July 6, 2016

Brexit:
What comes next? What are the potential consequences?

On June 23, 2016 voters in the United Kingdom were asked in a referendum whether the UK should remain a member of the European Union or leave the EU. By a vote of 51.9% to 48.1%, the voters opted to leave.

The UK is now in uncharted territory. No nation has ever left the EU. There is a clear procedure in the Treaty on European Union for doing so, but it has never been invoked. The economic consequences of leaving the EU – often referred to as "Brexit" – have been projected by the IMF to be, in the words of IMF Managing Director Christine Lagarde, "pretty bad to very, very bad," but those adverse effects are likely to fall more on some firms and individuals than on others. And the political consequences of Brexit are tearing at the fabric of both the UK and the EU, in both cases presenting what may constitute an existential crisis.

This memorandum outlines possible legal, institutional and political consequences of Brexit. Because there are at present so many variables at play, in many cases the memorandum can offer only speculation on possible outcomes. It concludes by summarizing the potential impact of Brexit on non-UK companies and other persons with investments, operations or subsidiaries in the UK. Specifically, we cover:

- the referendum and the campaign that accompanied it;
- the process of leaving the EU;
- the possible outcomes of the UK's negotiation of an agreement with the EU governing its future relationship with the EU;
- the impact of Brexit on the UK's relations with non-EU countries;
- the effects of Brexit on UK law;
- the effects of Brexit on the future of the UK; and
- the likely legal impact of Brexit on financial institutions, companies and investors in selected areas.

Executive Summary

The referendum has had a deeply divisive impact on UK politics, splitting young and old, and London, Scotland and Northern Ireland from the rest of England and Wales. It has also split, and given rise to leadership contests in, both the Conservative and Labour parties.

The formal process for leaving the EU entails the Prime Minister giving written notice under Article 50 of the Treaty on European Union. This starts an up to two-year negotiation period on the terms of exit and the relationship between the UK and the EU following exit. The two-year period can only be extended with the unanimous approval of the other 27 member states of the EU. There is no other way to leave the EU.

David Cameron has declined to give the notice, leaving that task to his successor as Prime Minister. There are an increasing number of commentators who are saying that the notice may never be given.

There are several "models" for what the relationship between the UK and the EU might be following the UK's exit. Some of these would be politically unacceptable to the UK; others would be politically unacceptable to some or all of the other 27 member states of the EU. Several are highly unlikely to be put in place within the two-year period contemplated by Article 50. In the absence of an agreement, following Brexit the UK's trade relationship with the EU would be protected only by the rules of the World Trade Organization (WTO), which should be viewed as a worst case outcome.

The UK will also need to negotiate trade agreements with 30-50 non-EU countries with which it has no trade agreements, because its trade relations with those countries are now governed by treaties with the EU. Its ability to handle this huge challenge will be limited, as the UK has virtually no experienced trade negotiators.

Much of UK law is now rooted in EU law, either EU regulations that have direct effect in the UK or EU directives that have been implemented by UK legislation. The UK government will need to review the estimated 6,000 pieces of legislation and regulations that are potentially affected by Brexit to decide what to keep, what to repeal, and what to amend. This is likely to be a multi-year project.

Assuming notice is given under Article 50, Brexit is likely to cause significant uncertainty concerning a wide range of issues for at least the next two, and perhaps many more, years. This is likely to reduce investment into the UK, result in the relocation of some businesses from the UK, and heighten volatility in currency and other markets. Some sectors – such as financial services – are likely to be particularly hard hit. On the other hand, non-UK companies and investors may find that Brexit provides unusual opportunities to create value by finding creative ways to reduce or cushion these risks, or by responding more quickly than others to the evolving situation.

Brexit may also present existential crises in both Scotland and Northern Ireland. Senior Scottish politicians have already called for a rerun of the referendum on Scottish independence, and current opinion polls suggest that those backing independence might win this time. The imposition of a "hard border" between the Republic of Ireland and Northern Ireland, which Brexit might necessitate, may cause serious disruption to the fragile peace in Northern Ireland. Brexit also threatens to have a fundamental, and highly negative, impact on the EU itself, weakening it both economically and politically.

The balance of this memorandum provides more detailed explanations of each of these points.

The Referendum

The Conservative (or "Tory") Party in the UK promised voters that it would hold the referendum as a part of its election manifesto for the general election held in May 2015, largely as a way to blunt the feared growing appeal of the UK Independence Party, or UKIP, to Tory voters. Neither of the other major parties in the UK – Labour and Liberal Democrats – had any interest in the referendum. To the surprise of pollsters and perhaps the Conservative Party itself, the Tories won a majority of seats in Parliament, and David Cameron was re-elected as Prime Minister, this time not as a coalition leader but with a clear but narrow majority.

Cameron made good on the Tories' promise to hold the referendum, after a frantic bid to negotiate changes to the UK's "deal" in the EU to address some of the issues that had motivated criticism. Thinking it best to call the question quickly, and reportedly motivated in part by a concern over the impact of a second wave of migration into the EU during the summer months, he scheduled the vote for June 23, presumably on the assumption that "Remain" would win and the UK could get back to business more rapidly.

The contest between the Remain and Leave campaigns became increasingly bitter as the date for the referendum drew close. Leave campaigners, led by former London Mayor Boris Johnson and Michael Gove, egged on by UKIP's leader Nigel Farage, attacked the EU and urged Brexit on three primary grounds: the threat of continued high immigration levels by EU nationals into the UK; the net financial contribution to other EU countries that EU membership imposes on the UK; and the loss of "sovereignty" over the making of laws in the UK that membership in the EU has entailed, and the consequent ability of "bureaucrats in Brussels" to make rules and regulations to which UK companies and persons are subject.

A fourth complaint, articulated in the Conservative Party's manifesto and echoed even by some Remain supporters such as the Home Secretary Theresa May, was that the UK's adherence to the European Convention on Human Rights subjects the UK to the judgments of the European Court of Human Rights in Strasbourg, resulting in the UK being bound by court decisions that restrict the extradition of persons who would be subject to torture in their home country, require the UK to consider whether prisoners who

have served their time in jail should have the possibility of regaining their voting rights if they have been fully rehabilitated, and grant other similar rights that offended those who viewed the Strasbourg court's rulings as an impermissible encroachment on the sovereignty of Parliament.

The Remain camp campaigned largely on economic grounds, trotting out a parade of economists and other experts who predicted – probably accurately – that Brexit would adversely affect the economy, cause a loss of jobs, lead to the relocation of some businesses out of the UK, reduce the value of the pound, etc. In these efforts, the Remain camp received the *de facto* support of both the Bank of England, which warned that a Leave vote would cause sterling to fall and might trigger a recession in the UK, and the IMF, which said that a vote for Leave could cause "severe regional and global damage."

In the end, perhaps to the surprise of both camps, Leave prevailed. Voter turn-out was high: 72.2%. London, Scotland and Northern Ireland all voted Remain, by fairly wide margins. These votes were offset and narrowly surpassed by support for Leave in the small cities and towns of middle and northern England and, to a lesser extent, Wales, where polls suggest many people felt that the globalization process inherent in the progressive expansion of the EU had offered them little benefit or value.

Younger voters – those under 35 – voted overwhelmingly to Remain, those in the 35-44 age cohort voted by a 2% margin to Remain, but those 45 and over voted by increasing percentages to Leave.

The vote showed a nation deeply divided, by region and age cohort, and nearly evenly divided – but favoring Brexit by a narrow but unmistakable margin.

Leaving the EU

The referendum is advisory and not legally binding in the UK. As a political matter, however, the UK now has little choice but to start down the path of withdrawing from the EU.

The process for withdrawing from the EU is, in its inception, deceptively simple. The rules for exit are set out in Article 50 of the Treaty on European Union. Prime Minister Cameron said to the House of Commons in February 2016 that "if the British people vote to leave, there is only way to bring that about, namely to trigger Article 50 of the Treaties and begin the process of exit, and the British people would rightly expect that to start right away."

In any event, David Cameron was unwilling to pull that trigger. Instead, on the morning of June 24 he announced his resignation as Prime Minister, effective (in accordance with the Cabinet Manual) upon the selection of his replacement. By doing this he in effect postponed delivering of the Article 50 notice by handing the next leader of the Conservative Party (as Prime Minister) that dubious distinction. It is expected that the Tories will select the next Prime Minister by early September, if not earlier.

Article 50 provides (in part) that:

(2) A Member State which decides to withdraw shall notify the European Council of its intention. In light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement … shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

(3) The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

As the Secretary of State for Foreign and Commonwealth Affairs reported to Parliament, "This is the only lawful route available to withdraw from the EU."

When the UK gives notice under Article 50, it will lose nearly all of its bargaining power in negotiating its relationship with the EU following its exit. In effect it will be saying "I am leaving; please tell me what are the terms of my departure." Presumably for this reason even the leading Leave campaigner Boris Johnson announced, in his first statement after the referendum, that "there's no rush" to invoke Article 50.

Many EU leaders have called for the UK to deliver its Article 50 notice promptly, but there is nothing in the Treaties that obligates the UK to do so. EU leaders are reported to be disinclined to commence even informal discussions on a withdrawal until the Article 50 notification has been served. Prime Minister Cameron was unwilling to serve the notice. The current frontrunner in the leadership contest to select the next Prime Minister, Theresa May, supported Remain and has said she would like to have a clear vision of what the UK wants to achieve in its exit negotiations and (if possible) some informal discussions with the EU, before delivering the notice.

Only the Prime Minister can deliver the Article 50 notice, and he (or she) cannot be forced to do so. There is a legal debate over whether the Prime Minister must seek authorization from Parliament before doing so, and a law suit has been commenced that may force a judicial determination of this question. Still, in the absence of some intervening decisive event, it seems hard to believe that the UK will not continue along the path to Brexit.

The two-year deadline imposed by Article 50(3) will present a formidable challenge to the UK and EU negotiators. In a report to Parliament delivered in February 2016, the UK government stated that it is

"probable that it would take up to a decade or more to negotiate firstly our exit from the EU, secondly our future arrangements with the EU, and thirdly our trade deals with countries outside the EU, on any terms that would be acceptable to the UK." The daunting nature of this task is magnified by the failure, or perhaps inability, of the Leave campaign to articulate a clear vision of the desired future relationship between the UK and EU. There is, in fact, considerable debate about what that relationship should be, even among the leadership of the Leave camp.

Since the referendum, over 4 million people have signed an online petition for a rerun (although there have been allegations that the numbers have been boosted by bots), but David Cameron has ruled out the possibility of a second referendum and there appears to be little chance of this happening.

In view of the political turmoil besetting both the Conservative and Labour parties, neither seems eager for a snap election, but the possibility of an election cannot be excluded. Indeed, if the Conservatives are too deeply divided, or if the next Prime Minister selected by the Conservatives is unwilling to deliver notice under Article 50, an early election might become inevitable. Under these circumstances one can imagine circumstances in which the notice is never given.

A number of EU leaders and legal commentators have claimed that a notice given under Article 50 is irrevocable, but Article 50 does not actually say that. Clause 5 of the Article does say that if a state which has withdrawn from the Union asks to rejoin, its request will be subject to the procedure applicable to new entrants. But that does not clarify what happens if a member state that has not yet withdrawn from the EU decides that it would prefer to remain and withdraws its Article 50 notice. Recent reports suggest that the French government's lawyers have advised that an Article 50 notice can be rescinded. It is not inconceivable that this issue will one day be a matter for the relevant EU authorities to consider.

Future relationship between the UK and the EU

There is no clarity on the nature of the future relationship between the UK and the EU. There are several "models" that have been discussed as possible templates for that relationship. Upon analysis, none of them seems to offer an easy, or in some cases even minimally desirable, path forward. The alternative "models" are:

- *The Norwegian model: Joining the EEA.* Norway is a member of the European Economic Area, or EEA, which was established in 1994 to give European countries that do not wish to be members of the EU a way to enjoy the benefits of the EU's "Single Market." The EEA comprises all members of the EU plus Norway, Iceland and Lichtenstein, each of which is also a member of the European Free Trade Association (EFTA).

Members of the EEA are afforded access to most of the Single Market, so there is free movement of goods, services, people and capital within the EEA. Members must implement EU rules concerning the Single Market, including legislation regarding employment, consumer protection, environmental and competition policy. Norway is not a member of the EU customs union, however, so Norwegian firms must comply with certain additional (and, in the aggregate, costly) procedures when trading with the EU.

EEA members also in effect pay a fee to be part of the Single Market. They do this by contributing to the EU's regional development funds and contributing to the costs of the EU programs in which they participate. Norway's per capita net contribution to the EU budget in 2015 has been estimated to be only about 25% lower than the UK's for the same period.

Members of the EEA that are not also members of the EU play no role in EU rulemaking. By exiting the EU but becoming a member of the EEA, the UK would relinquish virtually all influence over the preparation or modification of the multiplicity of laws and regulations that would govern many aspects of its economic life.

Although the EU might well be willing to agree to the UK following this so-called Norwegian model, it seems inconceivable that those who have campaigned for Brexit would find it acceptable. The UK would be required to allow the free movement of non-UK citizens into the UK, to pay substantial amounts into the EU budget, and to abide by most EU laws and regulations, while having virtually no say in in the process of formulating those laws and regulations. As this involves accepting most of the things that the Leave campaigners highlighted as the objectionable aspects of EU membership, the Norwegian model would seem to offer the UK nothing but a step backwards on nearly all issues.

- *The Swiss model: Bilateral treaties*. Switzerland is not a member of the EU or of the EEA. Instead, it has negotiated a web of well over 100 bilateral treaties providing it with full access to the EU market in specific sectors, in effect joining up to aspects of the EU on an *à la carte* basis. Switzerland is also a member of the EFTA, which provides for free trade with the EU in all non-agricultural goods.

  Switzerland allows free movement of EU citizens into the country, although in February 2014 the country voted in a referendum to limit EU immigration, which if implemented would violate its agreement with the EU on this issue. It makes a net per capita financial contribution to the EU that has been estimated to be a little over 40% of the UK's annual net contribution. Like the EEA member states, Switzerland has no influence over the formulation of EU policies and rules.

While the "Swiss model" may be more appealing to Brexiters than the Norwegian model, in that it might allow the UK to sidestep or limit its adherence to certain aspects of EU membership that they find most objectionable, it still suffers from many of the same drawbacks: continued free movement (perhaps with limits to be negotiated); continued financial support (at a level to be negotiated); and the need to abide by a suite of EU rules (scope to be negotiated) over which the UK will have no future influence. The Swiss model also offers far less than full integration in relation to financial and other services, which are a critical component of both the Swiss and the UK economies.

Perhaps the biggest impediment to the UK seeking to follow the Swiss model, however, is that it may not be an option, particularly not in the short run. Several in the EU have already signaled that the "Swiss model" is not one that the EU is likely to follow ever again, and in any event it seems unlikely that the UK and the EU could negotiate the multiplicity of bilateral treaties that it would likely entail in the two-year time period that Article 50 contemplates.

- *Free Trade Agreement: the Canadian model*. Recent press reports suggest that Boris Johnson hopes that the UK can negotiate a comprehensive bilateral free trade agreement with the EU, perhaps along the lines of the recently negotiated free trade agreement with Canada. Such an agreement could cover both goods and services, and address non-tariff barriers to the extent negotiated. The UK might have to contribute towards the EU budget, but at a reduced level reflecting its participation in EU-related initiatives and projects (and the fact that the EU would terminate its substantial funding of UK agriculture – under the so-called Common Agricultural Policy – and research projects). Products exported to the EU would still need to meet EU standards, but this requirement is likely to apply in almost any model.

  Another key question in considering the utility of a free trade agreement is its scope. The pending agreement with Canada does not fully extend to financial services, for example, and this would be a critical issue for the UK in light of the centrality of that sector to the UK economy. The Canadian-EU agreement also does not cover other service sectors, including the majority of air transport and audio-visual services, and permits quotas on some agricultural products.

  The primary impediment to this "model" is timing. It took Canada and the EU seven years to negotiate this free trade agreement, and the accord is still not in effect. Moreover, the UK's ability to move swiftly to negotiate a comprehensive free trade agreement is likely to be undermined by the nearly complete lack of experienced UK trade negotiators, as the UK has had little need for trade negotiators for over 40 years (when responsibility for negotiating trade agreements was shifted to Brussels).

On the EU side, many EU member states – particularly those with their own domestic "exit" movements, such as France and the Netherlands – will see no benefit to allowing the UK to exit the EU with a good, quickly negotiated comprehensive free trade agreement. And a new agreement on trade and wider cooperation would require approval by each of the remaining 27 member states of the EU, which in turn will in some cases require ratification by national parliaments such as the French National Assembly, the German Bundestag and possibly all seven Belgian parliamentary chambers.

A comprehensive free trade agreement is highly unlikely to be agreed within the Article 50 timeframe.

- *EFTA-plus.* If none of the Norwegian, Swiss or Canadian models are realistic alternatives for the UK-EU relationship post-Brexit, at least not within the two-year period contemplated by Article 50, the most likely outcome is that the UK would revert to membership in the EFTA, assuming its application for membership is accepted by the four current member states, Norway, Switzerland, Iceland and Liechtenstein. When the UK opted out of joining the European Economic Community, or EEC, as the EU was then called, in 1957, it founded the EFTA as its alternative.

  The EFTA is a free trade area covering all non-agricultural goods. The EFTA has free trade agreements with the EU and numerous other countries. Membership in the EFTA does not provide for free trade in services and does not protect against many non-tariff barriers, so the UK would also wish to augment the benefits of EFTA membership by negotiating a number of bilateral agreements covering financial services, agriculture (likely to be very hard hit by Brexit, unless aggressive steps are taken to ameliorate the impact), and the more significant non-tariff barriers.

  The UK would presumably need to accept being subject to a range EU laws and regulations, and may need to offer some financial support, in order to strike these additional bilateral deals, but the cost of these concessions is likely to be easily justifiable, if reasonable compromises can be reached. Whatever bilateral deals can be reached by the two-year deadline can come into effect on that date. Those that are still being negotiated will come into effect when they are agreed.

  This alternative – which might be termed either EFTA-plus or Swiss-lite – is the most likely path forward for the UK. Its drawback is that it will require extensive negotiations over the coming years and during that period the uncertainty surrounding the outcome of the negotiations is likely to stifle investment and make planning difficult.

- *WTO: the default position.* If the UK leaves the EU without succeeding in negotiating any agreement(s) with the EU in relation to the matters noted above, it will still have the benefit of the

protections afforded by the World Trade Organization, or WTO. As a member of the WTO, the UK's exports to the EU and other WTO members would be subject to the importing countries' most favored nation (MFN) tariffs. Compared with EU or EFTA membership, this would raise the cost of exporting to the EU for UK firms, and would also subject those firms to significant non-tariff barriers. Because the WTO's rules on trade in services are relatively undeveloped, compared with its rules on trade in goods, and are far less protective than the protections of trade in services that exists within the Single Market, this would also leave the UK's export of services at a significant disadvantage compared with the situation today.

While a complete disengagement from the EU, and reliance on the WTO rules as the default "safety net," has been embraced by some Brexiters as the best means of reasserting the UK's "sovereignty," this outcome would from an economic standpoint be the least attractive. The "WTO option" should therefore be viewed for planning purposes less as an option and more as the worst-case scenario.

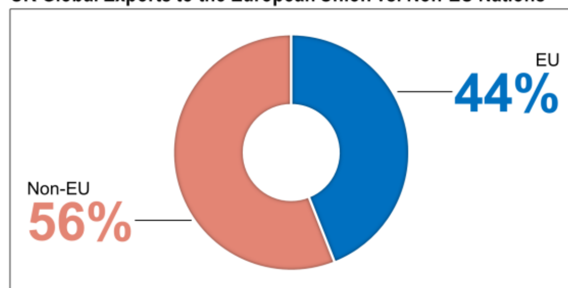
Many analyses of the various "models" that may provide a template for the future relationship between the UK and the EU have focused primarily on their efficacy in ameliorating adverse effects on the trade in goods and, to a lesser extent, services. As will be discussed in further detail below, however, the web of directives, regulations and other rules that apply within the EU cover much wider terrain. These include, for example, rules:

- regulating financial services firms (including banks, insurance companies and asset managers) and permitting the "passporting" of financial service activities throughout the EU;
- on the taxation of multi-national corporate groups and the remittance of interest and dividends;
- that give EU-wide effect to corporate insolvency proceedings and financial sector bail-outs;
- that coordinate environmental policies and the EU's response to the challenge of climate change; and
- that facilitate the enforcement of judgments and security across the EU.

As a result, except where the UK can find a work-around by joining a pre-existing convention that addresses the relevant issue, it will have to negotiate agreements with the EU (or, in theory, bilateral agreements with its remaining member states) to avoid the disruption or uncertainty that would otherwise arise upon these rules ceasing to apply upon the formal withdrawal of the UK from the EU. EU approval of these non-trade agreements may require unanimity among the 27 remaining member states of the EU.

Relations with non-EU countries

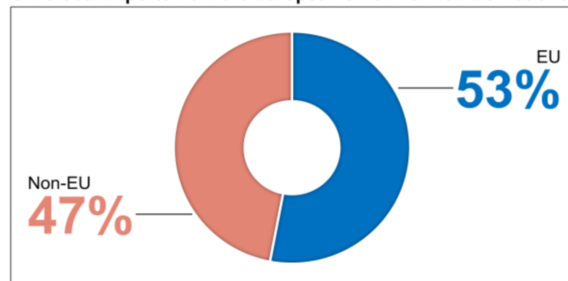
The EU is the UK's largest trading partner, with exports to the EU comprising approximately 44% of total exports and imports from the EU comprising about 53% of all imports in 2015. Aggregate trade with the US and other non-EU countries however remains critically important to the continued economic health of the UK.



As a member of the EU, the UK benefits from preferential market access to over 50 countries outside the EU, based on 36 free trade agreements between the EU and those countries covering trade, investment, or both. Although the multi-lateral trade agreements underlying the WTO generally provide MFN tariff rates with non-EU countries, these agreements are often critical in reducing or eliminating non-tariff barriers not prohibited by the multi-lateral accords or addressing trade in services or investment issues not addressed by them.

In order to replicate, or at least enjoy a subset of the benefits of, these many agreements, the UK will need to negotiate new bilateral trade and/or investment agreements with each of these trading partners (excluding any members of the Commonwealth with whom it may already have an acceptable trade or investment agreement in place).

The UK's top 15 non-EU trading partners in 2015 were, in order magnitude of exports, the United States, Switzerland, China, Hong Kong, the UAE, Japan, Saudi Arabia, Singapore, Canada, Turkey, South Korea, Australia, India, Norway and Qatar. Negotiating bilateral trade agreements with these countries, including if possible interim arrangements to be put in place at the time of Brexit, will be critical to avoid disruptions in trade flows. Unfortunately the UK will face three serious challenges in negotiating these agreements. The first is that it has virtually no experienced trade agreement negotiators. The second is that its negotiating leverage, compared with that of the EU as a whole, is significantly weaker. The UK's 2015 GDP was about £1.79 trillion, or about $2.85 trillion at the exchange rate then in effect. The EU's GDP (including the UK) was about $18.5 trillion.



The third challenge is that there are already a number of very large international trade negotiations ongoing – the politically controversial Trans-Pacific Partnership and the Transatlantic Trade and Investment

Partnership among them – that are occupying many of these countries, in many instances against the backdrop of public and political skepticism. President Obama may have been exaggerating for dramatic effect when he declared recently that the UK would be at the "back of the queue" in any future trade agreement negotiations, but neither should the UK expect to skip to the front.

With limited negotiation experience, sharply diminished economic clout, and the distraction of other ongoing trade negotiations, it is hard to see how the UK will have in place replacement trade deals with many of its key trading partners by the time the Article 50 deadline arrives.

Impact on UK law

A significant number of areas of UK law are either wholly or largely based on EU law. These include laws and regulations governing:

- banks, insurance companies and other financial services firms;
- the issuance, listing and trading of securities, including the content and review of prospectuses, and the offering of interests in alternative investment funds;
- employment and the transfer of employees;
- competition and merger review;
- the protection of the environment;
- the choice of law and forum, and the enforcement of judgments (including in insolvency proceedings);
- takeover bids and cross-border mergers;
- intellectual property; and
- data protection.

In some cases, EU law has emanated from "directives," which are incorporated into UK law by implementing legislation at the member state level. In other cases, EU law arises as a result of "regulations," which have direct effect in member states without the need for implementing legislation. By some estimates there are over 6,000 pieces of legislation in the UK that will have to be affirmatively retained, repealed, or modified, upon Brexit.

This will prove a daunting task. In some cases incorporating EU law into UK law, or confirming that UK law that reflects EU standards is not in need of any substantive amendment, will be rather easy. In other cases, the freedom to amend will create substantial domestic debate over the proposed changes, and in others an entirely new or greatly expanded UK legal regime and bureaucracy may be needed to take over functions now performed by the EU Commission (e.g., review of mergers and acquisitions from a competition standpoint). In all cases a massive review of existing UK and EU legislation will be needed in

order to make judgments about what to do with each law and regulation, and in many cases the UK bureaucracy will need to be created or significantly expanded in order to handle the repatriation of functions currently handled in Brussels.

The starting point for this review is arguably the European Communities Act 1972, which (to some extent) gave EU law supremacy over UK law. Simply repealing that law would however cause legal chaos, particularly as it would create large gaps in the legal and regulatory landscape in the UK. On the other hand incorporating all EU law into UK law (to the extent implementing legislation has not already done so) unless and until a decision is made to amend or repeal it might be politically embarrassing, if sensible.

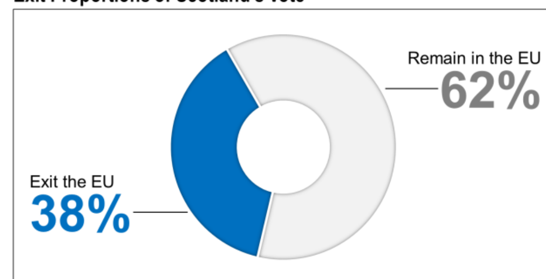
This process is likely to give rise to yet another political problem. Until now "Brussels" has played a useful role as the alleged source of all senseless or overly bureaucratic regulation, in much the same way as many Americans like to blame "Washington." Except to the extent that the UK agrees (or is required) to maintain EU laws and standards as part of a trade deal, that excuse will evaporate upon Brexit. Admitting that many of the laws and regulations made in Brussels that have irritated the British are actually needed, at least in some form, will be politically difficult.

Risks to the UK

Brexit also presents at least two existential risks to the UK.

Scotland. On September 18, 2014 Scotland held a referendum on the question "Should Scotland be an independent country?" In that vote 84.6% of the electorate participated, and 55.3% voted No (i.e., to remain within the UK). Shortly after the results of the UK referendum were announced, in which 62% of Scottish voters supported Remain, Nicola Sturgeon, leader of the Scottish National Party (which has a controlling position in the Scottish parliament) and Scottish first minister announced that it was a "democratic outrage" that Scotland would be taken out of the EU against its will, and requested that legislation be drafted providing a basis for a second referendum on the independence of Scotland. At the same time, she is appealing to EU member states directly for support for Scotland to remain in the EU, presumably by exiting from the UK upon Brexit.

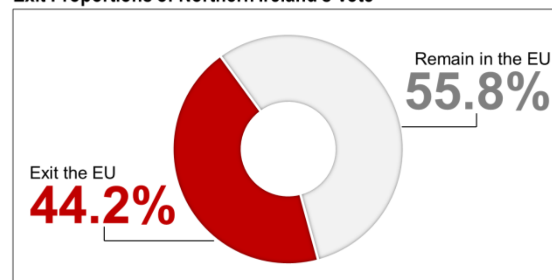
Exit Proportions of Scotland's Vote



Scottish fears about the difficulty of applying for EU membership if it were to exit from the UK were among the considerations that tilted its voters to vote "No" in the Scottish referendum. Now these arguments are reversed, and recent polls suggest that a majority of Scots would vote for independence, in light of the Brexit vote. Scotland's path out of the UK is complicated however. There will be questions about what currency it should adopt. The collapse in oil prices has damaged the Scottish economy, which is as a result somewhat reliant economically upon support from England. And the prospect of a "hard border" between EU member Scotland and non-member England would adversely affect the economic performance of both, but perhaps injure Scotland more. The likelihood of Scottish independence has, however, clearly increased as a result of the Brexit vote.

Northern Ireland. Northern Ireland – 55.8% of whose voters chose Remain – also faces serious issues. The imposition of border controls between Northern Ireland (which upon Brexit would cease to be part of the EU) and the Republic of Ireland (which is and would remain part of the EU) would be practically unwieldy, perhaps to the point of unworkability, and economically injurious, but most importantly it would undermine one of the key underpinnings of the (fragile) peace that still holds in Northern Ireland. The fact that the Irish and their goods and services can move from the Republic to Northern Ireland and vice versa not only without hindrance but without there being any

Exit Proportions of Northern Ireland's Vote



visible border has contributed significantly to the peace. On the other hand, if no border controls are imposed it will be easy for residents of any EU country to enter the Republic and then the UK by passing through Northern Ireland. And the practical solution – to impose border controls around the island of Ireland, instead of at the border between the two Irelands – will risk enraging at least some Unionists, in light of the symbolism of a border between Northern Ireland and the rest of the UK.

A second challenge lies in the risk that the UK will elect to exit not only from the EU but also from the European Convention on Human Rights (ECHR) and the jurisdiction of the European Court of Human Rights in Strasbourg. The ECHR and the Court, which were to some extent the postwar creation of Winston Churchill and the British government, would be harmful to the cause of human rights in Europe, particularly in those countries – such as Turkey and Russia – that are most often on receiving end of its criticism. But for Northern Ireland the withdrawal – which was one of the points included in the Tories' 2015 election manifesto – would undermine one element in the 1998 "Good Friday" accord that, with enormous effort, signified the end of the Troubles in Northern Ireland and inaugurated the current fragile peace. That agreement provides that the ECHR would be incorporated in its entirety into the laws of Northern Ireland, established a Human Rights Commission charged with a variety of responsibilities, and includes multiple provisions designed to ensure that the legislation and decisions of the government of Northern Ireland remain consistent with the rights set out in the ECHR.

Removing two of the fundamental building blocks of the Good Friday accord presents risks to the peace process that should not be underestimated.

Since the EU referendum, Martin McGuinness, Northern Ireland's Deputy First Minister and leader of Republican party Sinn Fein, has called for a referendum on the unification of Ireland. At present it is somewhat unlikely that the result of such a referendum would satisfy the conditions for unification imposed by the Good Friday accord, but the situation could evolve.

Legal impact: What does Brexit mean in practical terms?

Financial services and regulation

Brexit may present a significant challenge to UK-based financial services firms, and result in some movement of personnel and operations (including possibly European headquarters operations) by multinational financial services firms from London to cities within the EU. The UK's departure from the EU will also weaken substantially its ability to influence the direction and drafting of EU rules in relation to financial regulatory matters, an area in which the UK historically has been very active and often persuasive.

Since 1999 the EU has implemented a series of regulatory initiatives designed to develop a "single rulebook" for the EU banking, insurance and investment sectors, and to develop a framework that facilitates cooperation among national regulators in relation to financial services firms that are operating in multiple EU countries. As a result of these initiatives, financial services firms authorized in one member state (their home state) are able to carry on business in all other member states without the need for separate authorization, a process called "passporting." It will be critical to UK-based financial services firms that they continue to operate under this passport system, so as to avoid duplicative regulation of their operations within Europe. This may be a challenge, however, as services – and particularly financial services – are not covered by any of the most likely models for the post-Brexit UK-EU relationship, and one can anticipate a number of contentious issues that may arise in any attempt to negotiate a stand-alone agreement dealing with financial services.

Most of the UK's laws relating to financial services are now rooted in EU directives or apply by reason of EU regulations. To date, the UK has played a very active role in structuring and drafting these laws within the EU's rule-making processes. The result of Brexit may be to put UK financial services sector in the highly undesirable position of having to agree, in any UK-EU financial services accord, to continue to follow EU directives and regulations, while having either no, or sharply diminished, influence over their terms.

If the UK is unable to negotiate a bilateral agreement in relation to banking, insurance and/or other financial services, financial sector companies may need to obtain a "passport" based on a company and operations in another EU country. Beyond the legal restructuring that this will entail, this is likely to cause some firms to relocate from the UK, or to move overall or regional headquarters and/or back office staff from the UK to an EU jurisdiction. (Recent press reports suggest this is a process that is already beginning.) Related issues under, for example, the recast Markets in Financial Instruments Directive (MiFID) directive and regulation, the European Markets Infrastructure Regulation (EMIR) and data privacy laws may provide further incentives to relocate or shift operations. The uncertainty regarding these matters is likely to last for some time, and may result in global firms relocating staff or operations in anticipation of Brexit long before it is clear whether those moves will be necessary.

One factor that may ameliorate the risk to UK-based financial sector firms is the fact that many EU financial services laws are derived in large part from international standards agreed by global bodies of which the UK is a member, such as the Financial Stability Board and the Basel Committee on Banking Supervision. Both the EU and the UK will remain bound by such standards (including also those adopted by the G20, the International Organization of Securities Commissions and the International Association of Insurance Supervisors). The reduction in the UK's ability to influence the instruments implementing international standards into EU law will, however, be undesirable.

Private equity

Although many private equity fund managers have criticized the cost and complexity of complying with the Alternative Investment Fund Managers Directive (or AIFMD), the regime provides the ability for EU alternative fund managers to market funds throughout the EU. Unless a bilateral agreement to the contrary is reached, following Brexit, UK alternative investment fund managers are likely to be treated as non-EU managers and therefore may only able to market to EU investors under national private placement regimes. There is an expectation that the passport regime for alternative asset managers will be extended to non-EU managers domiciled in jurisdictions in respect of which the European Securities and Markets Authority (ESMA) has made an equivalence assessment. As a practical matter, this may mean that UK regulation of alternative investment fund managers will have to remain aligned with the AIFMD and its implementing rules.

M&A deal structuring

In recent years the UK has been recognized as a good place to select as the jurisdiction to locate the parent in a European group, in part because of EU directives that ensure that intra-group dividends, interest and royalties may move free of withholding taxes. Although the UK has an extensive network of double-tax treaties and an income tax treaty with each EU member state, not all treaties provide for 0% withholding and several are less protective than the equivalent provisions under the relevant directives. As a result, the attractiveness of corporate structures with an English parent company may be reduced by Brexit. Those planning new investments may therefore wish to select a different EU jurisdiction for this purpose, and in appropriate situations consideration should be given to migrating an existing English company parent structure into another EU jurisdiction.

EU law in relation to the acquisition of listed companies has been largely harmonized as a result of the Directive on Takeover Bids adopted in 2004 and subsequently implemented by conforming legislation in every EU member state. The possibility of cross-border mergers was facilitated by a directive adopted in 2005. The Takeover Bid Directive was based primarily on the UK's Takeover Code, so the exit of the UK from the EU is unlikely to have any immediate impact on takeover laws in either the UK or the EU. On the other hand, as the cross-border merger directive applies only to mergers between companies from different EU countries, it appears that after the UK leaves the EU, English companies would no longer be able to take advantage of that directive to merge with EU companies.

Capital markets

Brexit is likely to lead to significant market volatility in the capital markets, particularly for UK and other European issuers. Companies considering accessing the markets are likely to face challenges given the

concerns of investors driven largely by the uncertainty that the referendum has produced. Those with any choice are likely to postpone capital raising activities.

Companies with public reporting obligations will need to consider quickly whether they need to make public statements as to the implications of, or risks surrounding, Brexit and its impact on their business and financial performance. Companies with US reporting obligations should also expect comments from the Securities and Exchange Commission on their quarterly or annual filings as to whether they have considered the impact of Brexit on their financial condition and results of operations.

The EU capital markets regime already provides the potential for 'passporting' from a non-EEA prospectus regime if it is determined to be equivalent to EU requirements (which should be the case at the time of Brexit). The UK historically has been a thought leader on EU capital markets regulation, having had a significant hand in shaping the directives and regulations that today underpin the EU capital markets regime. As a result, it seems likely that equivalency would continue for the foreseeable future, mitigating risk in this area. The more awkward question is whether the UK will still be able to play as influential role in any evolution of the prospectus and other capital market rules after it is no longer part of the EU.

Dispute resolution

English law is often selected in international contracts, in part because it is the standard choice in many financing contexts and because it is a standard compromise in contracts between parties from different EU countries. An explicit choice of English law will be respected throughout the EU as a result of the so-called Rome I regulation, and the selection of English courts to resolve a dispute will be respected throughout the EU under the recast Brussels Regulation. Upon its withdrawal from the EU, these regulations would cease to cover the UK, unless the UK separately accedes to them by agreement. Enforcement of UK judgments in Europe might then become somewhat less certain. The UK may, however, mitigate or eliminate this risk by becoming a party to the Lugano Convention 2007 and/or the Hague Convention on Choice of Court Agreements 2005. In light of the importance of this issue to UK financial institutions and law firms, it should be assumed that the UK will take timely and appropriate steps to ensure the continued attractiveness of English choice of law and courts. It may be, however, that the propensity of parties to agree to English law as a compromise EU law will decline to some extent if the UK is no longer part of the EU.

Brexit should have no impact on the selection of London as the seat of arbitrations. The enforcement of arbitral awards is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which will continue to apply both in the UK and in each member state of the EU, regardless of a Brexit.

Insolvency and restructuring

More complicated questions may arise in relation to the enforcement of other judgments, including those arising in insolvency proceedings or financial institution resolutions. Within the EU, the Regulation on Insolvency Proceedings, the Credit Institutions (Reorganization and Winding Up) Regulations 2004, the Insurers (Reorganization and Winding Up) Regulations 2004 and the Cross Border Insolvency Regulations 2006 are all directly applicable in EU member states, but would cease to apply within the UK upon its exit from the EU. Although judgments in insolvency proceedings in the UK might be enforceable in other EU member states, and vice versa, in accordance with the Lugano Convention and/or national legislation in relation to cross-border bankruptcy proceedings, without an agreement to the contrary the reciprocal enforcement afforded by these regulations would no longer apply.

Similar issues might arise in connection with the enforceability of schemes of arrangement, as the European Judgments Regulation would no longer apply and enforcement across the EU would therefore need to rely on national rules of private law or perhaps the Lugano Convention.

In addition, the harmonization of European insolvency laws is currently under discussion, and proposals for minimum standards throughout the EU may be put forward later this year. By leaving the EU, the UK is likely to lose its seat at the table in the development of these proposals. In light of the central role played in the past by UK insolvency professionals in the development of EU law in this area, their absence going forward is likely to be unfortunate.

Uncertainty

Britain today faces an unprecedented domestic political and constitutional crisis. Both the Conservative and Labour parties are in disarray. The Conservatives must appoint a successor Prime Minister, while the leader of the Labour Party is facing increasingly strident calls to resign. Until a new Prime Minister is appointed, no action under Article 50 will be taken. Political leaders in Scotland and Northern Ireland are weighing their options. Leaders in the EU are expressing a range of positions, some urging a speedy notification, others calling for a calm and considered process.

International and British financial institutions, companies and investors, as well as expatriates in the UK and UK nationals resident in the rest of the EU, are seeking in this confusing environment to assess the potential consequences of an event that until recently seemed hypothetical and remote. While many of the consequences will be triggered only when the UK actually withdraws, the magnitude of those consequences means that planning must begin immediately, and the uncertainty regarding the future may be as destabilizing as the outcomes themselves.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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