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The UK Votes to Leave the European Union

The UK voted yesterday to leave the European Union. The timetable for the UK's exit, the terms of exit, and the UK's post-exit relationship with the European Union (EU), are still to be determined, which will take time. Until these issues are clarified, firms with a UK presence, or UK customers, will have to address the inevitable legal uncertainty regarding the legal environment in which their businesses operate. Those firms, in the meantime, should continue to monitor developments, identify those areas where their businesses are likely to be affected by new or amended legislation and regulation - and, importantly, those areas that are unlikely to be affected - and determine how to mitigate risks in affected areas.

How long will it take to exit?

Exit will not be immediate – there will be a transitional period in which the UK will negotiate the terms of its withdrawal from the EU.

The duration of this transitional period is uncertain, despite the two-year initial deadline specified in the EU Treaty. This is due to a number of factors that make the exit process unpredictable:

- > The process can start only when the UK notifies the European Council (Council) of its intention to leave the EU. The Council itself cannot initiate the process. There is no deadline for notification, and the UK could decide to delay it, for example, to give it time to make new arrangements for its relationship with the EU. Some commentators say that notification could be deferred for as long as two years, but that the associated risk of prolonged uncertainty could prompt the Council to find grounds to lay the process aside and force the UK into a quick exit.
- > The UK's notification will trigger negotiation of the exit agreement. Negotiations are likely to involve a wide range of complex issues that could take several years to resolve, requiring an extension of the two-year initial deadline. If the Council were not to agree an extension, the UK would have to exit the EU without an exit agreement.

- > Once the final version of the agreement has been settled, it must be:
 - > agreed by a majority of the other 27 EU Member States making up the Council;
 - > approved by the European Parliament;
 - > ratified by the UK Parliament; and
 - > implemented in UK legislation.

All of these formal approvals will take time and could further extend the exit process.

Taking these factors into account, the general view is that the UK's withdrawal from the EU could take an estimated 4-5 years.

What will the post-exit status of the UK's relationship with the EU be?

The UK has not so far specified the preferred model for its post-exit relationship with the EU.

There are several possible models, each of which would reduce the volume of EU laws applicable in the UK and, as a result, drive new UK legislation. Some of these models are listed below, in ascending order, starting with the model that may generate the least change to UK legislation:

- > **Membership of the EEA (European Economic Area) as a non-EU, EFTA member:** The UK would be part of the single market and required to apply a significant proportion of the EU legislation to which it currently adheres as a member of the EU, including, for example, the rules on free movement of goods, services and people, and on employment, financial services and competition.
- > **Bilateral agreements with individual states and agreement with the EU providing limited access to the EU single market.** Under this model, the UK would be required to apply fewer EU rules – mainly those governing free movement and other EU rules relating to the goods and services traded.
- > **Membership of the EU Customs Union:** This model would provide for trade in goods only and so further limits the volume of EU legislation to which the UK would be subject. It would involve tariff-free trades between the UK and the EU and a common tariff on trades with third countries, requiring the UK to apply only certain EU rules relating to the goods traded.
- > **An independent free trade agreement with the EU:** This agreement would be bespoke and so would take a long time to negotiate. The aim would be tariff-free trades for goods, and removal of non-tariff barriers to trades of goods and services, between the UK and EU. The terms of the agreement could impose on the UK a number of requirements that reflect EU requirements.
- > **No agreement with the EU, but retaining WTO membership:** Under the WTO rules, there would be caps on tariffs and restrictions on non-tariff barriers to trades in goods and services from the UK to the EU. The UK would not be required to apply EU laws.

Many commentators believe that the UK will opt for membership of the Customs Union or an independent free trade agreement. Membership of the EEA may be seen as too close to EU membership, bilateral agreements with individual Member States plus limited single market access would be too complex to operate, and reliance on WTO membership would not provide the benefit of tariff-free trades. Whichever model is chosen, however, there will be an impact on the UK legal environment.

What will be the impact on the UK legal environment?

An important point to note is that many areas of business will be entirely unaffected by the UK's withdrawal from the EU. Changes are possible only where the UK legal environment has been affected by EU legislation, which presently have precedence over UK laws, but would no longer have precedence on the UK exit.

In areas not covered by the model the UK chooses for its post-exit relationship with the EU, it is likely that the UK would need to adopt new legislation to replace the EU laws that no longer apply. It would have the choice of preserving the substance of those laws, or taking a different approach. If it decided to preserve the substance of any of those EU laws,

the form of those laws – whether they are Treaty provisions, regulations or directives – would dictate how it achieved this. Despite the complexity of the process that would need to be followed, adoption of EU laws is likely to create less uncertainty than a UK decision to take a different approach and adopt new legislation.

Even with the model that creates the least change, the volume of UK legislative work required will be substantial. It is unlikely that the UK will have the time and resources to decide which EU legislation to retain, and to adopt new legislation, in all affected areas of UK law before the UK exit takes effect. Post-exit transitional arrangements that provide for some if not all EU laws to continue to apply are therefore likely to be needed.

The UK also relies on free trade and other international agreements negotiated with third countries by the EU on behalf of all EU Member States. These agreements would no longer cover the UK after exit, adding to the legal work and negotiations required to establish the required degree of UK independence from the EU.

How will exit impact on the legal position of firms with a UK presence or UK customers?

The legal position of any firm with a UK presence or UK customers will depend on the sector in which it operates and the nature of its business. It will also depend on the model chosen for the UK's post-exit relationship with the EU, and our comments below are subject to the UK's decision on this.

In sectors where EU legislation has harmonised regulation across Member States and developed a unified set of rules for the single market, the UK's exit could free businesses from restrictions on the way they operate their businesses, for example, in the **energy** sector, where EU rules impact, for example, on the type of technology that can be used to generate electricity and state investments in the sector. In other areas, the UK's exit could increase the regulatory burden on businesses.

- > Under “passporting” rules, for example, UK **financial services and insurance** firms have been able to rely on UK authorisation to operate elsewhere in the EU without needing to obtain authorisation in other Member States. They may no longer be able to do so after the UK has left the EU, and they may have to consider establishment within the EU in order to continue operating there. Conversely, firms established in other Member States and relying on passporting to continue trading in the UK markets may no longer be able to do so, in which case the UK would have to consider adopting “grandfathering” measures permitting them to continue their activities in the UK. More generally, new legislation is likely to be required to preserve or replace EU-derived secondary legislation forming part of the UK financial services regime – although given that the UK regime has had a significant influence on the EU regime, it is unlikely to change significantly.
- > In the **chemicals** sector, registration with a central EU body allows chemicals to be sold throughout the EU. After the UK leaves the EU, these registrations will no longer be valid in the UK. UK-specific rules compatible with the EU regime could be needed to ensure local authorisation, to facilitate continued cross-border trading and protect sellers from liability. UK businesses exporting to the EU will have to continue to meet the requirements of the EU regime.
- > Similar issues arise in the **life sciences** sector. In addition, the EU wide system of granting supplementary protection certificates, extending the life of a patent for a medicinal product in certain circumstances, could cease to apply to the UK after EU exit, in which case a separate UK system would need to be established to continue protection of the patent in the UK.
- > Businesses operating on the basis of **intellectual property rights** can benefit from EU-wide registration of their rights in trade marks (EUTMs) and designs (RCDs) EU-wide. Post-exit, new EUTM and RCD filings will not cover the UK, so applicants will have to file separately in the EU and in the UK. The effect on existing EUTM and RCD registrations is unclear, but it is likely that they will continue in force until converted as part of a transitional arrangement. As regards patents, as a non-EU member, the UK will not be part of the forthcoming EU Unitary Patent system, so it will not be possible to obtain EU Unitary Patents that cover the UK. It would still be possible, however, to obtain a UK patent via the European Patent Convention.

An increase in the regulatory burden on businesses operating in both the post-exit UK and EU could also be seen in the **antitrust** field, with separate EU and UK approvals needed for M&A deals and separate EU and UK antitrust investigations initiated in relation to the same agreements or conduct – a change from the current one-stop shop approach operated by the European Commission in conjunction with the national competition authorities. In relation to **personal data**, the situation is complicated. Depending on which data protection “model” the UK adopts, the UK’s exit could have an impact on transfers of personal data both from the EU to the UK and from the UK to the EU. Enforcement of data protection law may also become more complicated, as a business which commits a data breach affecting UK and EU citizen data on servers in the UK and EU may become subject to two different supervisory bodies and enforcement regimes. The UK’s rules on **public procurement** are EU-derived, and could fall away on UK exit, so the UK approach to procurement would need to be considered and incorporated in new legislation, with businesses competing for contracts in the EU potentially losing some of the protections they currently enjoy.

The types of business likely to be most affected by the UK’s exit are businesses that **export** from the UK to the EU and from the EU to the UK. Once the UK is no longer in the EU, it may be slower and more difficult to export between the two territories, due to reintroduction of customs processes and, possibly, export tariffs. However, separation of the UK from the EU could make it easier for businesses to differentiate the terms and conditions applied in each territory and to prevent parallel imports from each territory to the other.

More generally, the UK’s exit from the EU may lead to changes in the rules governing all types of businesses. Examples include the following:

- > Possible changes to the **UK tax system**. VAT is imposed by EU Directive and could be abolished, replaced with a different UK sales tax or retained with modifications. The Parent-Subsidiary Directive, Interest and Royalties Directive, Mergers Directive and Capital Duties Directive would all cease to apply in relation to UK companies, which could result in UK companies and their investors and transaction counterparties suffering increased taxes on dividend, interest and royalty flows, certain M&A activity and capital raisings. Goods exported from the UK to the EU could be subject to VAT on import. The EU fundamental freedoms of movement have had a significant impact on tax regimes within the EU, particularly the tax treatment of dividends, the use of tax losses and Controlled Foreign Company regimes, and therefore the non-application of those fundamental freedoms could also lead to significant changes in the tax treatment of UK companies and their investors and transaction counterparties.
- > Non-application of the EU **state aids** rules. While exit will reduce access to EU **grants**, it may also allow the UK more flexibility in providing support to businesses in areas where state support is prohibited by the EU rules, for example, through favourable tax treatment.
- > Enactment of UK legislation relating to the **environment**. The laws that apply in relation to environmental matters across the UK are derived from a mix of international treaties, EU law and national legislation and policy. They are contained in both primary and secondary legislation. The UK’s international obligations will not change on exit, but replacements for, or alternatives to, EU legislation could need to be put in place and obligations relating to imports from the UK into the EU or transfer of waste between the UK and the EU, for example, may become more cumbersome and costly.
- > New legislation in relation to **health and safety**. Many of the UK’s laws in this area stem from EU legislation that will no longer apply on exit. Whether these laws will be preserved or replaced in new legislation will depend on the UK’s post-exit policy.
- > Possible changes to the UK **employment** rules to reflect UK policy – for example, in relation to working time, business transfers or agency workers – and possibly greater difficulty in employing EU nationals in the UK.
- > Changes to the rules relating to **commercial agents** to reflect UK policy.
- > A new treaty relating to **enforcement** of UK rights in EU Member States could also have to be negotiated.

A final example is **commercial contracts**.

- > Any commercial contract containing **geographical definitions** referring to the European Union or (assuming that the UK does not become a member of the EEA post EU exit) the European Economic Area could need to be considered, for example, agency arrangements, distribution contracts granting territorial exclusivity, IP licensing agreements, franchising documentation, confidentiality agreements and restrictive covenants. In addition, many elements of the current EU push to establish a Single Digital Market and related European Commission proceedings (including in relation to the non-permissibility of prohibiting passive sales within the EU) will require careful evaluation during the process.
- > References to **EU legislation, EU institutions and EU legal concepts** could also have to be revised.
- > **Choice of law and jurisdiction clauses** would need to be reviewed to ensure that they remained enforceable.

These are only some of the issues that can be identified at this stage, and it is highly likely that further issues and questions will arise as the UK, the EU, and individual EU Member States develop their policies for dealing with the UK's exit.

What should I do now?

Given the degree of uncertainty surrounding the timing and terms of the UK's exit and its future relationship with the EU, the safest course of action for firms at present is to monitor developments, to identify where their businesses may be affected by changes to the UK legal environment, and to consider risk mitigation measures, including providing for UK exit in new transactions and contracts. In most cases, greater certainty is likely to be needed before firms can implement strategies for managing the consequences of exit.

Further information on issues related to Brexit can be found [here](#).

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