12. BREXIT – ECONOMIC AND LEGAL IMPLICATIONS

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RESUMEN EJECUTIVO

Aquellos actualmente partidarios de Brexit no han presentado aún un guión elaborado sobre cómo se podrían estructurar las relaciones entre Reino Unido y la Unión Europea en un escenario post-Brexit y, lo que es más importante, qué parte de la legislación británica impulsada por la Unión Europea podría ser derogada. En consecuencia, las desventajas de Brexit son identificables y cuantificables, mientras que los beneficios son actualmente desconocidos.

Este capítulo examina, por tanto, los posibles escenarios de un post-Brexit:

- El Espacio Económico Europeo («EEE») y el Área Europea de Libre Comercio («AELC») miembros en el modelo noruego;
- Acuerdos bilaterales e integrantes de la AELC en el modelo suizo;
- Unión Aduanera en el modelo turco;
- Tratado de Libre Comercio entre Reino Unido y la Unión Europea;
- Miembros de la Organización Mundial del Comercio (OMC)

Existen además otras áreas en el Reino Unido tanto en el ámbito jurídico como en el de los negocios que pueden verse afectadas por Brexit. En este contexto, aspectos fiscales, laborales, mercantiles y relativos al derecho de la competencia son objeto de análisis también en este capítulo.

En principio es sencillo trazar los pros y contras de los diferentes escenarios que se plantean en este artículo. Sin embargo, en la práctica resulta mucho más difícil dadas las incertidumbres e interdependencias existentes entre ellos.

Una característica común importante de cualquier escenario en el que Reino Unido siga siendo miembro de la UE es hasta qué punto puede mantener cierto grado de con-

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trol en la toma de decisiones y la libertad de cambiar las políticas o tácticas en beneficio de su propio interés.

El denominador común en los cinco escenarios en los que Reino Unido podría salir de la Unión Europea es el patrón de riesgo, la incertidumbre comercial a largo plazo y la falta de control. Dejar la UE llevaría tiempo y el proceso de ninguna manera es certero. Tras su salida, Reino Unido estaría en un *impass* de espera hasta conocer el resultado de cualquier cambio regulatorio en los tratados de la Unión Europea, los cuales tendrían un gran impacto en términos de intercambio comercial entre Reino Unido y la UE.

Durante las prósimas décadas, la realidad de la relación de Reino Unido con la Unión Europea durante las próximas décadas bien podría dar por válidos algunos de los elementos analizados en alguno de los ocho escenarios examinados aquí, siendo además factible que cualquier escenario futuro tenga consecuencias diferentes y desconocidas hasta ahora.

Al mismo tiempo, y después de salir de la UE, el gobierno de Reino Unido deberá tomar decisiones para la adaptación del marco regulatorio británico a un escenario «post-Brexit». Ello entrañaría la necesidad de abordar un programa que bien podría durar toda una vida del Parlamento. Reino Unido tendría que embarcarse en una o varias de las opciones posteriores a la salida que puede barajar, ya sea intentando negociar con antelación, con posterioridad, o incluso mediante un proceso de prueba y error en las distintas negociaciones con Estados miembros también afectados por su salida con el objetivo de encontrar soluciones alternativas. Todos esos pasos implican una gran dificultad política, técnica y diplomática, que podría prolongarse durante años, en los cuales el régimen comercial global de Reino Unido se arriesgará a estar sujeto a la incertidumbre y la duda.

En el ámbito de los servicios financiero, ¿representa Brexit realmente una opción mejor que seguir siendo miembro de la UE? Después de todo, la creación de un marco integrado de la UE para los servicios financieros ha tenido un efecto notable y muy positivo para todos aquellos servicios financieros basados en Reino Unido de alcance europeo o global, con un efecto igualmente positivo para sus clientes. Resulta ahora sencillo dar por hechas las bondades de este marco jurídico común y el conjunto de libertades legales que representa, desarrollado a lo largo de más de 40 años. Sin embargo, sin ese marco común, las transacciones comerciales de las empresas de servicios financieros de Reino Unido bien podrían no tener lugar o incluso producirse en un epicentro distinto fuera de la UE. Sin ese marco, las compañías de otros Estados miembros de la UE no tendrían tanto interés en establecerse en el Reino Unido, y las autoridades de su país de origen (que entonces verían a Reino Unido como jurisdicción *offshore* extraterritorial) podrían no permitirlo sin garantías regulatorias adicionales. Hoy en día, la City funciona como un mercado natural de firmas de la UE y del exterior. Esto es posible gracias al marco legislativo del Mercado Interno que ofrece. El Reino Unido, avalado por su importante experiencia en servicios financieros, está en condiciones de mantener su importante influencia en este marco regulatorio, sólo en el caso de que realmente demuestre estar comprometido con ello. Abandonar esta posición por la expectativa de alguna otra alternativa no testada, desconocida o impredecible conllevaría riesgos significativos.

De los escenarios analizados en este capítulo queda claro que, desde un punto de vista jurídico, los intereses de Reino Unido como centro financiero de referencia, quedarán garantizados de una manera más efectiva si continúa siendo miembro de la UE y avanza en las reformas necesarias.

1. INTRODUCTION

The EU was created to ensure peace and prosperity in Europe, after the devastating conflicts of the first half of the 20th century. The EU has grown over time from six in 1958 to 28 today, with others hoping to join. For many states, becoming a member was a crucial milestone on the path to democracy. It now consists of a market of over 500 million people and in 2011 accounted for approximately £11 trillion in GDP. This makes the EU the largest borderless market in the world, bigger than the USA and bigger than China. In an increasingly interconnected world, it should be borne in mind how important it is to be part of the world's largest trading bloc.

The UK has been a member of the EU since 1973, and has ever since played a key role in the development of the Internal Market. It was a British member of the European Commission, Lord Cockfield, who masterminded the achievement of the EU Internal Market in the late 1980s. The UK has been the strongest promoter of integration in the goods, services and capital markets. In particular, the UK financial services sector has played a central role in shaping EU-wide norms concerning financial services regulation. For example, large parts of the Markets in Financial Instruments Directive (MiFID) are modelled on the corresponding UK legislation.

All EU members, including the UK, face the question of whether the benefits that come with membership are worth giving up individual rights of action in particular areas. Put another way, does EU membership provide benefits such that they are worth the risk of sometimes being outvoted in areas where previously one would have had the right to act independently? Also, would the UK outside the EU find that it becomes much more lightly regulated? The opposite is worth considering: that the UK may have to comply not just with existing EU regulations for its exporters to the EU but a UK-only layer of regulations in addition to that. With the possibility of a referendum on UK membership of the EU in the coming years, it is important to understand the nature of the UK's current status, and the alternatives. The EU is founded on treaties and therefore legally based – hence the importance of legal analysis.

An important preliminary point is that any analysis of this kind is, at this point in the debate, necessarily asymmetric. Those in favour of Brexit have not advanced a fully worked-out agenda as to how a post-Brexit UK might structure its relations with the EU and, more importantly, which parts of EU-driven existing UK law might be repealed. Consequently the disadvantages of Brexit are identifiable and quantifiable, whereas the benefits are currently unknowable. This analysis is therefore necessarily incomplete, and could only be rationally completed once a clear hypothetical for the state of the UK post-Brexit has been formulated. We do not believe that it is possible to formulate such a hypothetical at this point in the debate. This chapter therefore examines the following possible post-Brexit scenarios:

The European Economic Area («EEA») and European Free Trade Area («EFTA») membership on the Norwegian model;

- Bilateral Agreements and EFTA membership on the Swiss model;
- A Customs Union on the Turkish model;
- A UK – EU Free Trade Agreement;
- Membership of the World Trade Organisation (WTO).

The examination of these scenarios consists of analysis of their advantages and disadvantages. Further details, including a breakdown of the rights and obligations under each scenario are examined in the Clifford Chance publication, *Britain and the EU, alternatives to membership, prospects for renegotiation* published in August 2015.[1]

There are other legal areas of UK law and business may be affected by Brexit. Tax, employment, trade and competition law are also briefly examined in this chapter.

1.2. SUMMARY OF CONCLUSIONS

The UK's current membership of the EU is already highly tailored. While the phrases «Swiss option» and «Norwegian option» are commonly used in the debate about Britain and Europe, one could just as well add «UK option» on the grounds that it is unique to Britain. The UK has full access to the Internal Market, can vote and has the right to be represented in the EU's institutions, but has secured opt-outs from policy areas such as the Single Currency, the Schengen free movement area and various Justice and Home Affairs measures.

None of the alternatives to full EU membership would afford the UK the same level of market access, rights or legal protections that it is currently entitled to. The other common feature of the «out» scenarios is that each comes with a high risk of uncertainty for financial services and other areas of the UK economy as the period required to arrive at a new settlement with the EU would be complicated and extremely time consuming.

2. THE EUROPEAN ECONOMIC AREA («EEA») AND EUROPEAN FREE TRADE AREA («EFTA») MEMBERSHIP ON THE NORWEGIAN MODEL

The UK would leave the EU and could emulate Norway in becoming a member of the EEA and EFTA.

[1] This publication can be found online here: https://onlineservices.cliffordchance.com/online/freeDownload.action?key=OBWIbFgNhLNomwBl%2B33QzdFhRQAhp8D%2BxrIGReI2crGqLnALtlyZe8G3U%2BC4R%2Bvn1qSh7uO5pv7p%0D%0A5mt12P8Wnx03DzsaBGwsIB3EVF8XihbSpJa3xHNE7tFeHpEbaeIf&attachmentsize=1661829

The EU Internal Market constitutes a very significant body of laws, which has a huge impact on the UK. By joining EFTA and the EEA, the UK would maintain access to the EU's Internal Market, but would lose all formal legal influence over legislation while still having to implement the bulk of it. The UK would have to continue to implement all rules that related to the Internal Market including rules related to employment, consumer and investor protection, environmental policy and competition law rules. The UK would lose all its voting rights in the Council of the EU (including, obviously, the right of veto over legislation requiring unanimity), it would lose its directly elected members of the European Parliament, its nominee to the European Commission and it would not participate in meetings of the European Council. Another limiting aspect of EEA membership is that EEA/EFTA members work on the basis of unanimity. This means that Iceland, Lichtenstein and Norway all have to be ready to implement a piece of EU legislation before it can be effective in any of those states.[2] Given that Iceland and Lichtenstein has less capacity to keep up with the large volume of EU legislation, this can lead to delayed implementation, giving EU members states a head start.

In principle, financial services are covered by the EEA Agreement, but developments since the global economic crisis of 2007 have meant that, in practice, the Internal Market for financial services between the EU and the EEA/EFTA members is fracturing. This is mainly due to the advent of the European Supervisory Authorities (ESAs). The ESAs were put in place in 2010 to help oversee the financial services market and set universal standards on supervision. However, the ESAs also play a supervisory role themselves in relation to financial services. The EEA Agreement does not cater for this and, as a result, all measures taken in the field of financial services since 2010 which provide for any role played by the ESAs (which is nearly all of them) have not extended to the EEA/EFTA states. This has remained the case even after four years of negotiation to reconcile this problem.

Accordingly, if the UK were to go down the EEA/ EFTA path, like Norway, there would be a risk that it might, over a period of time, lose access to the EU's Internal Market in financial services as EU legislation develops (in particular the revision of MiFID – which acts as the backbone for much of the Internal Market in financial services – will entail a role for the European Securities and Markets Authority). Even if this issue were to be resolved, the UK's exclusion from crafting EU financial services legislation would mean that the EU could make new regulations which the UK would then have to adhere to if it wished to maintain full access to the EU financial services market. The UK would no longer be bound by EU measures in areas such as agriculture and fisheries, and would gain the freedom to establish its own VAT regime. See also paragraphs 37-44 below on tax issues.

If the UK were to leave the EU for the EEA/EFTA, there is a material risk that it would have to implement EU rules that ignored or even damaged UK interests where otherwise the UK would have had a vote or possibly veto.

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[2] See Article 93(2), Agreement on the European Economic Area.

3. BILATERAL AGREEMENTS AND EFTA MEMBERSHIP ON THE SWISS MODEL

The UK would leave the EU and could emulate Switzerland in agreeing sector-by-sector treaties with the EU, and free trade agreements with the EFTA countries.

Unlike Iceland, Liechtenstein and Norway, Switzerland has decided not to automatically implement EU Internal Market legislation. It has decided to conclude agreements on a case-by-case basis. The enforcement of the agreements within Switzerland is also solely in Swiss hands as there is no agreed enforcement mechanism. This piecemeal approach to these arrangements causes tension. In 2010, the Council of the EU stated:

> «Since Switzerland is not a member of the European Economic Area, it has chosen to take a sector-based approach to its agreements in view of a possible long-term rapprochement with the EU. In full respect of the Swiss sovereignty and choices, the Council has come to the conclusion that while the present system of bilateral agreements has worked well in the past, the challenge of the coming years will be to go beyond this complex system, which is creating legal uncertainty and has become unwieldy to manage and has clearly reached its limits. In order to create a sound basis for future relations, mutually acceptable solutions to a number of horizontal issues ... will need to be found.»[3]

This is therefore not an «off-the-peg» solution, but one that is very specific to Switzerland. It has developed by accretion, as extra layers of treaties have been added over a period of over 40 years. The EU does not consider the Swiss arrangement to be viable on a continuing basis. In 2010, the Council of the EU stated:

> «...the approach taken by Switzerland to participate in EU policies and programmes through sectoral agreements in more and more areas in the absence of any horizontal institutional framework, has reached its limits and needs to be reconsidered. Any further development of the complex system of agreements would put at risk the homogeneity of the Internal Market and increase legal insecurity as well as make it more difficult to manage such an extensive and heterogeneous system of agreements. In the light of the high level of integration of Switzerland with the EU, any further extension of this system would in addition bear the risk of undermining the EU's relations with the EEA/ EFTA partners.»[4]

One of the main reasons for the fact that the EU does not consider the Swiss model to be viable going forward is the lack of a proper shared dispute resolution mechanism. There is also no institution to give a single interpretation of sectoral agreements. This creates considerable legal uncertainty.

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[3] Council of the European Union, Conclusions on EU relations with EFTA countries, 3060th General Affairs Council meeting, Brussels, 14 December 2012, paragraph 6.

[4] Council of the European Union, Conclusions on EU relations with EFTA countries, 3213th Transport, Telecommunications and Energy Council meeting, Brussels, 20 December 2012, paragraph 31.

The EU has been working with Switzerland to bring together the current disparate agreements into a single instrument. However, Switzerland decided in a referendum in February 2014 to reject certain free movement aspects of the bilateral relations with the EU. This has raised the prospect of the entire series of agreements being repudiated. The EU has not been willing to separate the four freedoms – the free movement of people, goods, services and capital; there is no indication that this is likely to change.

It is therefore unlikely that the EU would be willing for a country much larger than Switzerland to enter into what it already considers to be a flawed arrangement.

The EU-Switzerland arrangements do not provide for bilateral agreements to be automatically – or dynamically – updated with EU legislation. This gives the Swiss full autonomy, but it also means that if EU regulation in a particular area is revised with new provisions, then the Swiss must renegotiate those provisions. This could be to the detriment of businesses which may have to wait for the regulatory regimes to be re-synchronised, or incur costs by producing to separate standards or implementing separate procedures for products destined for the EU compared to the domestic market.

The UK would only be bound by EU social legislation only in so far as it chose to be under bilateral agreements. However, the EU could make access to its markets conditional on the UK agreeing to certain social and employment provisions to safeguard against «social dumping». The EU has not required this of Switzerland, but could prove more cautious before allowing full access to its market to the UK, which may introduce more liberal rules for its 30 million strong workforce than those currently applying across the EU.

The current set of bilateral agreements between the EU and Switzerland do not provide for Swiss access to the EU Internal Market in financial services (other than some access for branches and agencies of non-life insurance business). In particular, Swiss firms face licensing and other barriers in many Member States (that do not apply to EU incorporated and authorized firms that benefit from one of the EU passport regimes) if they wish to conduct cross-border business from Switzerland with clients or counterparties situated in those states. A number of Swiss banks operate their EMEA investment banking business through subsidiaries set up in the UK which can take advantage of the UK's EU membership and the EU passport rights available to UK incorporated and authorized firms. While there are some recent EU initiatives to provide some access to the EU market to firms from non-EU jurisdictions which have equivalent legal regimes and which provide reciprocal access to EU firms, these depend on the ability of the non-EU regime to pass an equivalence assessment by the European Commission (which may require the non-EU jurisdiction to conform all or part of its legislation to EU standards) and in event are limited in scope and may not be available longer term to the UK if it were outside the EU.

It should be noted that Switzerland contributes to the EU budget despite not being a member. Since 2008, Switzerland has been contributing CH 1.257 billion (£830 million) towards funds that aim to reduced social disparities in an enlarged EU.[5]

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[5] Swiss Federal Department of Foreign Affairs website, retrieved on 10 November 2015, online here: https://www.eda.admin.ch/eda/en/fdfa/foreign-policy/european-politics/contribution-enlarged-eu.html

4. A CUSTOMS UNION ON THE TURKISH MODEL

The UK would leave the EU and could emulate Turkey and enter into a Customs Union with the EU.

Essentially, this option is limited to trade in goods. It would allow continued tariff-free access to the EU for UK manufactured goods, but the UK would lose the right to participate in standards setting in relation to the regulation of that trade. The UK would also have to abide by EU state aid and competition rules. The UK would also need to abide by the EU's common commercial policy and common external tariff regime, for example the implementation of the Customs Union with Turkey[6] has required Turkey to apply: the common customs tariff, common EU rules for imports, the EU procedure for administering quantitative quotas, EU protective measures against dumped and subsidised imports, common rules for exports, common rules for export credits, and common rules on textile imports and exports. Such a situation would not cover external trade in services with third countries that the EU negotiates free trade arrangements with.

In the EU market, the UK would lose its current right to provide services, including financial services, on equal terms with EU members. Apart from its obvious disadvantages, this could have serious and unexpected consequences, given the extent to which trade in goods – whether within or outside the EU – is now intertwined with services in modern supply chains.[7]

If the UK wished to gain preferential access in relation to financial and professional services and public procurement it would have to conclude additional agreements with the EU. See also paragraphs 59-71 on trade below.

5. A UK-EU FREE TRADE AGREEMENT

The UK would be outside the EU but could seek to negotiate a comprehensive free trade agreement with the EU. The UK would be free to regulate its own financial services sector. A comprehensive agreement could provide better access to the EU Internal Market in financial services and it would be preferable to simply relying on WTO/General Agreement on Trade in Services (GATS) membership alone. See also paragraph 61 below.

6. MEMBERSHIP OF THE WORLD TRADE ORGANISATION

The UK would leave the EU and rely on its membership of the World Trade Organisation as a basis for trade with the EU. This is the purest form of the «out» sce-

[6] Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union.

[7] See Kommerskollegium, Swedish National Board of Trade, 'Servicification of Swedish manufacturing', March 2010.

nario, with no formal connections or independently negotiated agreements with the UK's former European partners. The UK would regain the ability to act independently and unilaterally without being directly subject to any EU law.

As regards financial services, it could not be taken for granted that the WTO and the GATS would offer an automatic means for the UK to enforce a right to its current trading advantages for financial services within the Internal Market. See also paragraph 61 below.

What is more, the WTO is only concerned to a limited degree with regulatory issues (to the extent that they affect market access and national treatment): WTO membership would not, by itself, provide a means of approaching regulatory disputes in the way that is offered in, for instance, a number of the EU's FTAs. The UK would be free, outside the EU, to negotiate its own FTAs which might contain similar provisions; but this would depend on substantial diplomatic effort with reduced negotiating weight due to the fact that the UK would be offering access to a reduced market compared to that of the EU.

7. TAX

Upon Brexit, on the assumption that such settlement would not result in substantially equivalent obligations, the UK Government would be free to implement tax legislation without the restrictions imposed by the TFEU fundamental freedoms and other EU legislation.

The UK Government would also be able to enact tax legislation, or exercise its power to tax, in a manner which would currently constitute state aid incompatible with Art 107 TFEU.

Any area of UK tax law (be it VAT law or otherwise) which is currently incompatible with EU law ought to become valid upon a full Brexit. For example, the VAT «insurance intermediary» exemption is currently wider than EU law permits and this is in the process of being narrowed by HMRC to render it EU law compatible – this would no longer be required.

The UK courts would no longer be bound to follow principles of VAT law interpretation established by the Court of Justice of the EU (CJEU) upon a full Brexit so the overarching cornerstones of VAT law (such as the principles of fiscal neutrality, equivalence and non-discrimination) would fall away, and this would have a profound effect on the way in which VAT law is to be interpreted.

Preferential EU rules applicable to certain cross-border transactions would not apply following a full Brexit, i.e. VAT may need to be charged on transactions where it is currently not charged and UK businesses may need to register for VAT in EU countries where they are currently not required to do so.

Although the UK Government would be free to implement tax legislation which discriminates against entities in other Member States, the remaining EU Member States would also be free to exercise their taxing powers in a manner which, by accident or design, discriminates between local entities on one hand and UK entities (or local branches of UK entities) on the other hand. This could manifest itself in a number of ways, for example a future EU Financial Transactions Tax could be implemented which taxes transactions relating to, or with persons in, the UK.

The newfound legislative freedom with which the UK Government would find itself would, of course, create potentially unwelcome uncertainty for UK companies. For examples, There may be uncertainty as to the extent to which existing and future CJEU case law and EU jurisprudence would influence the decisions of UK courts after Brexit (especially in relation to VAT). Accordingly the scope of UK tax law, and what precisely will and will not be subject to tax under existing legislation, may not be immediately clear post-Brexit, and these uncertainties will extend to cases currently being litigated on the basis of UK tax law being incompatible with EU law. UK companies may currently rely, under the tax laws of other Member States, on tax legislation which provides exemptions for entities established in other EU Member States, which they could lose the benefit of upon Brexit. For example, a UK bank which has advanced a loan to an Italian or Spanish borrower would, upon Brexit, find that interest payments under the loan become subject to withholding tax.

Upon Brexit, the UK would continue to benefit from and remain subject to its extensive network of double tax treaties, including (where relevant) their non-discrimination provisions. The UK would also continue to have influence in international efforts to drive tax policy, including the ongoing Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Sharing (BEPS) project.

8. EMPLOYMENT

A significant portion of UK employment law is derived from EU law including the legislation that governs maternity and paternity leave, agency workers' rights, paid holiday and the protection of employment upon the transfer of a business.

EEA/EFTA states are obliged to accept the majority of EU legislation without being able to participate in, or influence, the EU decision making process or having any right of veto.

The EEA Agreement incorporates a number of employment law directives including the Equal Treatment Directive, the Collective Redundancies Directive, the Part-Time Workers Directive, The Fixed Term Workers Directive, the Parental Leave Directive, the European Works Council Directive, the Acquired Rights Directive (from which the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) are derived), the Working Time Directive and the Agency Workers Directive. In addition, the EFTA Court which interprets EEA Rules is obliged to follow ECJ case law.

If the Swiss model was adopted, the UK would almost certainly be required to accept certain EU rules (via bilateral agreements); whether this would include employment related rules, including rules on free movement of workers would depend on the UK's negotiating strength and stance. It is unlikely that all EU employment rules would be excluded from the scope of the bilateral agreements. Access to the EU markets without a requirement to maintain certain employment standards is improbable.

Only in the event of a total EU exit is there potential for a significant change to the UK's EU derived employment law. European law has been incorporated into the UK's domestic legislation in a variety of ways. Under the powers conferred by the European Communities Act 1972 (The ECA 1972), some legislation has been implemented via regulations including TUPE and the Working Time Regulations. Other European legislation has been implemented via primary legislation such as the Equality Act 2010.

If the Government repealed the ECA 1972 this would have the effect of automatically repealing all regulations implemented under it such as Transfer of Undertakings (Protection of Employment) regulations (TUPE) unless the Government opted to preserve all or part of any specific regulations.

In practice, an immediate repeal of all EU derived secondary employment legislation is likely to be unattractive, giving rise to inconsistency, confusion and uncertainty in the business community. Commercial agreements will have been drafted to take into account the existing legislative regime, for example, long term outsourcing agreements where pricing will have been dictated by the commercial risks under the prevailing employment law regime.

Primary EU derived legislation such as the Equality Act will remain in force until such time as the Government elects to repeal or revise it. If all primary EU derived legislation is repealed upon a Brexit this would give rise to a significant volume of simultaneous legal change that business would have to address in one go which is again is likely to be deeply unattractive, burdensome and give rise to considerable legal and commercial uncertainty.

A more likely outcome would be a piecemeal revision of existing legislation to address specific business and government concerns. This is likely to take time and be costly. There is no guarantee employment law will be prioritised over other areas of law that would also require updating following an exit.

Following a total EU exit it remains to be seen how the domestic courts will interpret EU derived legislation that is not revoked or repealed. Will they continue to consider themselves bound by the pre and post Brexit decisions of the ECJ? For example, in relation to holiday pay claims, domestic courts have read words into the legislation in order to give effect to the decisions of the ECJ. Will this approach continue to be adopted? They may do so for the sake of legal certainty and consistency until such time as the legislation is amended.

Where legislation has been drafted to give effect to ECJ decisions then it will continue to be binding until such time as it is repealed or revised.

An added complication is that whether or not legislation is repealed or amended some EU derived rights may have been incorporated into commercial agreements, employment contracts and company policies (e.g. paid holiday). In most cases a unilateral revocation of such contractual rights would give rise to breach of contract claims as well as potentially significant industrial relations issues.

Companies that operate European Works Councils will have to revisit their arrangements whether the Company is UK head quartered or not.

Companies may wish to audit their current staffing arrangements both within the UK and in EU Member States to assess which EU nationals may potentially be required to apply for a work permit if the current immigration treatment of EU nationals is not maintained. Equally UK nationals working in Member States may have to revisit their immigration status. It is likely that upn Brexit the government would consider providing a grandfathering arrangement to enable EU and UK employees to remain working in the UK and EU respectively without the need for a work permit on an interim or ongoing basis.

9. TRADE

Under the EEA/EFTA scenario, the UK would be free to conclude its own trade agreements with third countries, as it would no longer be a part of the EU Customs Union and Common Commercial Policy. The potential benefit of the power of independent action in this area should be balanced against the risk of not being able to conclude as favourable terms due to the UK's relatively smaller market and therefore lesser bargaining power compared to the EU, and the fact that the UK would not be entitled as of right to retain the benefits of some 50 trade and association agreements it enjoyed as a member of the EU by virtue of the fact that those agreements were signed between third countries and the EU. The UK would also no longer be involved in the EU trade negotiations with the USA on a Transatlantic Trade and Investment Partnership (TTIP), Japan and others. The UK would also have to comply with EU Rules of Origin regulations that are more complex than the current Internal Market arrangements, which do not distinguish between products from different Member States within the EU.

In a customs union, in terms of services, the UK would rely on its rights under the General Agreement on Trade in Services (GATS). Given the asymmetry of trading volumes between the UK and the EU, membership of the EU customs union would be most sensible as a step towards EU membership, not as a permanent model for engagement. It is true that the UK would be able to negotiate agreements with non-EU third countries on trade in services where it currently negotiated as part of the EU. For goods, however, the UK would have to follow the EU's overall trade policy as a member of its customs union, resulting (as in the case of Turkey) in loss of independence and influence in this area. The EU would retain the ability to conclude trade agreements (whether multilateral, plurilateral or bilateral) with third countries without any input from the UK. That would give those countries access to the UK goods market, on the terms the EU had negotiated to suit itself, not the UK. This would risk having an adverse impact on UK interests given that, in the case of bilateral FTAs, the EU's negotiating strategy is generally to offer access to its market for goods in return for the third country offering access to its market for services. The UK would then have to negotiate, after the fact and from a position of weakness, separate FTAs with the same third countries to gain reciprocal access for UK goods and, more importantly, services. This would risk disadvantaging the UK financial services sector as it is largely focused on the trade in goods and does not provide for special arrangements in other areas.

Trade treaties generally contain a provision known as a «prudential carve-out», under which parties to the treaty are permitted to retain restrictions on access to their financial markets on the basis of prudential regulations. This means, in effect, that if the UK were to rely only on free trade agreements in its relations with the EU, freedom of access would to some extent be preserved for manufactured goods, but would almost certainly not be available for financial services. Article 7.38 of the EU-Korea FTA for example provides that each party «may adopt or maintain measures for prudential reasons, including the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier; and ensuring the integrity and stability of the Party's financial system.[8]

Under all but the EEA scenario, the UK would no longer automatically be party to existing EU trade agreements or to negotiations for prospective agreements. Even though Opinion 1/94 of the CJEU concluded that WTO agreements in goods were an exclusive EU competence and those in services were partly a Member State competence, this situation has been changed by the Lisbon Treaty and both are now considered EU competences (except for certain transport and audio-visual services).[9] The movement to trade agreements being largely an EU competence has an impact on the status of what are known as «mixed agreements» – where international treaties are signed by both the EU and its constituent Member States.[10] For trade agreements signed as part of the EU's exclusive competence it is very difficult to maintain with any certainty that the UK would remain subject to the rights and obligations in such agreements and with mixed agreements there are some grounds to suggest that the UK may remain bound by certain aspects of these agreements but this is very uncertain and without legal precedent.

The analysis of both exclusive and mixed agreements relies upon the concept of a «successor» state and the «continuing» state under international law. The normal premise within conventional international law is that where a smaller proportion of the state decides to secede, the remainder of the state will normally be treated as a «continuing state» and the seceding state as a new state (for example the potential situation with Scotland and the Rest of the UK).[11]

Under conventional international law the continuing state will succeed to all the treaty rights and obligations of the original state and the seceding state may or may not continue to be subject to existing treaty obligations. Historically practice has varied and the key question is how other states/organisations will choose to treat the seceding state. There is no persuasive precedent to suggest that the rights and obligations of the UK under EU agreed free trade agreements would be maintained. In particular, for those agreements where the EU has exclusive competence the contracting parties may take the view that the agreement would not extend to an independent UK on its own, especially if the terms of market access granted had been negotiated on the basis of a wider EU market not the UK independently. Absent any real precedent, it would be very difficult to contend, for agreements with exclusive EU competence that the UK would maintain

[8] See Article 7.38, EU-South Korea Free Trade Agreement.

[9] See Article 207, TFEU.

[10] The legal landscape around mixed agreements under EU law is very complicated and cannot be discussed fully in this c. However, please see, amongst others, A Rosas, 'The European Union and Mixed Agreements' in Dashwood and Hilton (eds), The General Law of EC External Relations (Sweet & Maxwell, 2000).

[11] See Sir David Edward, written evidence to the European and External Relations Committee of the Scottish Parliament, 23 January 2014.

its rights/obligations, especially since the Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations[12] has not been ratified sufficiently to come into effect and neither the UK, EU nor WTO are signatories to it.

Currently, about 50 agreements have been concluded, with negotiations in progress with the USA, Japan, India and a number of ASEAN countries, among others.[13] In the case of existing agreements, there would at best be a great deal of uncertainty to whether these agreements would continue vis-à-vis the UK and the other contracting parties, a positive statement of acceptance would probably have to be sought from the EU and other contracting parties, failing which the UK would, at worst, either have to negotiate fresh bilateral FTAs with those countries, or fall back on its generic WTO rights (e.g. MFN tariffs and GATS rules for services). The UK would have to rebuild the capacity to carry on a large number of simultaneous negotiations with partners who might not feel obliged to give the UK as generous market access and national treatment as they did to the EU, given the UK's much smaller relative bargaining power and offered market access. The process could also be a lengthy one. For example, the EU began free trade negotiations with India in 2007 and negotiations were ongoing in 2015. Even simple agreements have taken two to three years to negotiate.

In the case of current negotiations, UK departure from the EU would leave the Commission, as EU negotiator, free to say that it no longer represented the UK, which was no longer involved; and it is hard to see how the UK could gainsay that contention. The UK would then be excluded from further participation in ongoing negotiations with key partners such as the USA and Japan, where it is currently a leader in setting the agenda. The EU/ USA TTIP negotiations are of particular importance in the international trade and standards setting agenda. If the UK were to be outside the EU, the relatively smaller size of its economy would risk disadvantaging it in negotiations with much larger economies such as the USA.

Trading with the EU as a member of the WTO would involve the UK and EU imposing MFN tariffs on each other's goods. A House of Commons Library study has estimated that about 90 per cent of UK goods would be covered.[14] The risk is that this would have detrimental consequences on UK consumers and trade; for example, the current average MFN EU tariff for motor vehicles is around 10 per cent, which would increase the costs of UK automotive imports into the EU. A further risk is that UK producers would put pressure on the government to raise tariffs on its competitors in order to protect their own interests, not just in Europe but globally, by increasing certain MFN tariffs. This would increase costs for consumers, and ultimately reduce the volume of trade. Indeed, the desire to mitigate the dynamic of raising barriers to trade in order to protect what may otherwise be uncompetitive domestic interests is one of the animating

[12] http://legal.un.org/ilc/texts/instruments/english/conventions/1_2_1986.pdf

[13] European Commission Memo, 'The EU's bilateral trade and investment agreements – where are we?', MEMO/13/1080, 3 December 2013, accessed on 10 April 2014 at: http://trade.ec.europa.eu/doclib/docs/2012/november/tradoc_150129.pdf

[14] House of Commons Library, 'Leaving the EU', Research paper 13/42, 1 July 2013.

forces behind the creation of the EU Internal Market. Examples of recent international trade disputes have seen the USA impose tariffs on UK steel producers and disagreements between China and the USA about disputed solar panel subsidies.

Free movement of capital would not, technically, be affected by UK departure from the EU. The Maastricht Treaty removed all restrictions on capital movements between EU members and also between the EU and third countries from 1994. However, the status of the UK as Europe's leading financial centre may be endangered by departure from the EU. London accounts for between over three quarters and just under half of, variously, EU foreign exchange trades, global trade in the euro, EU private equity funds, investment banking, pension assets and international insurance premiums.[15] The financial services «single passport» mechanism, which allows providers established in one Member State to provide their services in all, is not available to a country outside the EEA. Furthermore, other EU governments might no longer feel comfortable allowing such a large proportion of the activity of their firms to take place in what could be characterised (more easily than in the past) as an offshore centre. Research into the views of financial and professional services firms carried out by Ipsos MORI for TheCityUK revealed that 95 per cent of those polled believed that access to the Single European Market, particularly as a gateway for international business, is important to the UK's future competitiveness.[16]

More importantly for the financial services industry, the WTO regime, and GATS in particular, does not deal with non-tariff barriers in any great detail. Instead, the focus on non-tariff barriers tends to be concerned with whether they are discriminatory in nature and whether they can be objectively justified. The existence of non-tariff, behind-the-border barriers is perhaps the most significant obstacle to market access and national treatment faced by the financial services industry globally.

Departure from the EU would allow the UK to set its own regulatory framework. However, it could face restrictions in the EU and globally. While there is a general aspiration in the GATS framework to gradually liberalise trade in services to the greatest extent possible, this is balanced by recognition of «the right to regulate». As discussed, the prudential carve-out does not prevent a WTO Member from taking measures for prudential regulation and supervision of financial institutions. It is generally considered to be quite wide provided such measures are not «used as a means of avoiding the member's commitments or obligations under the GATS» (i.e. provided that they are not taken for protectionist reasons). Given that most measures taken in financial services regulation can be justified on this basis, relying upon the GATS would not provide to the UK financial services industry any guarantee of access to the EU Internal Market in financial services on a comparable basis to EU membership. Sydney J. Key, former member of the Board of Governors of the Federal Reserve Bank of Chicago, explains the difference between the European method of liberalisation of financial services and the GATS model in saying:

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15 TheCityUK, 'Key Facts about UK Financial and professional Services', August 2013.

16 TheCityUK/IPSOS Mori, 'The City Speaks', October 2013.

«The international framework for dealing with trade liberalisation and prudential regulation in the financial services sector is much more fragmented than that within the EU, where everything is being done within one institutional framework. That is, the European Community deals with all aspects of trade in financial services among the Member States, including liberalisation aimed at non-discriminatory as well as discriminatory barriers, removal of restrictions on capital movements, and harmonisation of essential national rules such as capital standards and consumer protection measures. Beyond the EU, international efforts must proceed without a supranational structure comparable to that of the EC and without the broad scope of its legislated harmonisation of essential national rules.»[17]

The presumed right of commercial establishment that comes with EU membership would also be lost on departure from the EU except to the extent that it is replicated under the EU's GATS commitments to third countries or through other instruments such as EU members' participation in the Organisation for Economic Cooperation and Development (OECD) Investment Guidelines. Dispute resolution and the enforcement of competition law through the ECJ is also stronger in the EU and provides considerable protection to EU members against anti-competitive practices.[18]

10. COMPETITION LAW

EU competition law prohibits anticompetitive agreements and concerted practices (Article 101 TFEU), abuse of a dominant position (Article 102 TFEU), governs mergers in the EU that meet clear thresholds and conditions (through the EU Merger Regulation) and prohibits certain state aid subsidies. The UK's Competition Act 1998 and Enterprise Act 2002 largely mirror EU legislation so Brexit would not necessarily entail an immediate divergence in competition policy. If the UK did not remain in the EEA then UK courts would cease to be bound by judgments of the EU Courts, so divergences could arise over time.

There is the possibility that UK enforcement practices in relation to mergers may diverge over time from those of the EU. This could add an extra element of risk to mergers of businesses that operate in the UK and the EU given the requirement for approval in an extra jurisdiction. Any activities including mergers with an impact outside the UK will continue to be subject to EU law.

State aid may be one of the areas that could change if the UK exits without remaining in the EEA, which would be an interesting development from the point of view of the greater freedom/flexibility it would give the UK government in terms of the assistance it might want to provide to UK industry or the incentives it might want provide to attract greater foreign investment into the UK.

[17] Sydney J. Key, 'Trade liberalization and prudential regulation: the international framework for financial services', International Affairs 75, 1999, page 74.

[18] CEPS Special Report, 'Access Barriers to Services Markets: Mapping, tracing, understanding and measuring', June 2013.

The UK is influential in the framing of EU competition policy. For example the recently passed EU Damages Directive will introduce minimum standards for antitrust damages claims in the EU, e.g. for disclosure, protection of leniency submissions, limitation periods, which are already features of damages actions in the UK. The departure of the UK may see the EU become more protectionist, with the risk of a renewed push towards establishing national champions and looser state aid rules.

11. CONCLUSION

It is easy, in principle, to posit the pros and cons of the different scenarios outlined in this chapter. In practice, however, it is far more difficult given the uncertainties and the interdependencies between them.

An important common feature of any scenario where the UK would remain an EU member is the extent to which the UK would retain a degree of control in exercising choices, and would retain freedom to change policy or tactics if it were in the UK's interest to do so.

The common feature of the five scenarios in which the UK would leave the EU is the pattern of risk, perhaps long term business uncertainty and lack of control. Leaving the EU would itself take time, and the process by which that would take place is by no means certain. After leaving, the UK would be put in a position of having to wait to learn the result of any subsequent EU treaty or regulatory changes, which could have a major impact on the terms of trade between the UK and EU.

The reality of the UK's relationship with the EU over the coming decades may borrow parts from a number of the eight scenarios examined here and it is possible any future scenario may take a different, as yet unknown, character.

At the same time, or after leaving the EU, the UK government would need to take policy decisions on post-exit adaptations to UK law. That would entail a legislative programme which could take the life of a whole Parliament or longer. The UK would have to embark on one or more of the post-exit options either by attempting to negotiate in advance, afterwards, or even possibly by a process of trial and error in negotiations for alternative solutions with the other member states themselves affected unpredictably by the UK's exit. All these consecutive steps would involve great political, technical and diplomatic difficulty, perhaps taking several years, during which the UK's overall commercial regime would risk being subject to uncertainty and doubt.

For financial services, would any of this represent a better option than EU membership? After all, the creation of the integrated EU framework for financial services has had a marked and highly positive effect for those UK-based financial services businesses with an EU-wide or global reach, and an equally positive effect for their clients. It is easy to take this common legal framework and set of legal freedoms, developed over 40 years, for granted. Without it, however, the commercial operations of UK-based financial services businesses might well not take place at all or else might take place in a non-EU centre. Without it, too, firms from other EU member states would have far less interest in establishing in the UK, and their home country authorities (who would then view the UK as an offshore jurisdiction) might not allow it without additional regulatory safeguards. The City as it exists today functions as a market place of firms from across the EU and outside. This is made possible by the framework of Internal Market legislation. The UK, backed by its expertise in financial services, is in a position to sustain its influence on the framework, provided it is seen as committed to it. To abandon this for some untried, unknown and unpredictable alternative would carry very significant risks.

It is clear from the scenarios examined in this chapter that from a legal perspective the interests of UK financial services are most effectively safeguarded through continued membership, and reform, of the EU.