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# A deal for the future?

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What the new EU/UK Agreement means for  
business strategy and dealmaking

January 2021

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From 1 January 2021, the UK has been outside the scope of EU law and regulations. Announcing the new international Agreement between the European Union and the United Kingdom, European Commission President Ursula von der Leyen described it as both an end and a beginning.

The Agreement opens a new chapter for business and operations, investment and M&A across the European continent. In this note, we explain why.

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## The end

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During the UK's long membership of the EU, internal barriers to the movement of businesses, goods, services and labour presented by national borders were systematically reduced.

Tariffs were removed and many aspects of regulation and enforcement standardised. In response, **businesses organised themselves, and their relationships with others, increasingly around the EU as a whole not individual Member States** within it: building international supply chains and corporate structures, and drawing talent from across the EU.

Global businesses – from the U.S. and Asia – have often been at the forefront of taking an EU-wide approach rather than one defined by national borders.

Brexit reverses this trend as between the UK and the EU. Whilst the two remain closely linked world top 10 economies, **cross-border activity will be subject to new costs, administrative burdens and restrictions**. The new EU/UK defines those new barriers, and how they are likely to evolve for decades to come.

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## The beginning

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The EU/UK Trade Agreement is itself an expression of the ability of the UK and EU to set their own, separate strategies, and to cooperate where it is in their mutual interests. From a starting-point of very close regulatory alignment, the Agreement is founded on the basis that **the UK and EU can each choose to develop different laws and regulatory systems**.

Such choices, however, come with consequences. In the immediate term, the extent of regulatory alignment will be critical to specific aspects of UK access to the EU market, such as equivalence decisions for financial services and an adequacy decision in relation for data protection. In the longer term, the Agreement sets out how each side can respond to regulatory and legal divergence by the other, which may drive further change in the EU/UK relationship.

The Agreement also expressly envisages that the UK and EU may agree further changes to their relationship in future, including regular reviews. **This will be a living, evolving relationship**.

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## Understanding the Agreement

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Understanding what the Agreement does, and does not do, is vital to any strategy for the EU and UK. Which investments? Which acquisitions? Which partnerships? **The Agreement can also inform not only what to do, but how to do it; how to make those investments, acquisitions and partnerships succeed.**

The Agreement is over 1200 pages long and ranges from high level principles to very specific technical details. Those details are summarised elsewhere<sup>1</sup> and that is not our purpose here. Rather, we aim to provide understanding of its essence and of what that is likely to mean for businesses in practice.

The Agreement does not deal with a number of areas which are important to businesses and drive the shape and implementation of many transactions, such as insolvency and competition law (meaning that the future position with respect to mergers and anti-competitive agreements will be that established by the UK's EU withdrawal Agreement; and so will be materially changed from that during the UK's membership of the EU).

It is also important to remember that EU membership had no significant relevance to:

- English contract law and the vast majority of contracts and agreements governed by English law;
- English company law and the vast majority of corporate transactions involving the UK; or
- the use of English law and jurisdiction for international business.

These areas are therefore not significantly affected by Brexit or the Agreement.

<sup>1</sup> Many excellent summaries have been produced. One we particularly like is <https://www.instituteforgovernment.org.uk/publication/future-relationship-trade-deal>

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## A deal for goods not services

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The primary focus of the Agreement is to avoid the introduction of most significant barriers to the movement of goods between the UK and EU by ensuring the avoidance of tariffs and quotas (albeit this is subject to new “rules of origin” and other increased red tape).

By contrast, the free movement of labour between the UK and the EU has largely been abolished and replaced with the limited ability to temporarily move staff between the UK and the EU. The historic freedom to provide services between the UK and the EU has been preserved only to a very limited degree, with no consistent framework for market access for the provision of services within the EU by UK companies or professionals.

The Agreement does not make provision for the mutual recognition of insolvency regimes between the UK and the EU. Particularly in the current economic climate, this is potentially a significant omission.

### *In practice this means:*

- *Goods based businesses should **urgently consider whether the new “rules of origin” require substantive supply chain changes.** Beyond this, there is generally no immediate need to restructure existing supply chains for the movement of goods between the UK and the EU, or to change corporate structures for goods-based companies.*
- *The implications of marginal cost increases and delays caused by new administrative and other technical requirements for supply chains and distribution networks which involved both the UK and the EU are likely to be less urgent. Businesses with existing activities should consider whether there are medium term opportunities for increased efficiency; **those looking at entering the European region (for example, from the U.S. or Asia) will want to take the new regime into account in establishing operations.***

- For businesses which provide services, going forward it is likely to be better to establish separate corporate entities or branches within each of the UK and the EU. In some regulated sectors, this will be a requirement, although the need for substance or people “in country” will vary and, in some areas, the UK in particular is allowing for flexibility – at least in the short term.
- The fact that, in some of the above scenarios, there will be new benefits to locating activities as between the EU and UK in ways which differ from historic practice is likely to create new opportunities for synergies if businesses with different geographic coverage are combined or work together, or if activities are redistributed. This is likely to drive specific opportunities for M&A, joint ventures or other strategic partnerships and provide rationale for corporate reorganisations.
- For businesses that deal in either goods or services, the lack of provisions in the Agreement which deal with insolvency is likely to add complexity in circumstances where a company which is part of a cross-border supply chain becomes insolvent.

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## Creating known unknowns

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In some key areas, the Agreement does not commit the EU or the UK to a particular course of action.

For example, it is specifically contemplated that the EU will take a unilateral decision as to whether the UK regulatory regime is recognised as sufficiently “equivalent” to justify a reduction in some of the barriers which would otherwise exist to transfers of personal data from the EU (beyond a temporary transition period of up to six months which is provided, subject to certain conditions accepted by the UK, for that decision to be made) to the UK and to UK based entities providing financial services within the EU.

### In practice this means:

- The identifiable period for the immediate adequacy decision regarding personal data creates a known period during which the initial uncertainty will resolve into a known position. With the outcome of that decision currently uncertain, businesses should assume that there is a real risk of significant additional barriers to the transfer of personal data from the EU to the UK. This is the advice the UK Information Commissioner is giving business.
- As equivalence decisions are unilateral, even if granted in the coming months, if the EU subsequently concluded that the relevant UK regime had ceased to be sufficiently closely aligned to that of the EU – for example, because the UK fails to track future evolution of the EU regime – the decision could be reversed. There is an identifiable risk, which can be evaluated and tracked, of significant future change.

- Given the evolution of both practice and regulation in these areas, *businesses should proceed on the basis that there is an ongoing risk of unilateral changes to the EU/UK relationship in the future*. Potentially affected businesses should consider:
  - structuring their businesses in the context of this risk (for example, ensuring they have the capability to continue operating if transfers of data from the EU to the UK were substantially interrupted in the future);
  - putting in place contingency plans to address the situation should this occur and undertaking diligence (where appropriate, supported by warranties or other forms of contractual protection) on the risks and contingency plans of key business partners or acquisition targets;
  - the impact of contractual provisions such as Material Adverse Change, Change Control or Force Majeure in these scenarios and the approach to such provisions both in existing and future contracts; and
  - as Brexit becomes less directly politically sensitive within the EU, when might it be possible and appropriate to actively make the case within the EU to establish, maintain and extend appropriate equivalence treatment for the UK.

More broadly the Agreement contains a number of mechanisms which allow or provide for future change. These include:

- in many areas the Agreement places no legal constraints on the approach which either the EU or UK take to regulation and/or policy;
- the Agreement includes a “rebalancing mechanism” where, if the policies and procedures of the UK and EU with respect to labour and social issues or environmental or climate protection diverge significantly in a manner which is likely to impact trade or investment, either party can initiate a “rebalancing” process by which it can make other changes with a view to neutralising the trade and investment impact of that divergence; and
- a formal rebalancing review (potentially every four years) and a full review of the implementation of the entire Agreement every five years, making these dates identifiable points at which there is a real possibility of change.

***In practice this means that businesses should consider:***

- *What flexibility they should build into their business and its contractual relationships with others to enable them to respond to further changes in areas where no constraints have been agreed and to monitor and evaluate the probability, and potential nature, of change (on an ongoing basis) in businesses.*
- *Where changes in the EU/UK relationship could have a material impact, whether to structure their own commitments (for example, contractual “options”, “break” or “price review” provisions) to coincide with the planned reviews of the Agreement.*

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## Enabling divergence whilst maintaining alignment

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One of the UK's key objectives for Brexit has been to secure flexibility for its regulation to diverge from that of the EU. **The Agreement duly allows the UK significant flexibility to diverge from the EU in large areas of regulation, particularly around services and the digital economy.**

However, it is clear that the EU and UK have many shared values and the Agreement reaffirms this. It reiterates a general principle that EU and UK standards should start from international standards and sets out a mutual commitment (underpinned by the “rebalancing mechanism” referred to above) not to lower labour standards, or environmental and climate protection, in a way which would impact fair competition, supported by some detailed and specific commitments in relation to environmental standards in areas such as carbon pricing.

### ***In practice this means:***

- *It will be more important than ever for businesses to take a “joined up” approach in engaging with international standard-setting bodies, the EU and the UK.*
- *There will be opportunities for businesses to use engagement with either the EU or the UK Government to put pressure on the other through the mechanisms of the Agreement. Similarly, the Agreement provides a tool for businesses to use in pursuing the shared climate change objectives which it reflects.*
- *Whilst the commitments in the Agreement in respect of labour standards are fairly loosely stated, this only reinforces the likelihood that the UK will retain the transfer of undertakings (TUPE) regime which is central to the implementation of business transfers and outsourcing transactions across the UK.*

The UK's declared policy intent is to use the flexibility which the Agreement provides to pursue its strategy of becoming a highly attractive destination, particularly for the high-tech and life sciences sectors, and of “levelling up” parts of the UK which are perceived to have “fallen behind”.

In addition, although the Agreement provides for the UK to establish a regime to protect against state aid and Government subsidies, these commitments allow the UK significantly greater flexibility than existing EU State Aid and Public Procurement rules. The combination of these factors means we are likely to see the UK Government engage in a more activist industrial policy focused on those priority areas.

The other side of this is that the UK will no longer be part of EU decision making. Historically, the UK's voice within the EU has often articulated a pragmatic “Anglo-Saxon, common law” approach to the development of policy and regulation.

The removal of the UK's powerful and quite distinctive voice at the table is likely to make it easier for the EU to reach consensus and move forward, but that consensus may well take less account of the potential concerns of international business, particularly a U.S. audience.

### ***In practice this means:***

- *EU businesses and those dealing within the EU should look to identify areas where the removal of the UK's voice from EU decision making could create risks or opportunities for example, opportunities for the EU to reach a clearer, simpler or quicker consensus and policy position). With this in mind, there may be opportunities, or a need, for those businesses to seek to engage more actively with the development of EU policy – both in relation to internal regulation and trade deals with the rest of the world.*

- As the UK looks to develop its distinctive post-Brexit place in the world, and to use newfound regulatory flexibility to do so, *there will be a unique period of opportunity for businesses to engage with UK Government to help shape the UK's future approach* particularly in areas like digital health and the wider digital economy.
- Businesses (particularly international businesses) should consider opportunities to engage with the UK Government to find practical ways to help it pursue its objectives in ways which can generate business opportunities and/or Government support for inbound investment. This is also likely to create *new opportunities for M&A and strategic partnerships involving UK businesses, particularly in high-tech sectors.*
- There are likely to be more opportunities to work alongside UK Government, particularly in its priority policy areas, and to flexibly structure deals with UK Government, than has previously been the case.
- There is an opportunity for businesses to engage with UK Government to help shape the UK's future regime for controlling subsidies.
- When negotiating with UK Government in the future, the position regarding controls on "subsidies" within deals is likely to become more opaque. Whilst this will potentially offer greater flexibility in terms, it also means counterparties will face additional risks of UK Government leveraging the point in negotiations.

The future direction of the UK following Brexit, the UK Government's economic, business and regulatory strategy, the UK's approach to achieving sustainability and the future of the UK high-tech and digital industries are core themes of our new UK 2030 programme.



# The future

The Agreement is an important step in defining the future relationship between Europe's two biggest economic zones. It creates a framework within which that relationship, and the future of those two zones, will develop.

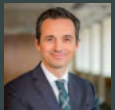
Businesses will need to be both alive to the operation of the Agreement, its implications and evolution and actively engaged in shaping the next steps in both the UK and the EU.

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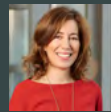


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