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## **Brexit: Britain Formally Enters Uncharted Waters**

Nine months after the British voted to withdraw from the European Union, Prime Minister Theresa May has provided formal notification of the country's intention to begin the mandated two-year period of negotiation to effect that withdrawal, as prescribed by the 262-word Article 50 of the Treaty of the European Union.

We set out below our thoughts on where this project is headed, with no pretense of being able to predict what ultimately will happen or when. Any attempt to foretell the ultimate outcome of the withdrawal process even nine months after the referendum is fraught with significant uncertainty. There simply are so many variables to consider and so many different challenges to achieving what, for the United Kingdom, will be the most significant political undertaking since the Second World War. From the perspective of many, the stakes for the United Kingdom, including whether the union comprised of England, Wales, Scotland and Northern Ireland will remain intact, and for the rest of the European Union (the so-called EU27), could not be greater. The withdrawal process envisioned by Article 50 was never intended to reward any member state wishing to leave the EU; those remaining have every incentive to preserve the union by limiting the attraction of departure, and the two-year timetable favors the bargaining position of the EU27 (as it was intended to do).

### **Nine Months in the Making**

The shock of the victory for the Leave campaign was followed by an intense period in Westminster as a new government formed around Theresa May, who emerged victorious from the snap leadership selection process following David Cameron's resignation. For much of the balance of 2016, the focus was on creating new departments to lead the Brexit effort, and on giving effect to the mandate of the 52% to launch that effort. On June 24<sup>th</sup> there was no plan and very little public appreciation of the magnitude of the endeavor and the consequences of departure; much of that uncertainty continued well into 2017.

The government's initial strategy of triggering Article 50 without Parliamentary approval – in spite of the fact that the rallying cry for many Brexiteers was the repatriation of sovereignty to Westminster Palace – hit a roadblock in November when the High Court ruled against the government in a decision, affirmed by the Supreme Court in January, holding that the government needed Parliament's authorization to give notice of its intent to withdraw from the EU.

Denied the ability to exercise its royal prerogative, the government drafted a tersely-worded Brexit bill, which authorized it to begin the process of withdrawal. Within six days of the Supreme Court's ruling, the House of Commons voted overwhelmingly in favor of the bill: by 498 votes to 114 the bill passed with no

amendments to the upper chamber of Parliament, where the ruling Conservative Party lacks a majority. Peers introduced two amendments to the bill: the first was intended to assuage the fears of EU nationals living in the UK, seeking to assure them that they will retain their rights after Britain leaves the bloc, and the second called for Parliament to have a meaningful vote on the final terms of the withdrawal. The lower chamber rejected both amendments. The Peers, some citing their status as unelected legislators, conceded.

### **The Article 50 Process Kicks Off**

The Prime Minister formally launched the Article 50 process on March 29<sup>th</sup> with a letter addressed to the European Council President Donald Tusk notifying him of the UK's intention to withdraw from the EU and from the European Atomic Energy Community. As a practical matter, the process will involve the negotiation of two separate arrangements: a withdrawal arrangement and a future trade arrangement. When Michel Barnier and David Davis, lead negotiators for the EU and Britain, respectively, first sit down together (likely at the end of May), they will be faced with the task of organizing the negotiation process and condensing it to fit within the mandated two years, failing which the process is extended by unanimous agreement of the EU27 or the UK "crashes" out of the EU.

After agreeing on procedure, both sides are expected to focus on the institutional and financial consequences of leaving, border arrangements for Northern Ireland (which will become the UK's only land border with the EU), the status of British citizens living in the EU and of EU nationals living in the UK, the structure of the UK's future relationship with EU regulatory bodies, the status of ongoing police and judicial cooperation and on a clear framework for UK-EU trade. Over the course of the past few months, the government has talked of special carve-outs for specific industries – automotive and financial, in particular – though these might breach World Trade Organization (WTO) rules, and EU representatives have already communicated their resistance to sectoral "cherry-picking." It will be, as the Prime Minister wrote in her letter, a "momentous task." Member states of the EU27 can reject the withdrawal agreement but cannot prevent the UK from withdrawing from the EU at the end of the two years.

In her letter, the Prime Minister stressed that the British government's principal desire is to maintain a "deep and special partnership" with the EU27, in spite of leaving the single market and most of the customs union, though maintaining through a new free trade agreement access for selected sectors. The Prime Minister called for agreeing to the terms of the future relationship with the EU alongside the terms of the withdrawal, but conceded that if the British were to leave the EU without an agreement, Britain would need to fall back on WTO rules to govern trade relations with third countries. A reference by the Prime Minister to a weakened ability to cooperate in the fight against crime and terrorism should the parties fail to reach agreement prompted a response from the European Parliament's Brexit coordinator, Guy Verhofstadt, that members of the European Parliament would not look kindly upon the use by the UK of military and intelligence cooperation as a bargaining chip.

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### **The EU Responds**

A European Parliament resolution leaked the day of the Article 50 notification called for adherence by EU negotiators to a series of general principles (which are not binding, but the European Parliament approval of the withdrawal agreement will be required), including that any trade agreement between the UK and the EU could only be concluded once the United Kingdom has withdrawn from the EU; a transitional deal to ensure that custom controls and barriers on trade are not enforced immediately could not last more than three years, and during the transition period, the European Court of Justice would have jurisdiction over legal disputes, while the UK would be able to revoke the Article 50 notice, revocation would be “subject to conditions set by all EU27 so they cannot be used as a procedural device or abused in an attempt to improve the actual terms of the United Kingdom’s membership; the cut-off date after which EU nationals coming to the UK lose the automatic right to residency in the UK must not be before March 29, 2019; the British should pay liabilities “arising from outstanding commitments as well as make provision for off-balance sheet items, contingent liabilities and other financial costs that arise directly as a result of its withdrawal”; and there could be no “trade-off between internal and external security including defence cooperation, on the one hand, and the future economic relationship, on the other hand.”

On a day that the Prime Minister noted was “a celebration for some and disappointment for others,” the contents of the letter and the legislative response underscored the deep divide that already separates the British government from its EU partners.

The following day the UK government released a white paper detailing its plans on legislating for the UK’s withdrawal from the EU (the Great Repeal Bill). The Bill will be introduced in the next parliamentary session, but must be finalized by March 2019. It will annul the 1972 European Communities Act and convert all existing EU laws into UK legislation for subsequent discussion and amendment. Some changes will be minor; others will be substantial, and might even require the creation of a new British regulatory regime in the model of its EU predecessor. Immigration, customs, trade and agriculture are all expected to be subject to substantial revision. There are almost 19,000 EU legislative acts in force, and working through them individually would quickly exceed the allotted two-year negotiation period. According to accompanying guidance, individual ministers will be authorized to amend or repeal entire parts of legislation without significant legislative scrutiny by using so-called “Henry VIII powers.” There is some concern that this would allow ministers to make major policy shifts without public input or approval, and ministers will be under pressure in the coming weeks to prove that they will have realistic checks on this power. It is important to note that the process of incorporating EU law into UK law, itself a complex process, will be complicated by the fact that certain sources of EU law are not legislative, such as judgments of the European Court of Justice and regulatory determinations.

Two days after Prime Minister May triggered Article 50, the European Council released its own negotiating framework, in which it set out its vision of a three-phase negotiation. During the first phase, Britain and the EU would negotiate the separation, disentangling from the financial and legal obligations

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that have bound them together since the 1970s. Only when this is complete – or, only when “sufficient progress” (in the view of the European Council) has been made – can either side begin to discuss the terms and framework for a future relationship. Should a third, transitional, phase prove necessary, the European Council stressed it must be clearly defined and consider preexisting EU “regulatory, budgetary, supervisory and enforcement” constraints.

In accompanying draft guidelines sent to national capitals, the General Secretariat of the European Council outlined nine key issues that it would seek to address during the first phase of negotiations. Many were familiar, as they were similar to those Prime Minister May addressed in her own letter on Wednesday: resolution of the status of EU citizens living in the UK and British citizens living in Europe; prevention of a “legal vacuum” for businesses operating between Britain and the EU; agreement on the value of Britain’s “legal and budgetary commitments as well as liabilities, including contingent liabilities” and protection of the peace in Northern Ireland. Others – such as in effect granting Spain a veto over questions relating to Gibraltar – were new.

The draft guidelines confirm that trade discussions could proceed once “sufficient progress” is made on the withdrawal arrangements. They state that the EU27’s primary objective in negotiating a trade deal will be to preserve the integrity of the single market, which “excludes participation based on a sector-by-sector approach,” noting that “the four freedoms of the Single Market are indivisible and that there can be no ‘cherry picking.’” The draft guidelines rule out the ability of individual EU27 member states to negotiate with the UK. Any trade agreement can only be concluded once the UK has become a “third country” (that is, once it leaves the EU). And in response to a threat to turn the UK into a tax haven if no deal is reached, the draft guidelines call for “a level playing field in terms of competition and state aid” and “safeguards against unfair competitive advantages through ... fiscal, social and environmental dumping.”

The European Council’s draft guidelines will now be reviewed by the governments of the EU27 before the bloc’s full negotiating stance is formalized at a summit on April 29. The European Commission will then draft more detailed negotiation instructions, which would be submitted for approval by ministers on May 22<sup>nd</sup>. Once the guidelines are approved, the EU27 must formally nominate the European Commission as the lead negotiator; then negotiations can begin. It is reported that the talks will begin in late May or early June. Michel Barnier is reported to have said that he hopes that the broad outlines of the withdrawal agreement can be reached at a summit in December, allowing negotiations over the trade relationship to commence in January 2018. Article 50’s two-year deadline is March 29, 2019, and the Prime Minister wishes the exit to precede the British elections in 2020.

### **Preserving the Union**

As the UK government grapples with the procedural and administrative aspects of leaving the EU, pressure on its own union grows. The Supreme Court, in affirming the High Court holding that

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Parliamentary approval of the Article 50 notification was required, ruled that the government was not required to consult with or seek the approval of the devolved Parliaments of Scotland, Wales or Northern Ireland before serving the Article 50 notice – and the government did not do so. The final deal, though, must provide clarity on the relocation of former EU powers between the UK and its devolved nations.

The Scottish parliament has backed a call by Nicola Sturgeon, Scotland's first minister, for a second independence referendum to be held before Brexit negotiations are finalized. Scotland voted 62%-38% to remain in the EU and, though its economy is weaker now than it was two years ago, Sturgeon is steadily becoming the political face of the Remain opposition. Sturgeon wrote to the Prime Minister following the delivery of the Article 50 notice requesting talks on a referendum; technically the referendum requires the approval of UK government, the UK Parliament and the Scottish Parliament. Any desire for a referendum has now been complicated by the sequence of events contemplated by the EU27 timetable. The hard-won seamless border between Ireland and Northern Ireland (where nearly 56% voted to remain in the EU) will also need to be addressed when Britain leaves the EU. Recent assembly elections suggest that support for unification has grown since last May; in her letter on Wednesday, Prime Minister May stated her intention to avoid a return to the hard border.

### **Why “no deal” is Possible**

By March 2019, there may well be no deal between the UK and the EU27. Both sides have entered the negotiations following an acrimonious nine months that have seen the simultaneous success of anti-globalization forces in the United States and the increasing relevance of far-right Eurosceptic candidates in France, Germany and the Netherlands. Hanging over the EU negotiators will be existential questions concerning the fate and future of their European experiment. For the British government, the Remain camp's resigned and lukewarm acceptance of Brexit means UK negotiators will enter negotiations with fractured domestic support.

A report by the House of Commons Foreign Affairs Committee emphasizes that Britain in effect will not be negotiating with the European Union as a single body: it is set to negotiate with the 27 remaining EU member states, each of which has its own domestic constraints and, at least in the case of France and Germany, its own elections to consider this year. Depending on the electoral outcomes in both those countries, Britain might be faced with a sudden change in negotiating partners or tactics.

Unity among the EU27 is also a key fracture point in the coming years. In addition to the domestic considerations that restrain each member state, each will need to agree on the union's negotiating principles and tactics. If they disagree, or if they seek a retributive final arrangement, the chances for resolution within two years decrease dramatically.

One of the most contentious issues is the exit bill, more specifically the value of unpaid budget commitments for amounts that would be paid after Britain leaves the EU (which fall into two principal

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categories: project commitments and structural funds), pension liabilities owed to EU offices and contingent liabilities (such as loan guarantees). The exit bill issue ultimately comes down to money – what items are covered, what amounts owed for committed contributions and whether contributions should also include budget items beyond 2019 (that is, costs that were promised but not reflected as commitments in a budget). While a number of reports cite ranges of €40-€60 billion, negotiators are reported to recognize that the eventual bill could be reduced by budget contributions made after withdrawal as a full member during any transitional period that may be agreed. Even if Britain succeeds in structuring talks on the withdrawal bill and trade agreement in parallel, negotiations could quickly become hostile. Talks could also quickly break down should either side misjudge its potential allies or under- or over-estimate the strength of its hand.

After negotiations conclude, the final exit deal must also receive the approval of the European Council, which has its own complex system of voting: 20 countries representing 65% of the population must vote in favor of the final deal or it fails. The European Parliament will also need to ratify the agreement. If, at the end of two years, there is no deal, the negotiation period can be prolonged – but only if the EU27 unanimously agree. Prime Minister May has successfully championed the view that Parliament should have a limited choice on the final deal: take it or leave it. Had Parliament won the right to a meaningful vote, as outlined in the second House of Lords amendment, they could have obligated the government to reopen negotiations.

### **What Happens if There is “no deal”?**

The exact implications of a failure to reach a deal may be unclear – a government representative who gave testimony to the House of Lords described it as an “exercise in guesswork” – but it is relatively simple to outline the key issues. If both sides fail to settle a withdrawal deal or a transitional arrangement, there will be an ongoing dispute over the value of Britain’s financial contributions to the bloc, uncertainty for British citizens in the EU and European nationals in the UK and a sudden shift to trading on WTO terms. The sudden imposition of higher tariffs – from 5% on automotive parts to 40% on agricultural products – would affect a wide variety of industries. A report by the House of Commons Exiting the European Union Committee found that reverting to WTO terms would also lead to the reappearance of non-tariff barriers, which would mean heavier administrative requirements (more paperwork, longer delays at the border) for British and European companies wishing to conduct cross-border trade.

Britain would be forced to navigate the European regulatory landscape as a non-EU member state, and it would face legal uncertainty in areas that are not covered by the Great Repeal Bill or, if covered, do not have the necessary administrative support behind them. Britain will be a third country, no longer a partner, and the EU will no longer be obligated to recognize its standards as equivalent.

Finally, should both sides fail to reach an agreement, a hard customs border would inevitably return between Northern Ireland and the Republic of Ireland. The government has pledged to maintain a

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“seamless and frictionless” land border, but that would be difficult to do. Cross-border trade would suffer, as WTO tariffs would slow the frictionless flow of goods and services across the border, and it would significantly jeopardize the 20-year-old Northern Ireland peace process.

If there is a transitional arrangement, Europeans remain adamant that ongoing access to the single market during that period would require ongoing submission to the jurisdiction of the European Court of Justice. As an indication of how politically sensitive this all is, the government is now talking of an “adoption phase,” as opposed to a “transition arrangement” which for some connotes an open-ended period.

### **What we can Reasonably Expect in the Coming Months**

In the days immediately preceding delivery of the Article 50 letter, the British government appeared to adopt a more conciliatory approach to the negotiations. Where the Prime Minister had previously said no deal would be better than a bad deal, in her letter she stressed the importance of agreeing to a deal. The Chancellor, Philip Hammond, appeared to walk back claims that Britain would not pay its exit bill of pre-existing commitments.

As in all negotiations, the outcome will depend first and foremost on the demands of the two sides and the willingness of both to compromise. While the UK enters the negotiations with a mandate and a vision (domestic politics and the fractured nature of the body politic aside), the same cannot be said of the EU27. The continent awaits the results from the first round of French elections in April. Marine Le Pen is expected to make it to the second round in May, and a victory for her far-right National Front would energize other far-right parties in Europe. It would weaken the EU’s hand in negotiations and, in fact, call into question the future of the European experiment. Even assuming that the far right neither wins the French elections nor significantly increases its representation in the National Assembly, it is important to bear in mind that the EU27 are not, public statements notwithstanding, a monolithic bloc, with sensitive issues such as the exit bill potentially pitting the European Commission against a shifting set of policy positions among the EU27.

Successful negotiations typically are undertaken beyond the gaze of the media and the public. In view of the number of participants and the difficulty of keeping anything a secret in the best of times, let alone the more febrile political environment in which the talks are taking place, leaks can be expected – some may be sanctioned, others not. And, with the exceptions of very few, most in their candid moments will concede the enormity of what needs to be accomplished in a highly charged environment, namely, untangling fundamental relationships that have evolved over 40-plus years and touch virtually every aspect of life, and doing so in the context of clearly conflicting principles – for the UK, maintaining control over its borders, while for the EU27, not allowing the withdrawal to be viewed by as being beneficial for the British. Clearly any activity that has any cross-border aspect – from air travel, to import or export of goods, to providing services – could be impacted by the withdrawal, but so too will countless

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purely domestic activities governed by rules that have originated in Brussels or that rely on non-British citizens to function. (One estimate suggests that the National Health Service alone employs over 58,000 EU nationals, social care includes another 90,000 EU nationals, and the tech industry has been at the forefront of a campaign to maintain access to skilled immigrants.)

An optimistic target for completion of the relevant negotiations and agreements would be March 2019, though, as a practical matter in the view of Michel Barnier, this is pushed up to October 2018 given the time needed to get buy-in from the capitals of the EU27.

Many businesses will need to act more quickly than either of these two proposed deadlines allow. For example, financial service firms will need time to relocate staff and operations to the EU27 to offset the loss of passporting rights. Airlines needing an open skies agreement (which permits any EU airline to fly between any two airports in the EU) will need to begin preparing at least a year in advance due to scheduling demands, and car manufacturers will need to rethink their supply lines. These are but three examples of the unfortunate challenges facing many businesses over the next coming months.

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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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