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Brexit opens Pandora's box of legal issues for international companies

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For many businesses in the United Kingdom and across the world, the most pressing question these days is exactly how the UK's pending exit from the EU (known as "Brexit") will affect the cross-border movement of people, goods, capital and data and the provision of cross-border services. But before we get any answers, we will suffer an extended period of uncertainty as the EU and the UK work out the Brexit's terms.

In the meantime, in-house legal teams face the enormous task of interpreting and advising on the best responses to the terms on which the UK withdraws from the EU and new UK legislation and rules as they are developed — and the stakes have rarely been higher. The EU is the largest market for many UK-based businesses, and many EU businesses do extensive business in the UK. The terms of Brexit and ensuing legislation will have wide-ranging effects on the operating models of these businesses as well as what these businesses buy and sell, how they buy and sell it, and whether they continue to turn profits.

In this report, we highlight some specific areas that warrant legal advisors' attention. We also present a suggested framework for legal teams to partner with other business functions to create an effective, business-wide Brexit plan.

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Brexit process: 2 or more years of suspense

On 29 March 2017, Prime Minister Theresa May triggered Article 50 of the Treaty of Lisbon, initiating a 2-year timeframe for the UK and the EU to negotiate the terms of the UK's exit. Thus, the UK could leave the EU by as early as 29 March 2019 — whether or not a Brexit agreement has been reached. There will likely be a delay, possibly of months, before negotiations start in earnest.

With her snap election call for 8 June 2017, the Prime Minister aims to strengthen her mandate for the Brexit negotiations. The prospect of a government serving until 2022 creates a window for clearer negotiating objectives and a longer implementation period. Given the unpredictability of Brexit-related events to date, however, the Prime Minister's intended outcome is far from certain.

The Council of the European Union has published guidelines for the Brexit negotiations, outlining a phased approach to negotiations with "nothing agreed until everything is agreed":

— The first phase of negotiations will deal with orderly withdrawal of the UK from the EU, including rights for EU and UK nationals living and working in the UK and EU, transitional arrangements to prevent a legal vacuum for cross-border trade, and financial settlement of the UK's commitments.

— Once the first stage is complete, the second phase will include the negotiation of a free trade agreement between the UK and the EU. This free trade agreement can be ambitious in scope. However, it will not amount to participation in the single market and must ensure a level playing field in terms of competition and state aid.

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Preparing for any scenario

It seems unlikely that definitive decisions on many crucial issues will emerge until toward the end of the Brexit negotiation process, and the next 2 or more years will be fraught with uncertainty.

During this period, businesses inside and outside the UK need to review and ensure they understand the spectrum of Brexit scenarios on their existing business models, contractual arrangements and commercial relationships. Where Brexit-related change might prompt significant changes to a group's corporate structure and operations, legal teams should look at issues such as:

- the legal, business, tax and regulatory implications of establishing legal entities in other jurisdiction, while unwinding existing structures or moving businesses to new locations
- which countries would be favorable for relocating businesses, employees or activities by conducting preliminary reviews of the regulatory environment as well as employment law, legal restrictions and forms of incorporation, property and commercial law
- additional considerations such as access to benefits, grants and subsidies or specific skills.

If less dramatic changes are expected, the business should drill down to determine how to manage Brexit's impacts to maintain, at least, the status quo. Multinationals might also consider taking advantage of acquisition opportunities to gain market share from competitors that are more adversely affected.

With these analyses in hand, businesses will have a firmer foundation to enable them to respond effectively to when the outcomes of the negotiations become clearer.

'All bets are off' planning

Large multinationals should have a contingency plan in place in case the EU and the UK fail to conclude an agreement within the 2-year window — a plan that dictates how the group would proceed when 'all bets are off'. Such planning involves questioning assumptions, undertaking political due diligence and preparing for the worst-case scenario (such as a public backlash resulting from the Brexit talks), upcoming elections in Europe or dealing with unexpected developments.

For example, in 2003, France's resistance to using force in Iraq caused international attitudes to turn against the country with surprising force and speed. The resulting international boycott was especially damaging for vintners, cheese makers and other French businesses. Predicting such a backlash is impossible, but having an 'all bets are off' plan can be invaluable should such a situation occur.

That being said, some brands may get a boost from Brexit, for example, if their 'Made in Britain' status increases their appeal to UK consumers.

Brexit's specific risks and opportunities

As part of their scenario planning, businesses should evaluate and plan to address the impact of changing laws and regulations in specific areas that could affect their business operations. Some key issues and areas to consider are discussed here.

Passporting rights

One of the biggest areas of uncertainty is how the Brexit negotiations will deal with existing EU passporting rights for financial services firms. Passporting rights allow UK-based banks, insurers and other financial services firms to do business across borders within the EU and European Economic Area (EEA). About 5,500 UK-registered firms with combined turnover of 9 billion British pounds (GBP) rely on these rights to do business in European countries, while 8,000 EU businesses rely on them to do business in the UK.[1] These rights would automatically lapse if the UK leaves the EU and EEA. If the Brexit negotiations do not produce a comparable alternative, the impact on the UK financial services industry and European financial system could be significant.

[1] "UK banks can withstand 'worst' outcome on EU passporting – Fitch," Financial Times, 29 September 2016.

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Immigration and employment

The EU's existing laws on working conditions and workers' rights are likely to be replicated by the UK.[2] However, immigration laws are expected to be central to the Brexit negotiations, and the outcome could create significant business impacts. In 2015, almost 3 million EU nationals were living in the UK, and over 1 million UK nationals were living in the rest of the EU. The current absence of immigration controls means many EU nationals in the UK — some of whom have called the UK home for years — would never have imagined the need for a UK passport or to formalize their immigration status.

Again, the UK financial services industry is particularly vulnerable. As a global financial center, the city of London relies heavily on the specialized skills of bankers, accountants, lawyers and other highly-trained workers drawn from across the EU. What immigration rules will be in place for existing expatriates and future immigrants and secondees to the UK remains to be seen.

This pre-Brexit uncertainty may be a concern for EU nationals employed currently in the UK and even cause some to act now to seek work elsewhere in the EU or to secure their right to remain in the UK. Businesses can reassure employees by developing a communication strategy that outlines the type of legal and other immigration assistance it can provide to retain its foreign workers. In fact, such a strategy could be a source of competitive advantage for UK businesses seeking to attract skilled foreign workers, both from within the EU and from other businesses in the UK that are slower to address expatriates' concerns.

Similarly, changing immigration rules could produce harsh effects for businesses in industries that rely on migrant workers, such as the retail, agricultural, food production tourism, hospitality and healthcare industries. Given the amount of funds these types of workers often send home, countries in eastern Europe and elsewhere — for which migrant workers' remittances can amount to up to 1 percent of GDP — are already suffering from a weak British pound. These economies could suffer even more if access to temporary UK work is restricted. The decline in value of remittances could cause migrant workers to remain in their home countries or pursue jobs in countries other than the UK. Some businesses are trying to mitigate the weak pound by offering workers the choice to be remunerated, for example, in US dollars rather than the British pound.

To address Brexit-related job vacancies, businesses are looking to hire more home-grown talent and institute training programs. The anticipated labor shortage also opens the door for businesses to rethink their human resource strategies. For example, the lack of workers might make it more socially palatable for businesses wishing to reduce their workforce and overheads and rely more on automation, digitization, robotics and artificial intelligence.

[2] Institute for Employment Studies, "Brexit implications for employment and social affairs: facts and figures," European Parliament, January 2017, p. 8.

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Regulated professions

For some regulated professionals, Brexit may affect their ability to continue providing services in their current locations. For example, it is unknown whether EU lawyers will be able to practice in the UK and vice versa. This will depend on the negotiation of mutual recognition agreements that would automatically allow appropriately credited lawyers from one jurisdiction to practice in the other. As a back-up plan, some UK lawyers are already applying for admission to the Irish bar.

Personal data protection rules

Data and the rights to move data from one country to another are another area of regulatory uncertainty. The EU's General Data Protection Regulation aims at protecting EU citizens' personal data in the digital world, while harmonizing the legislation for the processing of personal data across the entire EU. When it takes effect on 25 May 2018, the regulation will have a large impact, requiring businesses to put in place processes and safeguards for the processing, storage and transfer of personal data. With the UK out of the EU, one significant data protection issue to be resolved involves transferring personal data from an EU member state to the UK.

A new umbrella agreement for data protection between the EU and US for co-operation on law enforcement is also in the works. Once the UK is no longer relying on these agreements, the ability of UK businesses to transfer data across borders could be restricted, with severe effects. For example, the use of a single, global data center may be no longer feasible, requiring businesses to set up regional data repositories in different jurisdictions.

Income taxes

Where international taxation is concerned, Brexit has injected even more uncertainty into the complex transformation now underway. Multinationals are already dealing with extensive change as countries around the world work to adopt proposals resulting from the Action Plan on Base Erosion and Profit Shifting published by the Organisation for Economic Co-operation and Development (OECD). Meanwhile, businesses that are based in or have business dealings with the EU are also grappling with the implications of proposals set out in the EU Tax Transparency package.

Once Brexit is accomplished, the UK may take steps to change its tax laws so as to attract more international business and investment, albeit within the parameters endorsed by the OECD. Businesses should review their international structures and transactions to determine how these developments could affect their tax positions, including any head office location decisions and permanent establishment issues that might arise.

Indirect taxes

For companies moving goods between the UK and the EU, the UK's departure from the Single Market and the EU Customs Union will mean significant changes and increased costs for cross-border trade, including additional customs duty costs, increased VAT cash flow cost, higher administration costs. Delays at the border are also possible.

To understand and quantify these exposures, businesses should examine their supply chains and, in particular, their flows of goods, values, volumes, rates, destinations, warehousing arrangements and countries of origin for goods moving into and out of the UK, along with any existing free trade or other agreements that are currently relied on.

By modelling the impact of Brexit on VAT and customs duties based on a spectrum of scenarios from worst to best case, businesses will be better positioned to manage their potential Brexit risks and maximize any opportunities.

Financing

Access to financing is key to the health of any economy, and it is unknown whether or how Brexit could affect access to credit and financial services markets. For the foreseeable future, Brexit uncertainty will likely fuel volatility in interest rates and foreign exchange rates, causing ripple effects across the UK and world economies and increasing the need to hedge against currency fluctuations.

Brexit could cause some UK organizations to lose access to EU benefits. For example, UK universities that rely on the EU for grants and research funding may be denied these funds in the future, or they may be compelled to open new locations in Europe to preserve access to these funds.

Mergers and acquisitions (M&A)

Uncertainty over how Brexit will unfold is dampening M&A activity. Nevertheless, some buyers may be benefiting from the ability to acquire assets in the UK more cheaply due to the depressed British pound. Some UK businesses might already be shopping around for opportunities to expand in Europe and cover their bases.

In the current environment, potential buyers of UK and EU businesses should undertake a specific Brexit due diligence exercise. This review involves understanding how the business would make the transition to the post-Brexit world and what risks that would entail. With this understanding, contingencies can be written into sale and purchase agreements that address potential implications of Brexit down the road.

For example, Brexit due diligence could include examining the implications of changes to immigration policies on the existing workforce. In some deals, for example, the buyer would

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acquire the seller's existing arrangements with EU nationals currently based in the UK, which are crucial for businesses in the professional and financial services sectors.

Brexit clauses can also be written into individual employment contracts, for example, allowing the employer to terminate employment if the worker's immigration status changes post-Brexit. However, such a clause would need to be drafted carefully to avoid falling foul of labor laws.

Cross-border joint ventures

Cross-border joint ventures that benefit because the venturing parties are all currently based in the EU may see these benefits lost if Brexit puts one or more parties outside of the EU. Existing joint venture contracts should be reviewed to understand Brexit's potential impacts on existing cross-border arrangements and to develop exit strategies if needed.

Forging a business-wide response

As the examples above show, the legal and business uncertainties stemming from Brexit could have wide-ranging effects across a business, supply chain and customer base, and they demand a business-wide response. In an emerging leading practice, many multinationals based or doing business in the UK and EU are forming steering committees to connect relevant internal stakeholders and guide the group's entity-wide response to Brexit's risks and opportunities.

These committees are being charged with:

— setting the tone for the group's overall response

— channeling the direction of activities

— representing the group's interests as a whole

— coordinating the activities of issues-led sub-groups into a coherent, overarching approach.

Members of the committee should be drawn from functions across the business, including the CEO, heads of product groups and regions, and the leaders of human resources, public relations, procurement, strategy, finance, tax and operations. While authority for making decisions may remain with product groups, regions or corporate functions, the representation of individual areas on the committee should ensure alignment of the interests and appetite of the group at large, while ensuring the hierarchy of authority allows for speed and clarity of decision making and execution.

Including in-house legal counsel on the team is vital. Legal knowledge will be critical for:

— analyzing the implications for, for example, directors' responsibilities, employees' rights, terms of business contracts and other legal obligations

— developing the legal framework for the company's Brexit response.

It is also considered a good practice to appoint a third-party legal or business advisory firm to offer independent expert advice from an external perspective.

Businesses are also advised to ensure their legal team has multilingual capabilities. Because much of the Brexit negotiation may not occur in English, it is important to have legal counsel with the skills to understand legal nuances and subtleties in multiple languages.

The task of domesticating UK laws will be a massive legislative exercise, and legal counsel will need to monitor and interpret the implications of new laws as they are proposed and enacted. As new laws are being drafted, legal counsel also can help their businesses to identify legal implications and business opportunities and to lobby the UK government in efforts to influence the direction of travel.

With any crisis comes opportunity. In-house legal teams have a pivotal role in helping their groups navigate the Brexit transition and seize those opportunities. At the same time, Brexit is giving lawyers themselves a chance to go beyond their traditional role as risk managers, elevate their profile in the business, and add more strategic value.

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Designed by Evalueserve.

Publication name: Brexit opens Pandora's box of legal issues for international companies

Publication number: 134479-G

Publication date: May 2017