Q3 Commercial Forecast: Brexit Edition

June 2016

Welcome to the Summer edition of our Commercial Forecast.

Our forecasts help our business clients stay in the know about legal developments that might affect them and the markets in which they operate. For this edition we have focused on the outcome of the Brexit referendum and some of the legal issues that arise. There is a lot of uncertainty at the moment and it likely to take some time before the new normal emerges. With the benefit of our long and stable history we are well placed to take a measured and long term view of such momentous changes. We also benefit from having experts in the areas we believe are most likely to be affected so please do get in touch if you need our help or would like to discuss the challenges that may face you.

As the story evolves we will be keeping in touch with clients and our articles will be available on our website. Experts from across the firm will also be preparing briefings and events on Brexit related themes.

Brexit and Intellectual Property Rights

Intellectual property law is one of the areas of domestic law that has been most re-shaped by EC and subsequently EU membership. There are two aspects to this re-shaping:

- the creation of unitary EU rights with effect across the EU, such as EU Trade Marks and Community Designs.
- harmonisation, whereby UK copyright, design and trade mark laws have been amended in light of a succession of Directives – the UK Trade Marks Act 1994 is, substantially, a harmonised law, and the Copyright, Designs and Patents Act 1988 has been amended in light of at least 17 Directives affecting different elements of copyright law.

What will happen to harmonised legislation post-Brexit?

What happens will depend on how the relationship between the UK and EU will be re-structured following Brexit.

Broadly speaking, harmonised legislation will remain on the statute book until amended or repealed. It is unlikely that legislation would diverge rapidly from EU law. UK case law has, to date, interpreted harmonised legislation in line with EU law and subject to the overriding decisions of the Court of Justice of the EU (**CJEU**). Depending on the model of UK/EU interaction which emerges, CJEU decisions may (at one end of the spectrum, eg EEA membership) retain their binding authority, as most Directives apply to the EEA; or (at the other end, eg a complete break with the single market) cease to have any binding effect. In the latter scenario, we can expect EU and domestic case law to begin a gradual divergence, and potentially challenges to certain authorities handed down over the past 15 years (since the 2001 Copyright Directive). Legislation might be re-cast, for example, if there is pressure from certain industries to seek a more favourable position under UK law.

What will happen to unitary EU rights post-Brexit?

In terms of the unitary EU rights (principally EU Trade Marks (**EUTMs**) and Registered Community Designs (**RCDs**)), the UK has at least two years more as an EU member (even if Article 50 TFEU is triggered), so these will remain valid in the UK until at least June 2018. Unitary IP rights would, however, cease to have effect in the UK from the date of the UK's exit, bar any transitional provisions saying otherwise. While it remains to be seen exactly what transitional mechanism might be used, the hope is that once the UK has left the EU there will be a way to convert the UK 'coverage' of EUTMs and RCDs into separate UK registered rights. The most favourable outcome, from rights holders' perspectives, would be for this to happen automatically at no extra (or nominal) cost, with continuity of protection. But nothing is certain at this stage. There is likely to be an increase in the costs of Europe-wide protection post-exit because new applicants seeking protection in the UK and EU will henceforth need to register their rights separately in each territory.

How will Domestic Intellectual Property Rights be affected?

Some UK intellectual property has remained entirely domestic in character. This is the case with the law of 'passing-off' which protects unregistered trade marks from use which confuses the public and damages goodwill. This remains unaffected. The law on trade secrets also remains largely domestic (UK law already being largely compliant with a recent EU Directive).

European Patent Office, European Patent Convention and the Unitary Patent.

Some intellectual property rights stand outside the system of EU law: the UK would continue to participate in the European Patent Office and be a signatory to the European Patent Convention. However, the new Unitary Patent system, which is only applicable to EU member states, requires UK ratification, and the existing agreement is therefore likely to need to be re-written.

Finally, Brexit may have an impact on exhaustion of rights rules if the UK left the EEA (as well as the EU). Trade mark and design right owners would no longer be prevented from relying on their rights to restrict imports from the UK into the EU (or vice versa).

We are monitoring developments closely and will report further, as exit negotiations evolve.

For further information please contact David Copping.

Brexit and Employment Law

Now the UK has voted to leave the European Union, businesses and employment lawyers alike are questioning what impact this vote might have on our existing employment protections - after all, much of our employment law is derived from or interpreted in accordance with EU law (particularly in relation to discrimination, working time, collective rights, agency workers... the list goes on). The short answer is that until the nature of our exit is determined, it is business as usual.

In our view, rather than a radical overhaul of our current legislation post-Brexit, it is likely that a softer approach will be taken – simply revising the existing regime to make some of the more unpopular rights more palatable to business. A few of the possible targets and examples for reform might include:

- TUPE – making it easier to harmonise terms post-transfer and/or reducing

protective awards.

- Working Time – limiting what must be included in the calculation of statutory holiday pay and/or how the accrual/carry-over of leave is dealt with.
- Agency workers – this is an area where we may see complete revocation of the existing Regulations – which have proved extremely unpopular with businesses.
- Discrimination – the introduction of caps on compensation levels and/or qualifying periods (similar to unfair dismissal awards).

Obviously, another key aspect of the post-Brexit landscape will be the impact on the current free movement of people with the EU, both on UK nationals working elsewhere in the EU and UK employers who work with EU nationals. Immigration is a highly emotive subject and one that was a divisive issue in the Leave v Remain campaigns. It is hard to see how any ongoing trade arrangement with the EU could ignore this freedom (and the difficulties that will be faced by global organisations who employ individuals throughout Europe), but it remains to be seen how this issue (and indeed all the issues) will be negotiated. For further information on the Immigration issues highlighted by Brexit see here.

For further information please contact Claudia Rooney.

Brexit and Property Law

Given the current uncertainty, the good news is that a large amount of UK property law is domestic and will not in itself be affected by a British exit from the EU. Commercial and residential property sales and acquisitions, and the associated management work that follows, will continue much as before, although the market in which we operate may well be different.

How will environmental and agricultural law be affected?

The same may not be quite so true of environmental and agricultural law, where much of the relevant legislation originates from the EU, whether directly or through UK Acts responding to EU Directives. Given the nature of the issues at stake, public opinion may persuade the government to retain many of the existing environmental laws and encourage continued British co-operation with the EU on this emotive subject. That said, many will argue that the government could usefully simplify the existing environmental regime and urge that it seeks change in this area. By contrast, the Common Agricultural Policy is of course very much a creature of the EU, and agricultural markets, including land, will no doubt face a significant adjustment in the near future. Some form of British agricultural subsidy may follow.

How will the property market be affected?

The property market as a whole will no doubt be affected, at least temporarily, by the general uncertainty that now exists. We have already felt the tremors in the UK commercial property investment market. If this had slowed to a crawl before Brexit, it is in danger of stalling altogether – at least in the short term. Lenders may also be reluctant to provide finance in turbulent times. International businesses may choose to relocate elsewhere, and any dip in the economy could lead to a drop in property prices (although London appears to have weathered recent storms rather well compared to other areas, so perhaps it can do so again).

Conversely, and more positively, those who hold money in currencies other than

sterling may be inclined to capitalise on the temporary low by investing in the UK now, albeit possibly for short-term rather than long-term gains. As demand for UK property has remained high for some time, perhaps we should not be overly concerned about a decline in prices.

How will planning laws be affected?

Whether the supply of UK property will be able to keep up with demand remains to be seen. Planning considerations draw heavily on environmental impact assessments, so the planning process may be adversely affected. Developers will be reluctant to invest money in applications if there is to be an overhaul of the statutory regime. The change in the Conservative Party leadership casts doubt over plans to expand Heathrow Airport and other major regeneration projects could face delay.

How will the construction industry be affected?

The construction industry may, in the long term, be affected by any restrictions on the free movement of people from Europe, dependent as it is on migrant workers. This, together with any trade barriers affecting the supply of materials, may make running a construction business more costly (although on balance, trade barriers in respect of materials are probably unlikely). On the other hand, EU procurement rules have been seen by some as unnecessarily burdensome, and if these will no longer apply, some developers may benefit from increased flexibility. The Government may step in to offer a simplified procurement regime in the UK.

In short, while there will be concern across most sectors of the UK property market we think there are also reasons to be cheerful. Once the temporary uncertainty has subsided, we may find ourselves with a property market not radically different to the one we have now – and it may just be bound by a little less red tape.

For further information please contact Andrew Bailey.

Brexit and Competition Law

The substantive law found in the UK Competition Act (and Enterprise Act) and the Treaty on the Functioning of the EU is essentially identical so, with the exception of State aid, the legal tests to apply to anti-competitive behaviours – certainly where cases have only a national dimension – would likely not change once the UK leaves the EU (in the short term, at least).

However, section 60 of the Competition Act provides that UK rules are to be applied in accordance with European jurisprudence, which creates a potential problem to be 'untangled' when the UK leaves the EU (depending on the new model for the UK's relationship with the EU and the effect which EU laws generally will have under that model).

In practice, UK companies will need to continue to comply with EU competition laws if they wish to secure ongoing access to the European market. Moreover, the European Commission regularly reviews mergers between non-EU parties where there is a significant EU dimension to their trading and turnover, and issues fines to non-EU cartel operators where they have sold their goods or services into the EU. That means that the European Commission's competition decisions will still be highly relevant for British businesses.

The future of State aid rules remains uncertain. On one level, as a creature purely of EU law, State aid rules would come to an end on a departure from the EU. However, they would remain largely unchanged if the UK remained in the EEA or joined the

EFTA. The State aid rules in the EEA Agreement are broadly equivalent to the state aid rules in the EC Treaty and which apply across the EU. On the other hand, if the UK were to be outside the EEA and EFTA altogether, then they would cease to apply. It remains to be seen whether a domestic version of State aid law would be enacted – this would be a political decision, perhaps reflecting the desire to enable the government to support domestic industries or businesses.

For further information please contact David Copping.

Brexit and Jurisdiction Clauses

What is a jurisdiction clause?

When negotiating a contract, parties can agree in advance which court will deal with future disputes between them, and then record that agreement in the form of a jurisdiction clause. This can be "exclusive" or "non-exclusive". Put very broadly:

- An exclusive jurisdiction clause provides that future court proceedings must be heard by the courts of a single named state.
- A non-exclusive jurisdiction clause lists a number of named states, and potentially permits parties to pick one of those jurisdiction or to bring concurrent proceedings one or more of those named states.

In either case, the parties benefit from the certainty of knowing where disputes arising in relation to the contract are likely to be determined.

The Pre-Brexit Position

Pre-Brexit, the Recast Brussels Regulation EU 1215/2012 (the "**Brussels Regulation**") bolstered this certainty.

So, for example, where a clause provides for the exclusive jurisdiction of a Member State court, the Brussels Regulation prevents other Member States from challenging that jurisdiction. Furthermore, the judgment of a Member State's court will be recognised and enforced by another Member State, as if the decision had been made in its local Court. This is important because it gives greater strength and commercial value to an English Court judgment, as it can be enforced relatively easily not only against assets in the UK but also those elsewhere in Europe.

In the case of **non-exclusive** jurisdiction clauses, the Brussels Regulation adds certainty by stipulating that, if proceedings are brought first in the courts of Member State A, then the courts of Member State B cannot entertain the same causes of action and must stay any proceedings there at least until the courts of Member State A have decided whether or not they have jurisdiction.

The Post-Brexit Position

As Britain negotiates an exit from the EU, the impact on jurisdiction and enforcement in cross-border cases will need to be considered - both when negotiating contracts and in the context of litigation strategy. The key issues to bear in mind are:

- The ability for parties to negotiate the terms of their contract and to determine the governing jurisdiction in the event of a dispute is unlikely to change of itself.
- Traditionally the English legal system has been respected for its widely perceived

independence, reliability and commerciality. Despite the financial and political uncertainty post-Brexit, England is likely to remain a popular forum for the resolution of commercial disputes.

- However, post-Brexit, there can be no guarantee that other Member States will agree to continue to recognise and enforce English judgments. Indeed, there is potential value in foreign courts undermining the strength of the English Court's judgments, if it means other Member States have the opportunity to attract litigants to their jurisdiction over England, since the lucrative nature of foreign court proceedings has become increasingly apparent in recent years.
- It seems likely that there will be some uncertainty as to how a 'jurisdiction race' will be resolved where proceedings are issued concurrently in England and in a Member State. As such, there may be a potential increase in so-called "torpedo litigation" where a party who, for tactical reasons, does not wish to submit to the jurisdiction of the English Court, files proceedings another Member State's courts in an attempt to delay proceedings, or to open up the battle on a new front, adding to the cost and uncertainty of litigation.
- In the absence of the European regime, England may have to revert back to common law principles on jurisdiction, which have the potential to conflict with the Brussels Regulation.
- Given the degree of uncertainty over questions of jurisdiction and enforcement, we may see a trend towards parties opting for arbitration clauses in contracts, because arbitral awards are widely enforceable by virtue of the 1958 UN Convention on Enforcement of Arbitral Awards.

For parties who are entering into contracts post-Brexit, careful thought therefore needs to be given to the inclusion of a jurisdiction clause, and the drafting of that clause. If the parties choose to submit to the English court's jurisdiction, consideration will also need to be given as to whether or not a defendant's assets against which a judgment might be enforced are located in England or elsewhere.

For further information please contact Kate Allass.

Brexit and Financial Services Regulation

The EU Referendum result will have a significant impact for financial institutions as so much financial services regulation has an EU dimension. The regulatory landscape we end up with will depend on the nature of the agreement reached with the EU, including whether or not the UK negotiates membership of the single market. We set out below a summary of certain key areas for our clients to consider.

What is the impact on forthcoming EU legislation?

Until we withdraw from the EU we are required to implement EU Directives and subject to the EU Regulations. In relation to forthcoming EU legislation (such as MiFID II) firms should continue with implementation as planned as confirmed by the FCA in a statement released shortly after the Referendum result.

Will there be any relaxation in regulation?

In practice any relaxation of regulation is unlikely. Many EU laws impacting the financial services sector are global initiatives following the financial crisis, with the UK government closely involved in many of these initiatives.

Further in order to gain access to the single market the UK may want to be considered to have “equivalent” standards meaning that the scope for any relaxation of regulation is limited. However, an opportunity arises for the UK to implement financial services legislation, which while equivalent to the EU, puts the stability and prosperity of the UK's financial services sector at its core.

What will be the impact on passporting rights?

Once the UK leaves the EU our passporting rights as an EU Member State will cease; unless we re-join the EEA or otherwise conclude an exit deal which retains them. Without passporting rights firms would need a local subsidiary in the EEA state adding to the costs and complexity of doing business.

However, certain recent EU Directives have provisions allowing access to the EU market for non-EU firms where the regulatory regime of such country is considered "equivalent" to the EU (third country passports). Seeking to be regarded as "equivalent" may well form a key part of the UK's negotiations.

What is the impact on investment funds?

UCITS will face particular issues. The UCITS directive does not contain an equivalence regime for third country firms; UCITS must be domiciled in a Member State and self-managed or managed by an EU manager. Therefore unless otherwise agreed in the exit deal, existing UK UCITS would need to be redomiciled or cease being UCITS. Further, the ability of UK banks to act as depositaries of UCITS following the UK's exit from the EU needs to be negotiated. Investment restrictions for UCITS funds will also need to be addressed.

AIFMD however envisages a third country passporting regime for non-EU Member States from equivalent jurisdictions (although this has not yet been implemented), potentially this status could be negotiated for UK AIFMs, and UK depositaries.

A commitment to the importance of the City to the UK's economic stability and future prosperity is clearly required in the exit negotiations. Membership of the EEA would, we believe, provide continuity and clarity for the financial services sector however at this stage it is not certain whether this is the government's preferred approach. Whether there will be scope to implement amended legislation which is more practical for UK firms as part of that process is unknown but a potential opportunity for the financial services sector. We shall be working closely with our clients and industry bodies to assist in a positive outcome from the forthcoming negotiations.

For further information please contact Grania Baird.

Brexit and Data Protection

A question of substantial interest to UK business is whether the General Data Protection Regulation (GDPR) will still come into effect, and what it will mean if it does not.

The EU-wide GDPR "start date" is already marginally ahead of the two-year transition allowed for by the exit process under Article 50 of the Lisbon Treaty, even assuming notice were given tomorrow. However, it would be a very odd outcome for any government to allow a brief period where the legislation was directly effective on all UK business and then dropped for good.

It is more likely that Parliament’s transitional arrangements will either incorporate

GDPR into domestic legislation, as a vital component to trading within the EEA, or consider amending the existing Data Protection Act 1998 (DPA) to reflect the heightened legal standard in important concepts such as consent, data subject rights and so on – and hence seek to meet the EU's "adequacy" requirements under domestic law. The DPA remains effective, despite its origin in a European directive, a point the ICO was keen to make in its statement on Friday.
If nothing is done by legislators on data protection, perhaps owing to an extended negotiation period, or if Britain remains a *de facto* Member State for some time yet (owing to an ongoing failure to notify under Art.50), it is possible that GDPR would still take "direct effect" on 25 May 2018. Any divergence from that standard might then follow gradually, assuming there is any appetite for it, over the course of the decade that some are predicting the process will take.
Conventional wisdom therefore persists that the direction of travel for data protection law in this country is towards the GDPR standard. It was always true – remain or leave – that those wanting to do business in the EEA would need to be compliant, either by law or under some private agreement, and hence for simplicity it seems probable the domestic legal standard will be brought in line. The UK would not wish to be on the wrong end of a Schrems-style judgment by the CJEU (the case that did away with "Safe Harbour" in US/UK data transfers).

Thus it would be wrong to assume that the Brexit vote marks a turning of the tide in data protection law. That door of possibility is now ajar if a future administration decides that doing away with "red tape" and "box ticking" is more important for our economy than aligning our position with Europe: but although organisations will be forgiven for holding back business-critical decisions until there is greater clarity, an unpanicked phasing-in of GDPR standards remains a sensible approach for data controllers.

For further information please contact Owen O'Rorke

Brexit and VAT: Will there be major change or minor tinkering?

The UK adopted Value Added Tax in 1973 as one of the conditions for its entry to the Common Market. Even at the time the UK was unhappy with the level of tax harmonisation imposed by VAT and negotiated derogations for certain goods and services which were zero-rated. Ironically, these were permitted as a "transition measure".

Brexit provides the UK with an opportunity to completely revise VAT. However seemingly attractive, a wholesale revision is improbable for the following reasons:

- *Revenues* – VAT accounts for approximately 20% of the UK Exchequer's total tax receipts with 2016/2017 projected revenues of £120.4billion.
- *Business neutral* – As a consumer tax, VAT can be significant for businesses' cash-flow but not for their bottom line.
- *Accepted worldwide* – More than 130 countries (but not America) have adopted a VAT-equivalent tax albeit mostly at lower rates than those applied within the EU.

More likely is that the UK would use Brexit to:

- interpret national VAT law with less regard to European court rulings;
- rectify some perceived injustices and oddities of the VAT system (eg VAT costs for charities and some investment funds); and
- boost consumption by restoring zero-rated supplies (eg on domestic fuel and

power).

Regardless, a fundamental change in the UK's relationship with the EU would necessarily involve:

- a revision of VAT invoice and reporting protocols for cross border supplies; and
- changes in VAT accounting, in particular for certain industry sectors (eg the tour operators' margin scheme and the Mini One Stop Shop for B2C digital services).

For further information please contact Charlotte Black.

Tell me more...

If you'd like to discuss any of these issues further, please contact the authors or speak to David Fletcher on **020 3375 7117** or email him at david.fletcher@farrer.co.uk.