing of notification to the European Council of the intention to withdraw would be a matter for the UK government.

See also *What legal form(s) will the UK–EU political and trade relationship(s) take if Brexit occurs?* (page 5).

How would Irish business be impacted by a Brexit?



As a small open economy, many of the most important risks for the Irish economy and Irish businesses lie in the economies beyond our shores. However, the possibility of a Brexit is probably today the most significant risk for the Irish economy and Irish business.

A "changed relationship" between the UK and the EU could potentially have far-reaching consequences for Ireland and especially in areas such as trade, foreign direct investment, energy and migration. In addition, the impact on Ireland's labour market could be significant.

It is reported that Ireland's Financial Regulator, Cyril Roux, has requested Ireland's principal banks to report to him how they intend to handle the risks and challenges of Brexit. Specifically, the banks will "look at the impact on their businesses under a number of fronts" including "on their business model, governance, funding and liquidity, capital adequacy and legal arrangements".

Since it is recognised that Brexit could have a "very large impact" on banks, such a request is highly appropriate and prudent. However, there would be merit in Irish companies and businesses which trade and engage with the UK, depend upon UK-based entities and/or which do business under English law reviewing their own business model and arrangements to identify weaknesses or possible concerns that could arise if there is a vote in the UK to leave the EU.

Ireland-UK: Very Strong Connections

Ireland has very strong trade, investment and financial connections with the UK. Key points include:

- €1.1 billion of trade between Ireland and the UK each week
- that trade directly employs 400,000 jobs, split evenly, with many more in the supply chain
- 15% of all Irish goods, and 20% of all Irish services, exported go to the UK
- 32% of all goods, and 11% of all services, imported to Ireland come from the UK
- the UK's 5th largest market is Ireland - with 5% of the UK's total goods and 6% of total services exported to Ireland
- UK is Ireland's biggest customer for food exports, and Ireland is the UK's biggest customer for its food exports

Questions for Irish corporates include:

- how reliant is our business on UK or UK-based counterparties who, in turn, are reliant on EU business, support, grant aid, counterparties?
- would a change in the UK regulatory environment affect, interrupt and/or expose our business?
- would our funding or funding sources need to be revised?
- could our cost of funding be impacted?
- what is our position in relation to sterling? And would we need to change our currency exposure(s)?
- would any material contracts require reworking or revision? Are there any potential serious 'hits' or exposures for the company in existing contracts?
- do we need to review investment decisions taken or consider future investment decisions differently?
- what, if any, employment, visa, etc. impact(s) could there be for us?
- what sector specific issues are there for us?

See also *Legal Consequences?* (page 6)

How would UK business be impacted by a Brexit?

It depends on what the new relationship would be agreed between the UK and the EU – see further *What legal form(s) will the UK-EU political and trade relationship(s) take if Brexit occurs?* (page 5). However, uncertainty as to the form that new relationship will take and how long it will take to settle that form would undoubtedly impact UK businesses adversely including their investment decisions. The impact on the value of sterling and equities denominated in sterling could also hit some companies very hard. Some commentators believe that it could take up to ten years before the position could be truly settled.

> "Political, economic and regulatory uncertainty would be damaging to UK business."

However, immediately following a vote to leave the EU, all of the UK's national laws which implemented EU directives would have to be reviewed, modified and/or replaced – that is over 40 years' worth of EU law and regulation. Clearly, it would be expected that much of that law would be retained, and quickly. However, uncertainty in any areas could be damaging to UK business. Legal uncertainty could also be damaging e.g. in the areas of restructuring and insolvency, employment, health and safety, consumer protection, etc.

Four Freedoms

Free movement of goods, capital, labour, services and establishment underpin membership of the European Union and the single market. UK businesses that rely on these freedoms could be impacted adversely, and quickly. Many UK businesses do not realise just how much they rely directly and indirectly on the four freedoms.

> "Many UK businesses do not realise just how much they rely directly and indirectly on the four freedoms."

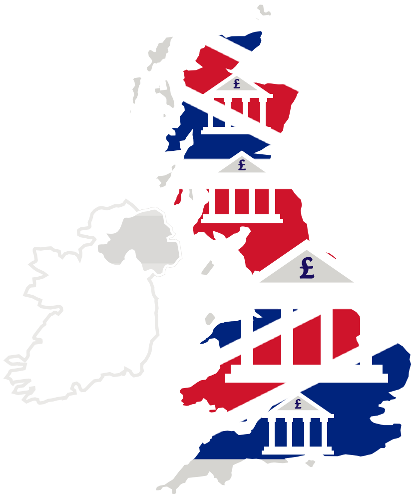
For non-EU trade, Brexit would mean that the UK would loose the rights and benefits under the various existing EU trade agreements with a number of countries *eg* Mexico, South Korea and South Africa. Benefits under future prospective agreements such as TTIP and with Canada would also not flow to UK business.

From a mergers and acquisition, state aid and competition perspective, the UK's exit from the EU could give rise to additional regulators and regimes to be considered in relevant transactions.

Exports

Top 10 export countries for the UK in December 2015 were – 5 of which were EU countries:

HM Revenue & Customs
9 February 2016



How would banks and financial institutions based in the UK be impacted?

Brexit would lead to new regulatory regime(s) for UK based banks and financial institutions.

EU 'passporting' would end – a key element to the success of the City of London and the UK in the last 30 years. UK authorised banks, insurers, investment advisors, financial intermediaries, *etc.* would all be impacted.

Brexit could lead to challenges to London's and the UK's competitive advantage(s):

- Banks and financial institutions may have to consider moving some business activities from London to the EU – it may thought difficult to achieve leadership in certain European markets from outside the EU
- Euro-denominated markets (e.g. wholesale banking) may, or may be forced to, move to the EU
- Enforcement of single market rules may (arguably, could) not be provided by British courts
- Separate or dual capital requirements would be costly
- Future liberalising initiatives such as the Capital Markets Union may happen in the EU and not benefit UK based banks and financial institutions.

The disruption and cost of changing operations and locations could be very high to banks and financial institutions that now have their principal or major operations based in London. The large funds and asset management operations based in Edinburgh could also come under challenge.

Brexit risk factors?

> "Some capital markets transactions already include Brexit risk factors."

In some capital markets transactions there are already risk factors regarding the occurrence of Brexit being included in the selling documentation. The following is typical:

"*A referendum on UK membership of the European Union (expected before the end of 2017) may affect the issuer's risk profile through introducing potentially significant new uncertainties and instability in financial markets ahead of the date of the referendum and, depending on the outcome, after the event. These uncertainties could have a material adverse effect on the issuer's business, financial condition, results of operations and prospects. In addition, it is unclear at this stage what the consequences would be for the issuer, the manager, the sponsor or any other transaction party should the UK leave the European Union.*"

What legal form(s) will the UK – EU political and trade relationship(s) take if Brexit occurs?

The UK would have to develop new trade arrangements with the EU (and the rest of the world). It is questionable as to how 'match-fit' the UK is to enter wholesale trade negotiations since it last entered trade negotiations in 1973.

It is not possible to predict which model(s) would govern the UK's future relationships with the EU following a Brexit. Under article 50 of the EU Treaty, the leaving state (the UK) and the EU have two years to negotiate a "withdrawal agreement" containing the details of the separation (interim/transitional and future arrangements/relationships) and the timetable. The European Parliament would probably have the final sign-off which might restrict the terms of any agreement. Somewhat concerning is the fact that if no agreement is made within the two year period both parties 'walk away' - with the result that the UK would no longer be bound by, and the remaining EU countries would have no obligations to the UK under, the various EU treaties. The two year period could however be extended if the European Council and UK were to "unanimously decide" to extend this period.

Questions

- How 'match-fit' is the UK to enter wholesale trade negotiations?
- How would the UK preserve its existing trade with the EU?
- None of the exiting models would seem to fit or be appropriate for a country that is the EU's second largest economy and the fifth largest economy in the world?

None of the exiting models for international relationships with the EU would seem to fit or be appropriate for a country that is the EU's second largest economy and the fifth largest economy in the world. Those current models are:

Switzerland: EFTA membership plus a series of bi-lateral treaties/agreements relating to different trade and other sectors. At present, it is estimated that Switzerland has entered into almost 130 bi-lateral agreements

Norway: EFTA (European Free Trade Association) and EEA (European Economic Area) membership but outside the EU customs union. Although the UK would be bound by future EU law and the single market rules in certain areas, it would have significantly reduced power in relation to the making of such law or rules

WTO: the 'purest' form of Brexit which would not involve separately negotiated agreements with either individual EU member states or the EU itself. However, the WTO rules have a number of shortcomings in terms of trading arrangements and exports to Ireland and the rest of the EU may be subject to restrictions and/or tariffs. Market access could also be significantly restricted

Customs Union *eg* **Turkey:** this model would involve the UK being a member of the customs union of the EU with little influence or power to shape the rules or policy of the union. The result could be reduced access for British traders and business to the EU market place

Single free trade agreements (FTAs) *eg* **South Korea:** a bold option which could take several years to settle

Singapore: again, a model which took many years to put in place and which ignores the size and complexity of the British economy and the variety of British business and trade.

Legal consequences?

Without any sense of what new legal, constitutional, regulatory, tax and economic regime(s) and relationships might be created in place of today's laws, regulations and arrangements, it is not possible to anticipate all of the consequences of Brexit. However, for transactions involving English law and UK based parties we would anticipate legal and regulatory considerations to arise and possible changes in the following areas:

> "Most businesses have not yet focused on the legal or regulatory consequences - this needs to change."

Banking and Lending: loan and credit documentation, security and guarantees, would need to be reviewed. Standard wording reviewed and amended

Financial Services, Asset Management, Funds: possible significant changes to both the structure of transactions (as a result of the loss of passport rights) and documentation reflecting revised and/or new legal and regulatory framework(s). Issues of recognition of equivalence of regulatory standards for clearing, etc. could arise. In derivative transactions, the non-application of the EU directive on financial collateral arrangements would raise many issues

Mergers & Acquisitions: although underlying company law may not change very much, the competition law regime will change and this could be important in a number of deals. There may also be a risk of some dual regulation being applicable

Companies and Corporate Transactions: underlying law may change a little but areas such as employment, pensions, health and safety and data protection would all require consideration

Restructuring and Insolvency: a potentially difficult area. The automatic direct effect of the Insolvency Regulation in the UK would end and while it is likely that it would be replaced with a similar legislative regime that would require change to both UK law and EU law. One particular area that would be concerning is the Bank Recovery and Resolution Directive (BRRD) under which all member states have to apply a single rulebook for the resolution of banks and large investment firms. The directive was designed to harmonise and improve the tools for dealing with bank crises across the EU following the financial crisis – which, because of the number and size of the banks and financial institutions based in the UK, and their operations across the EU, will remain an area requiring legal and regulatory co-ordination and certainty

Employment: would non-UK nationals employed in the UK, and UK nationals employed in the EU, have continuing rights to work and live in the 'other' jurisdiction following a Brexit?

Commercial Dispute Resolution: because the UK would no longer be a part of the EU some parties may review governing law, jurisdiction and arbitration provisions when entering into new contracts with cross border elements

Environmental and Energy: a Brexit would mean the EU energy and environmental directives and regulations would no longer be applicable to the UK or UK businesses. The impact on existing and future contracts could be considerable – especially in time.

Longer term implications?

The long term implications of a Brexit for the UK and the continuing member states of the EU (including Ireland) legally, economically and politically cannot be predicted. However, some commentators predict very adverse consequences: "If it goes wrong, the British economy would vanish for the next 10 years..." – Willem H. Buiter, Citi.

> "If it goes wrong the British economy would vanish for the next 10 years. Because it would create uncertainty about the EU unravelling, it's big enough to matter for the global economy."
>
> Willem H. Buiter,
> Global Chief Economist
> Citi

Mark Carney, Governor of the Bank of England, said in a speech in October 2015 that for the majority of the period since the UK joined the EU the greater openness and deeper integration afforded by EU membership had very likely increased the UK's dynamism - *ie* the ability of the UK economy to grow and progress. He added that "*in some respects the UK is the leading beneficiary of the famous four freedoms in the Treaty of Rome*". In addition, broadly speaking, the evidence suggests that the UK has "*successfully harnessed the benefits of openness afforded by its EU membership while avoiding some of the drawbacks of reduced flexibility from which some continental European economies suffer*".

The question is, if Brexit occurs and the UK enters into new legal and economic treaties and arrangements with the EU and the rest of the world, whether similar statements could still be made about the UK in the longer term?

It is very likely that regulatory divergence in many trade and business sectors would increase over time. The impact on some sectors could be marked affecting investment and trading in significant ways.

McCann FitzGerald Brexit Group

We have established a cross-sector team that advises and represents Irish and international business clients on the legal, regulatory and tax implications of a possible Brexit. The team comprises partners in a number of key areas including: financial services regulation, asset management, corporate, employment, IP and data protection, health and safety, competition, telecoms, pensions and tax. The group is headed by John Cronin.

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