

BUSINESS

Defining the new normal in the post-Brexit economy



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The United Kingdom's vote in favor of Brexit surprised many, including the markets. And while withdrawal from the European Union will not be immediate — the U.K. will have a two-year period that it decides when to trigger for negotiating its exit — it's important for companies to monitor developments and prepare for the "new normal" business relations.

E.U. membership benefits

As part of the E.U., the U.K. currently benefits from access to the world's largest single market. There are harmonized trading rules across the European Economic Area consisting of the 28 E.U. member states plus Norway, Iceland and Liechtenstein. The "internal market" is based on four fundamental freedoms of movement of goods, services, capital and labor. Businesses are able to move and sell goods and services throughout the European Economic Area without incurring trading tariffs. Free

movement of people allows businesses to select from a wide pool of skilled labor and place employees in different member states without restrictions.

The E.U. has exclusive competency in trade agreements and conducts negotiations on behalf of member states. The E.U., therefore, has a common international trade policy and has agreements with countries including Mexico, South Africa and South Korea. The E.U. is negotiating the Transatlantic Trade and Investment Partnership with the United States to reduce tariffs and regulatory burdens between the two economic blocs. This reflects President Obama's widely reported comments on his recent visit to the U.K. that the U.S. prefers to conclude trade deals with large trading blocs rather than individual countries — a position he reaffirmed following the referendum result.

What it means for the U.S.

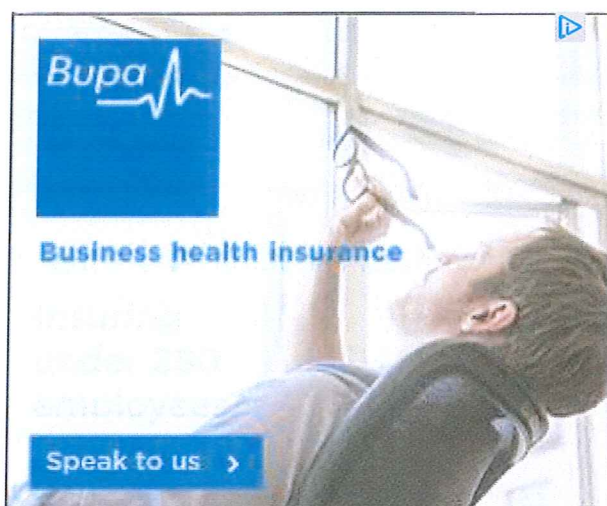
For many U.S. businesses trading internationally, the U.K. has been a natural point of entry to the European, Middle Eastern and African markets. London's position as one of the world's key financial centers with a time zone conveniently between the U.S. and Asian markets has made it attractive. London is also a global center for dispute resolution and has been pre-eminent in arbitration, including international trade disputes. Minnesota companies dealing internationally are most likely to have English or New York law and jurisdiction provisions in any contracts that are not governed by Minnesota law. The dramatic fall in the value of the GBP may make U.K. companies attractive to buyers based overseas, particularly in the U.S., where the dollar remains strong.

What's next for U.K. and E.U.?

The referendum was structured as a simple choice between leaving or remaining. Accordingly, there are no rigid pre-defined exit options. Critically, E.U. membership allows financial services firms authorized in one member state to carry on business in any other member state without the need for a separate authorization (the so-called "passporting" system). This accounts, in part, for London's success as a financial center, providing the base from which many financial institutions carry on their business both in the U.K. and in the rest of Europe. Bank stocks have suffered greater losses than most in recent days.

To protect this position, the U.K. government will likely need to negotiate with the European Free Trade Association, allowing access to the E.U. markets and some degree of passporting. This would, however, limit the ability to deliver on exit campaign promises to limit immigration through the adoption of a points-based system. The price for free access to unified open markets is free movement of goods and people — the financial services industry in particular depends on a number of highly skilled and mobile workers.

A series of bilateral agreements between the U.K. and other countries, including the U.S., seems less likely — at least in the short term.



Minnesota businesses in highly regulated industries such as pharmaceuticals, medical devices, consumer products and financial services will need to follow developments closely. These industries need to comply with a myriad of E.U. regulations regarding things such as product testing and labeling.

Although such regulations are often onerous, one of the advantages of E.U. membership is the fact that businesses only have to comply with one common set of standards across 28 countries. While Brexit proponents support reduction in administrative burdens and bureaucracy, the practical scope for making significant changes may be limited. In the medium term some U.S. businesses will need to review separate sets of regulations — for the U.K. and the E.U.

The U.K. is the world's fifth-largest economy (following the U.S., China, Japan and Germany), and London is one of the world's key financial and legal centers. Despite short-term uncertainty, this is likely to remain the case. Some large companies, mainly in the financial services sector, are formulating or implementing plans to relocate employees to other countries. This is likely to be a slower- and longer-term adjustment for most industries. Some large U.K.-based corporate transactions may be reviewed or postponed in the immediate short term, although the fall in the GBP makes acquisitions in the U.K. potentially cheaper.

Finally, it is important to understand that dissatisfaction with the E.U. is not uniquely British. Recent calls for similar referendums have come in a number of E.U. member states, including the Netherlands, Denmark, Italy and Austria. This may lead to a more fundamental reshaping of the E.U. structure or a halt on closer economic and political integration. While uncertainty will be the "new normal" for some time, one thing is clear: U.S. businesses will need to be ready to adapt to new trading environments.

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