

Brexit legal implications: the road less travelled

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On 23 June 2016, during an epic day of flooding in London and South East England, which did not deter a record 72.2 percent of voters to turn out, Little Britain decided to terminate its 43-year membership with the European Union (EU). What are Brexit legal implications that creative industries need to know about?

Now, the United Kingdom (UK) – or possibly, only England and Wales if Northern Ireland and Scotland successfully each hold a referendum to stay in the EU in the near future – will join the ranks of the nine other European countries which are not part of the EU, i.e. Norway, Iceland, Liechtenstein, Albania, Switzerland, Turkey, Russia, Macedonia and Montenegro. Of these, two countries, Russia and Turkey, straddle Europe and Asia.

What are the short-term and long-term consequences, from a legal and business standpoint, for the creative industries based in the UK or in commercial relationships with UK creatives?

The two main treaties of the European Union, which are a set of international treaties between the EU member states and which set out the EU's constitutional basis, are the Treaty on European Union (TEU, signed in Maastricht in 1992) and the Treaty on the Functioning of the European Union (TFEU, signed in Rome in 1958 to establish the European Economic Community).

The TFEU in particular sets out some important policies which guide the EU, such as:

- Citizenship of the EU;
- The internal market;
- Free movement of people, services and capital;
- Free movement of goods, including the customs union;
- Competition;
- Area of freedom, justice and security, including police and justice co-operation;
- Economic and monetary policy;
- EU foreign policy, etc.

How is the ending of those policies, in the UK, going to change and affect UK creative professionals and companies, as well as foreign citizens and companies doing business in the UK?

1. Brexit legal implications: removal of EU citizenship for UK citizens and of freedom of movement of people coming in and out of the UK

Citizenship of the EU was introduced by the TEU and has been in force since 1993.

EU citizenship is subsidiary to national citizenship and affords rights such as the right to vote in European elections, the right to free movement, settlement and employment across the EU, and the right to consular protection by other EU states' embassies when a person's country of citizenship does not maintain an embassy or a consulate in the country in which they require protection.

By voting out of the EU, Little Britain has made it difficult for EU citizens to come to the UK, as a visa or work permit may be required in the future, depending on the agreement that the UK will strike with the EU. However, it will also be much more difficult for UK citizens to travel to EU member states, for work, studies or leisure.

Probably, the majority of people in the UK who voted out of the EU do not travel much out of the UK, either for work or leisure, so there was definitely a class battle going on there, during that Brexit referendum, as high flyers and Londoners (who have to be quite wealthy to live in such an expensive city) wanted to remain in the EU, while the working class population and English & Welsh regions were firmly on the Leave side. That's democracy for you: one individual, one vote and the majority of votes always has the upper hand!

If we look at the example set by some of the other nine European states which are not part of the EU, we see that several options are available. Although Norway, Iceland and Liechtenstein are not members of the EU, they have bilateral agreements with the EU that allow their citizens to live and work in EU-member countries without work permits, and vice versa. Switzerland has a similar bilateral agreement, though its agreement is slightly more limited. At the other end of the spectrum, the decision about whether to permit Turkish citizens to live and work within member countries of the EU is left to the individual member nations, and vice versa.

So what's it going to be like, for the UK?

Time will tell but as we now know that David Cameron, a relatively “mild” member of the conservative party, will step down as the UK prime minister in October 2016, we are under the impression that his leadership will be replaced with an atypical and highly-strung right-wing and nationalistic team, probably led by hard-core conservatives such as Boris Johnson. Mr Johnson not being renowned for his subtlety and impeccable political flair, we think that negotiations for new bilateral agreements between the UK and EU as well as non-EU countries will be a difficult, protracted and ego-tripped process which may take years to finalise.

The UK will try to reduce immigration from the EU, probably with a points-based system such as the one in place in Australia. It means giving priority to high-skilled workers and blocking entry to low-skilled ones. But first, the UK will have to clarify the status of the nearly 2.2 million EU workers living in the UK. The rules for family reunions may get tougher. Also, 2 million UK nationals also live abroad in EU countries – so any British measures targeting EU workers could trigger retaliation against UK nationals abroad.

This, of course, may have an extremely negative impact on the freedom of movement of people, in and out of the UK, which may have a catastrophic impact on trade, human rights and political relationships with other states, for the UK.

Article 50 of the Lisbon Treaty, another treaty from the set of international treaties between the EU member states and which sets out the EU’s constitutional basis, relates to the rules for exit from the EU and provides that:

- “1. Any Member State may decide to withdraw from the EU in accordance with its own constitutional requirements.*
- 2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the EU 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 EU. That agreement shall be negotiated in accordance with Article 218(3) of the TFEU. It shall be concluded on behalf of the EU 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.*
- 4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the TFEU.*
- 5. If a State which has withdrawn from the EU asks to rejoin, its request shall be subject to the procedure referred to in Article 49?.*

Therefore, the UK now needs to notify its intention to withdraw from the EU to the European Council. We understand that such notification will be handed over by the new prime minister in the UK, therefore after October 2016.

The UK will have, at the latest, a period of two years from such notification date to negotiate and conclude with the EU an agreement setting out the arrangements for its withdrawal, taking out of the framework for its future relationship with the EU. After this period of two years or, if earlier, the date of entry into force of the withdrawal agreement, the EU Treaties will cease to apply to the UK.

Let's hope that the new UK government will have the ability and gravitas to strike a withdrawal agreement with the EU, in particular in relation to free movement of people coming in and out of the UK, which will be balanced and ensure fluid and constructive relationships with its fellow neighbours and main import partners.

Companies which have – or plan to have – employees in the UK, or which staff often travels to the UK for business reasons, should monitor the negotiation of the bilateral agreements relating to the freedom of movement of people, between the UK and EU member-states, as well as non-EU countries, very closely, as costs, energy and time to secure visas and work permits could become a significant burden to doing business in and with the UK, in the next two years.

2. Brexit legal implications: removal of free movement of goods, services and capital?

The EU's internal market, or single market, is a single market that seeks to guarantee the free movement of goods, capital, services and people – the “four freedoms” – between the EU's 28 member states.

The internal market is intended to be conducive to increased competition, increased specialisation, larger economies of scale, allowing goods and factors of production to move to the area where they are most valued, thus improving the efficiency of the allocation of resources.

It is also intended to drive economic integration whereby the once separate economies of the member states become integrated within a single EU wide economy. Half of the trade in goods within the EU is covered by legislation harmonised by the EU.

Clearly, the internal market and its wider repercussions have gone totally over the head of Little Britain, who wiped out 43 years of hard-won progress towards economic integration in 12 hours on 23 June 2016! “Put Britain first”, which was what the mentally ill racist and right-wing extremist shouted when he murdered Jo Cox, a Labour politician and campaigner for the rights of refugees, a week and a half ago, summarises what Little Britain had in mind, when they voted out of the EU.

Having said that, it is possible that the internal market remains in place, between the UK and the EU, as such market has been extended to Iceland, Liechtenstein and Norway through the agreement on the European Economic Area (EEA) and to Switzerland through bilateral treaties.

Indeed, the EEA is the area in which the agreement on the EEA provides for the free movement of

persons, goods, services and capital within the internal market of the EU. The EEA was established on 1 January 1994 upon entry into force of the EEA Agreement.

The EEA Agreement specifies that membership is open to member states of either the EU or European Free Trade Association (EFTA). EFTA states, i.e. Iceland, Liechtenstein and Norway, which are party to the EEA Agreement participate in the EU's internal market. One EFTA state, Switzerland, has not joined the EEA, but has a series of bilateral agreements with the EU which allow it to participate in the internal market. The EEA Agreement in respect of these states, and the EU-Swiss treaties have exceptions, notably on agriculture and fisheries.

2.1. Free movement of goods?

Thanks to the internal market, there is a guarantee to free movement of goods.

If the UK decides, during its withdrawal negotiations with the EU, to become a party to the EEA Agreement, then such freedom of movement of goods will be guaranteed.

If the UK decides, during its withdrawal negotiations with the EU, to put in place a series of bilateral agreements with the EU, then such freedom of movement of goods may be guaranteed.

Otherwise, there will be no freedom of movement of goods, between the UK and the EU, and non-EU countries, which would be an extremely perilous commercial situation for the UK. The EU is also a customs union. This means that member-states have removed customs barriers between themselves and introduced a common customs policy towards other countries. The overall purpose of the duties is *“to ensure normal conditions of competition and to remove all restrictions of a fiscal nature capable of hindering the free movement of goods within the Common Market”*.

Article 30 TFEU prohibits EU member-states from levying any duties on goods crossing a border, both goods produced within the EU and those produced outside. Once a good has been imported into the EU from a third country and the appropriate customs duty paid, Article 29 TFEU dictates that it shall then be considered to be in free circulation between the EU member-states.

Neither the purpose of the charge, nor its name in domestic law, is relevant.

Since the Single European Act, there can be no systematic customs controls at the borders of EU member-states. The emphasis is on post-import audit controls and risk analysis. Physical controls of imports and exports now occur at traders' premises, rather than at the territorial borders.

Again, if the UK becomes a party to the EEA Agreement, or signs appropriate bilateral agreements with the EU and other countries party to the internal market, customs duties will be prohibited between the UK, the EU, the EEA states and Switzerland. Otherwise, customs duties will be reinstated between the UK and all other European countries, including the EU, which would be again a very disadvantageous situation for UK businesses as the cost of trading goods with foreign countries will substantially increase.

The same goes for taxation of goods and products which will be reinstated if the UK does not manage to become a party to the EEA Agreement or to sign appropriate bilateral agreements with the EU.

This is going to become a major headache for the UK's new leadership: goods exports of the EU, not including the UK, to the rest of the world, including the UK, are about 1,800bn euros; to the UK, about 295bn euros, or a little under 16 percent. So, in 2015, the UK accounted for 16 percent of the EU's exports, while the US and China accounted for 15 percent and 8 percent respectively.

The UK would, indeed, become the EU's single largest trading partner for trade in goods. However, this would probably not be the case for trade overall. Including services would probably reduce the UK's share somewhat (the EU ex UK exports over 600bn euros in services, while the UK imports only about 40-45bn euros in services from the rest of the EU). Moreover, the US will very probably overtake the UK as the EU ex UK's largest single export market.

What does this tell us about the UK's bargaining power with the EU after a Brexit?

It certainly confirms that the UK would become one of the EU's largest export markets, even if not necessarily the largest. But the UK would still be far less important to the EU than they are to the UK – the EU still takes about 45 percent of UK's exports, down from 55 percent at the turn of the century. And, if you treat the EU as one country, as this analysis does, “exports” become considerably less important overall (intra-EU trade is far more important to almost all EU countries). Indeed, as this Eurostat table shows, only for Ireland and Cyprus does the UK represent more than 10 percent of total (including intra-EU) exports.

So how important will exporting to the UK be to the EU economy after Brexit? EU exports to the UK would represent about 3 percent of EU GDP; not negligible by any means, but equally perhaps not as dramatic as one might think. The EU, and even more so the UK, would certainly have a strong incentive to negotiate a sensible trading arrangement post-Brexit. But no-one should imagine the UK holds all the cards here.

Bearing in mind that the EEA Agreement and EU-Swiss bilateral agreements are both viewed by most as very asymmetric (Norway, Iceland and Liechtenstein are essentially obliged to accept the internal single market rules without having much if any say in what they are, while Switzerland does not have full or automatic access but still has free movement of workers), we strongly doubt that currently feisty UK and its dubious future leadership (wasn't Boris Johnson lambasted for being a womanising buffoon by both the press and members of the public until recently?) are cut from the right cloth to pull off a constructive, seamless and peaceful exit from the EU.

Creative companies headquartered in the UK, which export goods and products, such as fashion and

design companies, should monitor the UK negotiations of the withdrawal agreement with the EU extremely closely and, if need be, relocate their operations to the EU within the next 2 years, should new customs duties and taxation of goods and products become inevitable, due to a lack of successful negotiations with the EU.

The alternative would be to face high prices both inside the UK (as UK retailers and end-consumers will have to pay customs duties and taxes on all imported products) and while exporting from the UK (as buyers of UK manufacturers' goods will have to pay customs duties and taxes on all exported products). Moreover, the UK will face non-tariff barriers, in the same way that China and the US trade with the EU. UK services – accounting for eighty percent of the UK economy – would lose their preferential access to the EU single market.

While an inevitably weaker pound sterling may set off some of the financial burden represented by these customs duties and taxes, it may still very much be necessary to relocate operations to another country member of the EU or EEA, to balance out the effect of the Brexit, and its aftermath, for creative businesses which produce goods and products and export the vast majority of their productions.

Fashion and luxury businesses, in particular, are at risk, since they export more than seventy percent of their production overseas. Analysts think that the most important consequence of Brexit is *“a dent to global GDP prospects and damage to confidence. This is likely to develop on the back of downward asset markets adjustments. Hence, more than ever, the fashion industry will have to work on moderating costs and capital expenditures“*.

2.2. Free movement of services and capital?

The free movement of services and of establishment allows self-employed persons to move between member-states in order to provide services on a temporary or permanent basis. While services account for between sixty and seventy percent of GDP, legislation in the area is not as developed as in other areas.

There are no customs duties and taxation on services therefore UK creative industries which mainly provide services (such as the tech and internet sector, marketing, PR and communication services, etc) are less at risk of being detrimentally impacted by the potentially disastrous effects of unsuccessful negotiations between the EU and the UK, during the withdrawal period.

Free movement of capital is intended to permit movement of investments such as property purchases and buying of shares between countries. Capital within the EU may be transferred in any amount from one country to another (except that Greece currently has capital controls restricting outflows) and all intra-EU transfers in euro are considered as domestic payments and bear the corresponding domestic transfer costs. This includes all member-states of the EU, even those outside the eurozone, provided the transactions are carried out in euro. Credit/debit card charging and ATM withdrawals within the Eurozone are also charged as domestic.

Since the UK has always kept the pound sterling during its 43 years' stint in the EU, absolutely refusing to ditch it for the euro, transfer costs on capital movements – from euros to pound sterling and vice versa – have always been fairly high in the UK anyway.

Should the withdrawal negotiations between the EU and the UK not be successful, in the next two years, it is possible that such transfer costs, as well as some new controls on capital movements, be put in place when creative businesses and professionals want to transfer money across European territories.

It is advisable for creative companies to open business bank accounts, in euros, in strategic EU countries for them, in order to avoid being narrowly limited to their UK pound sterling denominated bank accounts and being tributary to the whims of politicians and bureaucrats attempting to negotiate new trade agreements on freedom of capital movements between the UK and the EU.

To conclude, we think that it is going to be difficult for creative businesses to do fruitful and high growth business in the UK and from the UK for at least the next two years, as UK politicians and bureaucrats now have to not only negotiate their way out of the EU through a withdrawal agreement, but also to negotiate bilateral free trade deals that the EU negotiated on behalf of its 28 member-states with 53 countries, including Canada, Singapore, South Korea. Moreover, it would require highly-skilled, seasoned, non-emotional and consensual UK leadership to pull off successful trade negotiations with the EU and, in view of the populist campaign lead by a now victorious significant majority of conservative politicians in the UK up to Brexit, we think that such exceptional and innovative UK leaders are either not yet identified or not in existence, at this point in time. The pains and travails of the UK economy may last far longer than just two years and, for now, there is no foreseeable light at the end of the tunnel that all this fuss will be worth it, from a business and trade standpoint. Did Little Britain think about all that, when it went out to vote on 23 June 2016? We certainly do not think so.

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