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The UK’s vote to leave the EU brings with it the possibility of so-called ‘hard Brexit’. Business needs to understand what Britain leaving the EU without a smooth transition to a new framework might mean for cross-border trade both within Europe and between Europe and the rest of the world.

At the point when the British government announces its formal intention to exit the EU by triggering Article 50, a two-year countdown will begin to the UK leaving the EU. Understanding the various changes, analysing the risks they pose and working through potential solutions will all be essential to help firms position themselves to navigate the challenges and opportunities that lie ahead.

The peculiarity of the Article 50 process - with its two-year ticking clock - makes this preparatory work all the more urgent. If no alternative relationship or even temporary transitional arrangement were to be agreed between Britain and the EU before the two years run out, the EU treaties would cease to apply to the UK, with nothing to replace them. This has profound implications for both sides. This report is designed to help business leaders understand and prepare for a sharp shift in the UK’s relationship with the EU: hard Brexit.

Our conversations with business leaders suggest the mood is not necessarily one of negativity, but the scale of the potential change coupled with the lack of clarity as to how it might be effected leaves a lot of uncertainty in the short-to-medium term. Businesses are struggling to understand what Brexit would mean for them. Understanding hard Brexit is a good place to start.

‘We do not necessarily think that a hard Brexit is the most likely outcome of negotiations,’ says Lode Van Den Hende, a partner and international trade law specialist at Herbert Smith Freehills. ‘But planning for this scenario is the most effective way for businesses to compare their current position from within the EU single market with a counterfactual position in which the UK trades with the EU and the rest of the world on the basis of WTO rules. From this baseline, organisations can see most clearly the potential impact of the possible changes and make a corresponding plan of action.’

This report not only aims to help businesses understand the implications of a hard Brexit, but the role they may play in shaping that or an alternative outcome.

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The term “hard Brexit” is generally taken to mean the UK leaving both the EU and the European Economic Area (EEA) and in doing so placing itself formally outside the EU single market and the EU customs union.

In its “hardest” form, hard Brexit also means that there would be no new (or interim) trade agreements in place between Britain and the EU at the time of the UK’s exit. Such a scenario could take the UK abruptly from having one of the deepest sets of trade ties in both goods and services with the other 27 EU Member States to being in the same position as most of the EU’s third country trading partners with whom no special trade agreement has been negotiated.

The benefits of membership of the EU include the free circulation of goods between members, without tariffs, customs formalities or other forms of border control. Members also enjoy wide-ranging rights to sell services without discrimination, for example by establishing operations anywhere inside the single market. A shared regulatory framework facilitates trade, with rights protected by EU law and enforced by EU and national courts.

Conversely, it should be noted that a hard Brexit also implies the removal in relation to the UK of the corresponding obligations of single market membership, including regulatory harmonisation with the EU in many areas and acceptance of free movement into the UK of goods, services, labour and capital of EU and EEA businesses and nationals. The UK would also be free to adopt import duties distinct from those of the EU’s Common Customs Tariff, to develop its own international trade policy and to diverge from other EU regulatory frameworks.

Popular support for some form of hard Brexit and the political imperative not to imperil prosperity mean that a carefully crafted compromise will be called for in balancing the minimum elements of hard Brexit (eg, controlling immigration and elective alignment with EU rules) with the greatest possible degree of reciprocal market access.
The EU single market is by far the most advanced free trade area currently in existence — especially for goods. In the event of a hard Brexit, UK exports to the EU would become subject – as they crossed into the EU - to the rates of duty set out in the EU’s Common Customs Tariff. The same would be the case in reverse as EU goods were imported into the UK.

Rates of duty vary depending on the goods in question. For example, the duty on personal computers and mobile phones is nil, sunglasses 2.9%, and motor cars 10%. UK exports could, in principle, also be subject to EU trade defence measures in the event that they were deemed to be priced unfairly low (‘dumping’) or to benefit from subsidies or other forms of support prohibited under the World Trade Organisation (WTO) rules.

In the other direction, it seems reasonable to expect that in general the UK would - at least initially - apply at its own international borders the same duties that it does now - the EU’s Common Customs Tariff.

Taken together, this implies that a hard Brexit would see duties applied to many of the significant trade flows between the EU to the UK, with particular impact on agricultural products and manufactured goods.

Owing to the “most favoured nation” principle enshrined in the rules of the WTO, hard Brexit would mean that the UK would be obliged to impose the same duties on imports from the EU as it applied to those from all other WTO members unless and until it reached preferential trade agreements with them, and vice versa.

While the UK could reduce tariffs unilaterally, the WTO rules against discrimination mean that, at the outset, the UK would not be free to distinguish between trading partners in doing so. Such variation can only be done through the signing of free trade agreements (FTA) with other WTO members.

These preferential trade agreements must themselves meet certain requirements under WTO rules, chiefly relating to the breadth and depth of the trade they cover.

In addition to duty on imports and exports, goods currently moving freely between the EU and the UK would become subject to the same customs formalities and import and export processing procedures currently imposed on trade into and out of the EU to and from countries outside. In short, more red tape.

As a member of the EU, the UK also currently benefits from either tariff-free or reduced-tariff access to the markets of third countries with which the EU has concluded preferential trade agreements on behalf of all EU Member States. These include the 2011 EU-South Korea FTA, which has progressively removed all tariffs for industrial and agricultural goods, and the Canada/EU (CETA) Agreement, under which almost all tariffs would be immediately eliminated. Following a hard Brexit, the UK may not immediately or automatically continue to benefit from these agreements with third countries. A period may ensue during which the UK would fall back onto WTO rules on the general treatment of trading partners while it renegotiates its own preferential terms with the countries in question.
INDUSTRY IMPACT

‘Even seemingly small tariff changes can be significant. A few percentage points here and there may not sound transformational, but if the margin on a product is 5% and there’s a shift of 5%, that’s 100% of the profit that is potentially in play,’ says Pierre Mercier, senior partner and managing director in the London office of The Boston Consulting Group. ‘Unless companies can pass on the costs to suppliers or customers, they will risk eroding their own profit. In any case, for domestic consumption or exporting, that could lead to significant long-term shifts in supply chains and the flow of goods.’

The UK auto industry is a case in point. Given the large production base in relation to the UK market, plants located in Britain focus heavily on exports. ‘The UK as a source for manufacturing could be jeopardised considerably if exporting conditions change,’ says Mercier. This risk is exacerbated by the fact that the auto industry operates across a small number of plants – often only one or two for most models – and the UK, as an island that is not in the middle of the EU, is already geographically challenged as a manufacturing base.

‘It’s unlikely to be a binary decision,’ Mercier adds. ‘But if there were no future investment, UK manufacturing’s EU-bound flows would dwindle, while investment would go into plants in continental Europe.’

Other industries – typically those with more variable costs that can scale to respond to changes in demand patterns – might be able to adapt, at least in the short term. Mercier cites the meat industry by way of example: if trade barriers for bringing European pigs into the UK go up, there could be more production of pork in the UK to accommodate that.

In the medium-to-longer term, however, even those companies may come under pressure to relocate. ‘If the UK becomes less competitive as a place to convert raw materials or intermediate goods into finished products, then part of that activity will move to more favourable locations in the EU,’ Mercier concludes.

“...it seems reasonable to expect that in general the UK would - at least initially - apply at its own international borders the same duties that it does now”
Case studies

08 Case study 1: UK auto manufacturer
   UK car exporters face high tariffs on sales to EU markets

10 Case study 2: UK fashion/apparel retailer
   UK retailers face high tariffs on clothes traded with the EU

12 Case study 3: UK chocolate manufacturer
   UK chocolate manufacturers face high tariffs on trade with the EU
BACKGROUND: APPROACH AND ASSUMPTIONS TAKEN

APPROACH

We have modelled the potential impact of tariff changes due to Brexit for three case studies...

- auto manufacturer
- fashion/apparel retailer
- chocolate manufacturer

...comparing ‘pre-Brexit’ with two ‘hard Brexit’ scenarios.

ASSUMPTIONS

In doing so, we note that this relies on several assumptions:

- it ignores any changes made to the manufacturing/purchasing process post-Brexit
- exchange rates are considered fixed
- UK companies do not change their export patterns nor prices (i.e., export prices and flows of goods are held consistent)
- reduction in tariff costs (e.g., in the UK Zero Tariff scenario) are passed on to manufacturers/distributors
- anti-dumping measures, (present or future) are ignored for the purposes of this analysis.

1. Hard Brexit assumes no trade deal with the EU.
2. MFN = WTO tariffs currently charged on goods imported into the EU

THESE ARE

PRE-BREXIT
- Free trade within the EU

WTO
- Hard Brexit - WTO MFN tariffs applied
- UK tariffs also set at current EU rates

UK ZERO TARIFF
- Hard Brexit - WTO MFN tariffs applied
- UK tariffs set at zero
UK AUTO MANUFACTURER

UK CAR EXPORTERS FACE HIGH TARIFFS ON SALES TO EU MARKETS

Most purchased goods (PGs) sourced abroad (36% EU, 21% RoW) with the rest sourced locally

75% of cars are exported with most going to the EU (55%)

Car assembly plant based in the UK

IMPACT OF BREXIT

PRO-FORMA EBIT

WTO

Pro-forma EBIT pre-Brexit

8%

Pro-forma EBIT post-Brexit

2.4%

Import / Export tariff impact to absorb or recover

0.6%

Import

5%

Export

8%

Pro-forma EBIT pre-Brexit

8%

1. Exports: 1/2 of RoW exports go to US (tariff = 2.5%) and 1/2 to China (25%). 2. At expense of UK treasury Source: BCG analysis, WTO website, HM Government: ‘The process for withdrawing from the European Union’. Figures are rounded to the nearest whole number.
Under these assumptions, UK auto manufacturers would have to recover 2/3 of current EBIT from tariff changes.

Mitigation of this impact by auto manufacturers could take several forms including:

- lobbying the UK government to avoid impact / compensate for increased tariffs
- passing increased costs on to customers
- renegotiating supply agreements to lower costs
- shifting component and material sourcing to the UK or to origins with trade agreements in place

Failing that, auto manufacturers might take part or all of assembly out of the UK.

In addition to the increased tariffs, the new trade regime will likely increase the administrative burden and would result in slower, less predictable flows that could disrupt the “just in time” philosophy that the auto industry operates with.
FASHION/APPAREL RETAILER

RETAILERS FACE HIGH TARIFFS ON CLOTHES TRADED WITH THE EU

Imports clothing from non-EU (75%), EU (25%)

Re-sells some to mixture of EU and non-EU (eg, China)

Sells majority of clothes to UK market (60%)

UK-based fashion/apparel retailer that imports finished goods

Simplified business profile

25% EU

75% RoW

IMPACT OF BREXIT

PRO-FORMA EBIT

WTO

1.4%

3.2%

5.4%

10%

3.2%

Pro-forma EBIT pre-Brexit

Import / Export tariff impact to absorb or recover

Pro-forma EBIT post-Brexit

10%

Pro-forma EBIT pre-Brexit

1. Assumed: 100% sales to China (tariff = ~16%) 2. EU tariffs for clothing imports will be affected by the EU's Generalised Scheme of Preferences (GSP) for developing countries, with tariffs as follows: non GSP (12%), GSP (9.6%), GSP+/EBA (0%). These are all maintained in WTO scenario but set to 0 under ZT scenario. Thus a blended rate is shown to reflect the actual average tariff faced by importers (assumed geographic distribution: 25% non GSP, 50% GSP, 25% GSP+/EBA)

Source: BCG analysis, WTO website, HM Government: 'The process for withdrawing from the European Union'. Figures are rounded to the nearest whole number.
Revenue 100%

<table>
<thead>
<tr>
<th>Costs</th>
<th>90%</th>
</tr>
</thead>
<tbody>
<tr>
<td>SG&amp;A</td>
<td>50%</td>
</tr>
<tr>
<td>COGS</td>
<td>41%</td>
</tr>
<tr>
<td>IPGs</td>
<td>41%</td>
</tr>
<tr>
<td>Clothing imports</td>
<td>41%</td>
</tr>
<tr>
<td>EBIT</td>
<td>10%</td>
</tr>
</tbody>
</table>

Impact of Brexit on Tariffs (%)

<table>
<thead>
<tr>
<th>Pre-Brexit</th>
<th>WTO</th>
<th>UK ZT</th>
</tr>
</thead>
<tbody>
<tr>
<td>RoW</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>EU</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>Apparel exports</td>
<td>16</td>
<td>0</td>
</tr>
<tr>
<td>Clothing Imports</td>
<td>7.8</td>
<td>7.8</td>
</tr>
</tbody>
</table>

Consequences and implications

- Under these assumptions, fashion retailers would have to recover about 50% of current EBIT from tariff changes.
- Mitigation of this impact by fashion retailers could take several forms including:
  - Increasing sales prices
  - Value engineering clothing (e.g., reducing quality to match current “total landed cost”)
  - Shifting material sourcing to the UK (unlikely) or to origins with more favourable tariffs
  - Setting up a bonded warehouse in the UK to avoid duties on items that will be re-exported
  - Setting up offshore distribution facilities to avoid import/export friction in the UK
- Increased trade barriers would also reduce retailers’ ability to pool inventory between UK and non-UK demand and reduce the ability to operate seamlessly between markets and sales channels (e.g., a global distribution centre for e-commerce located in the UK could become less favourable).
CHOCOLATE MANUFACTURERS FACE HIGH TARIFFS ON TRADE WITH THE EU

UK-based chocolate manufacturer that imports the majority of materials from around the world (EU = 55%, RoW = 25%). Sells most goods in the UK, but exports 25% chocolate to the EU.

Very simplified profile assumed (e.g., wrapping excluded).

IMPACT OF BREXIT

PRO-FORMA EBIT

WTO

<table>
<thead>
<tr>
<th>Import</th>
<th>Export</th>
<th>Pro-forma EBIT pre-Brexit</th>
<th>Pro-forma EBIT post-Brexit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>10%</td>
<td>1.9%</td>
</tr>
<tr>
<td>4%</td>
<td></td>
<td>4.2%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1%</td>
<td></td>
<td>10%</td>
</tr>
</tbody>
</table>

1. Assumption: 50% of this category is part of Cariforum (tariff = 0%) of which the UK would still be a member of post-Brexit. Non-Cariforum rate = 7.7%. Thus an average rate is shown = 3.85%.


Figures are rounded to the nearest whole number.
Impact of Brexit on Tariffs (%)

<table>
<thead>
<tr>
<th>RoW</th>
<th>Pre-Brexit</th>
<th>WTO</th>
<th>UK ZT</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>30</td>
<td>0</td>
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<td></td>
<td>0</td>
<td>36</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>0</td>
<td>7.7</td>
<td>0</td>
</tr>
</tbody>
</table>

CASE STUDY 3: CHOCOLATE MANUFACTURER

**Consequences and implications**

- The pro-forma impact of Brexit on a chocolate manufacturer’s EBIT will be dependent on how much the UK government’s agricultural policy (post-Brexit) replicates current EU policy and tariffs.
- To the extent that it is possible, chocolate manufacturers in the UK might reconsider where they source their materials since the higher % of purchased goods that are imported, the greater the impact on EBIT; but some products (e.g., cocoa) cannot be sourced locally.
- UK plants might be encouraged to shift their focus towards domestic sales and scale down to avoid EU tariffs.
- Depending on UK policy, multinationals may find it more advantageous in the future to import finished chocolate to the UK from the EU rather than manufacturing it in the UK.
International trade in services typically involves more complex considerations than trade in goods. In particular, many services are heavily regulated and such regulation often concerns the service provided as well as the service provider.

Where services are regulated, a variety of methods can be applied to facilitate cross-border delivery, ranging from mutual recognition of standards or qualifications through to foreign businesses being required to establish a physical presence within a country in order to facilitate supervision of compliance and enforcement for more heavily regulated services. Free trade in services, especially across borders, requires a high level of cooperation, coordination and trust between the regulators of the participating jurisdictions.

In a hard Brexit scenario, outside of the EU and the EEA, national and EU law and licensing regimes would dictate the UK’s rights to access EU markets for services. While many services can be supplied across borders without regulatory restrictions, access for regulated sectors would be guaranteed only to the extent that these terms of market entry and operational rights were codified in the EU’s schedule of commitments at the WTO level. The same would be true for EU firms wishing to provide services in the UK. In many cases, these codifications are much less comprehensive than actual conditions on the ground, which are therefore vulnerable to change.

The EU single market for services is much more developed than other international trade agreements on market access. While it is still subject to considerable fragmentation and a wide range of practical obstacles, in principle the EU Treaties and EU legislation guarantee the right to provide a wide range of services throughout the EU and to establish services businesses for the purposes of doing so.

In contrast, the EU’s WTO schedule of commitments provides generally weaker market access across fewer areas, especially for cross-border trade. For example, the EU ‘passporting’ system for financial services businesses allows financial services firms in defined areas to operate across the EU once they have been authorised in one EU state. No such comprehensive regime for financial services trade exists for states outside the EU and the EEA – or indeed anywhere else in the world. It is just one example of the way the single market creates a framework for cross-border trade inside the single market that has no equivalent for businesses outside it.

Please refer to our separately-published materials for detailed analysis of the EU financial services market.

“Free trade in services, especially across borders, requires a high level of cooperation, coordination and trust between the regulators”
ALTERNATIVE SOLUTIONS: THE POLICY TOOLKIT

Such a hard Brexit baseline is of course not the only future relationship open to the EU and the UK should the UK ultimately find itself outside of the single market. There are a range of ways in which the two sides could continue to facilitate trade and preserve some aspects of the status quo for their mutual benefit.

CUSTOMS UNION

In principle, the EU could accept a UK request to participate in a customs union with the EU. This could involve joining the existing EU Customs Union with Turkey and a number of other small states, which covers a wide range of industrial goods. In theory it could also cover a wider range of products, including agricultural goods. Inside a customs union, trade in the covered goods would be free of tariffs and subject to reduced customs formalities. However, the UK would also have to mirror the EU Common Customs Tariff and any preferential EU tariff rates agreed with other countries when applying duty to its own import of these goods.

Stephen Adams, a partner at Global Counsel and lead consultant on European and multi-lateral issues, thinks that this is an issue on which the British government has focused closely. He has his doubts, however, that the UK will ultimately pursue this option because of the way it may be perceived to limit leverage in future trade deals, binding the UK to EU tariffs across a wide range of products.

‘The case for customs union is a question of weighing up the good for businesses individually and in the short term, against what may be good for the UK in the long term in terms of bargaining power in future trade deals,’ he says. ‘The customs union has no tariffs and a high level of regulatory convergence, which are good for business and trade in very many respects. But both tie the UK’s hands as a regulator and trade partner outside the EU.’ Given the emphasis on returning regulatory control to the UK, he thinks this could be problematic.

A FREE TRADE AGREEMENT (FTA) BETWEEN THE EU AND THE UK

An FTA between the EU and the UK, would achieve similar things. It would:

1. Reduce or eliminate tariffs on most goods traded between the two markets. An FTA could also be used to agree certain simple forms of customs facilitation between the two, such as the elimination of low value goods from customs requirements or forms of cooperation at borders.

2. Confirm preferential terms for services exporters in both directions, including rights to own local businesses and to sell services cross-border in many areas. The EU and the UK could use such an agreement to confer reciprocal access for each other’s firms that goes well beyond commitments in the EU’s current WTO schedule.

3. Create bespoke dispute settlement arrangements between the two sides in which market access problems could be raised and solutions sought.

Pursuing an FTA could result in the same tariff-free benefits as a customs union, but does not necessarily have the same focus on regulatory harmonisation and leaves intact the UK’s prerogative on its own external tariff argues Adams. This might give the UK more freedom to set its own priorities in trade policy, to strike new deals or go further in deals than it can as an EU member state. ‘If there’s a possible opportunity in Brexit – and it is an if – then it’s the possibility for the UK to be a more autonomous regulator and an actor that can improve its trading links with the rest of the world in a way that it cannot as part of the wider block,’ he says.

With trade between the two sides already highly liberalised and many businesses exposed to new tariffs, quickly agreeing an FTA would make sense for the two sides. However, politics may complicate things. Any agreement would first need to be negotiated and approved at EU level and may also have to be ratified by individual EU member state parliaments, which creates plenty of potential for delay or obstruction.
All of the matters discussed in this report will inform the strategy for exit negotiations. ‘We will need a quite finely-tuned and sophisticated solution to satisfy both the EU and the UK,’ says Van Den Hende. ‘Even where there are common economic interests, there is currently little political alignment. The EU and the UK face an enormous task in achieving agreement.’

This is further complicated by the fact that the exit protocol set out in the EU Treaty has been interpreted by some as suggesting that such a negotiation on a future agreement can only start once the UK has left. It is almost certainly the case that the time required for negotiations and the need for the UK to have left the EU to conclude a formal bilateral treaty with it, means that such a deal could only be signed and ratified after exit. This raises questions over what might happen in the interim: will there be a temporary imposition of tariffs or a transitional period maintaining something akin to the status quo as a bridge to a future FTA?

‘The biggest risk is the UK falling out of the EU at the end of the process without an FTA or transitional arrangement in place – and that’s a risk for the other side as well. It will hurt both,’ says Adams.

Time and close cooperation are of the essence for both business and government. ‘The British government is well aware that it needs to understand what the different options mean for an array of key sectors and that to do this it must engage with business directly. It is business that understands who imports what from where, what exactly is exported, the location of warehouses and the structures of supply chains and so on. This is why the government should conduct very extensive conversations with business,’ says Van Den Hende.

Business too has to rise to the challenge. Companies will need to undertake operational and structural assessments to determine their exposure to a hard Brexit scenario and devise strategies to mitigate the risks.

‘If there’s a problem, engaging with the government with well-evidenced argument is crucial,’ Adams agrees. ‘Your future is dictated by policymakers’ choices, so it is vital to equip them with both evidence and argument. Only with that kind of collaboration can we ensure every policy tool is used to deliver as little disruption as possible.’

With considerable on-going uncertainty, it is perhaps unsurprising that many businesses are focusing on the immediate future. Mercier thinks this is no bad thing – advocating at least for the moment, a phased approach, as the course of Brexit becomes clearer.

‘To the extent that you can defer big strategic decisions linked to heavy capital expenditure in the manufacturing or distribution footprint for six to twelve months, then it would probably be wise to do so, at least until you know more about the future trade regime with the EU, potential trade agreements with other countries outside the EU such as the US, Canada and China. Not to mention F/X (foreign exchange) considerations,’ he says.

At the same time, this should not translate into doing nothing. Businesses will need to be proactive – analysing and assessing developments, formulating arguments to defend their interests and seeking to influence the approach of governments in both the UK and EU. Scenario planning for a hard Brexit and the issues it presents will also be critical to being able to adapt strategy and implement operational and structural change as necessary. Businesses that do this will be better able to manage whatever economic, political or trading shifts lie ahead.
In some cases, this will require new UK regulatory regimes to replace rules currently applied directly from the EU level – for example, some parts of the prudential framework for banks and market infrastructure. In others, EU frameworks may be confirmed as the UK’s future domestic rules. The UK government’s ‘Great Repeal Bill’, for instance, aims to convert existing EU law into domestic law on the day that the UK leaves the EU. This may be a useful tool to avoid any initial regulatory gaps, but it may not be a straightforward or indeed an effective solution in all cases.

This raises important questions about the future for business. One issue is the fact that the UK will no longer be covered by EU rules that confer operational rights or advantages in the internal market. For example, the UK may no longer be able to participate in the EU’s Unified Patent Court system or be directly covered by EU General Data Protection Regulation. This implies checks on freedoms or advantages that are currently part of the single market package.

The prospect of two separate regulatory regimes inevitably raises the question of duplication and even divergence over time in regulatory licensing procedures and standards. At present, many products licensed for sale in one EU member state can be placed on the market in any other. Mutual recognition and equivalence regimes may need to be agreed, which would recognise UK standards as equivalent to those of the EU, and remove the need to conduct product approval procedures in both markets. In the absence of mutual recognition, business would face the prospect of additional time being spent and costs being incurred dealing with a rising compliance burden.

### Enforcement Rights

Protection and enforcement of operational rights are crucial for businesses, especially when large investments in trade are made up-front. Inside the single market, EU law protects trading rights which are directly enforceable by private parties. This means that businesses can claim financial compensation or other recourse from EU Member States that fail to abide by their obligations under EU law. These rules have an independent enforcement agency in the European Commission, and can also be enforced through EU and national courts.

By contrast, international trade treaties, such as the WTO rulebook, generally only provide for state-to-state dispute settlement, in which case businesses are reliant on WTO states commencing an action to enforce the rules. When two states have agreed a FTA, these will often also contain a mechanism for raising issues and addressing disputes between the two parties, but these are generally weak. In both cases, private complainants need to persuade a state to take action, and governments may have in mind other economic or indeed political interests when they decide whether to act.

Although the analogy is far from perfect, it is instructive to note that the WTO dispute settlement system, which is the most active of all international trade treaties, will handle approximately ten cases per year, whereas the EU courts will handle approximately 1,500.
QUESTIONS BUSINESSES SHOULD ASK

- Do my supply chains straddle the EU and the UK in a way that could expose my organisation to new tariffs post-Brexit?

- Are my exports to EU markets going to meet rules of origin requirements sufficiently to ensure preferential treatment?

- Do my final distribution networks cross the same line between the EU and the UK? What does this imply for the cost of my product for the end customer?

- How well can my business model adapt to the need to process all imports and exports between the EU and the UK through the customs systems of both sides?

- What does this imply for inventory management and the routes to market my business uses to present goods from the global economy to EU customers?

- In the services sector, to what extent does my cross-border business's regulatory position depend on EU status? Does a hard Brexit incur a significant disadvantage and, if so, how can this be remedied in a cost effective manner?

- How dependent am I willing to be on third country dispute settlement systems for enforcing the rights of my operations in the EU? What does this suggest about how I should be structuring my commercial footprint in the EMEA region to maximise my routes of legal recourse?

- How concerned should I be about the possibility that the EU and the UK will no longer mutually recognise the product standards, licensing decisions or regulatory decisions that apply in each market? Does this mean duplicating product approvals or operating licences?
HOW WE CAN HELP

Brexit – and the challenge that it represents - has many facets. Our three firms’ collaboration on this report and in advising organisations on Brexit, is borne out of this very fact. A measured and methodical response to the questions raised requires legal, regulatory and supply chain analysis, political and policy insight and strategic advice and implementation.

The Boston Consulting Group, Herbert Smith Freehills and Global Counsel recognise the importance of these essential elements and of offering holistic assessments on the impacts of, and possible responses to, Brexit aligned with individual clients’ needs and strategies.

Initial analysis or due diligence of Brexit-related risks and opportunities, establishes risk exposures and opportunities - a “Brexit audit”. Issues affecting organisations may be general, they may affect an entire sector, or they may be idiosyncratic and only affect a specific business. For this reason, review exercises must be tailored for individual organisations to reflect their business activities and their specific operating environment.

As and when the time comes to take action to mitigate risks or seize opportunities, this may involve deploying arguments with government (UK, EU and third countries) directly or through industry bodies to influence their approach based on prioritised analysis. On the operational plane it may mean strategic M&A, devising alternative legal structures, changes to geographical footprint and workforce, re-assessing investment plans, revising compliance frameworks and so on.

Given the uncertain timescale and outcome of Brexit, analysis must be scenario based using a hard Brexit base case as suggested by this report alongside selected alternatives.

The focus of any review will be dictated by the nature of the underlying business but might include regulatory analysis (eg, market access issues and deregulation opportunities), supply chain analysis (eg, impact of tariffs and non-tariff barriers) and contract reviews (eg, identification of problematical terms and contracting strategy issues).

The conclusions of this type of analysis allow organisations to assess identified risks and opportunities, calibrating their relative importance and likelihood, and to prioritise further action. Understanding the interdependencies and lead times (political, operational and regulatory) is crucial to the development of a phased and proportionate response.

“...review exercises must be tailored for individual organisations to reflect their business activities and their specific operating environment”
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