Uk General Election Impact on Brexit: Overview of Events for Emerging Market Private Equity Funds

By Owen Lysak, Clifford Chance LLP

The UK has had its first general election since it voted to leave the European Union (EU) last year, just weeks ahead of the start of Brexit negotiation talks. The asset management industry continues to face a period of uncertainty whilst we wait to see how the UK/EU relationship will take shape, particularly what it might mean for UK and EU investor appetite for emerging market private equity funds.

This article gives an update on the implications—if any—that the UK's general election on 8 June 2017 has on Brexit and provides an overview of the current state of affairs.

BREXIT

Implications from the UK General Election

The inconclusive outcome of the UK's general election on 8 June 2017 has magnified the uncertainties surrounding Brexit. For business, those uncertainties mean that the prudent planning assumption remains that Brexit will happen and that it may be hard.

The UK election result – no overall majority

In theory, 326 MPs in the UK Parliament are required to form a majority, but Sinn Fein members do not, as a matter of principle, reducing the number of sitting MPs from 650 to 643. Neither the Speaker of the House of Commons nor his two deputies vote, reducing the effective number of MPs to 640 (but also reducing the Conservatives by two and Labour by one). A majority is, therefore, 321 MPs, and with the Conservatives, having 316 voting MPs after the general election, were still five short of an overall majority. Hence the need for the Conservatives to find a partner in order to offer them some hope of controlling the House of Commons.

The Conservatives' chosen partner, and the only one which was realistically available, has been the Democratic Unionist Party, which has ten MPs for constituencies in Northern Ireland. The DUP was established by the (late) Rev Ian Paisley as the political expression of the church he founded, the Free Presbyterian Church of Ulster. The party came to the fore by opposing any form of compromise with Irish (Catholic) nationalists, whether in the Sunningdale Agreement of 1974, the Anglo-Irish Agreement of 1985 or the Good Friday Agreement of 1998, before reaching a power-sharing agreement with Sinn Fein within the Northern Ireland executive in 2007. The DUP has always opposed the UK's membership of the EU, and, consistent with that position, supported Brexit in the referendum of 23 June 2016 (despite which, a majority in Northern Ireland voted to remain in the EU).

Confidence and Supply

In the 2010 general election, no single party secured an overall majority in the House of Commons. On that occasion, the largest party, the Conservatives again, entered into a formal coalition with the Liberal Democrats. This coalition involved both parties agreeing on the coalition Government's programme, and both Conservatives and Liberal Democrats taking posts within that Government.

The Conservatives have not entered into a coalition agreement with the DUP. Instead, the Conservatives and the DUP have reached a "confidence and supply" arrangement. This will provide for the DUP to vote with the Conservative party if there is a vote of no confidence in the Government and in order to ensure that the Government can raise money through taxation to fund Government activities, but it allows the DUP to choose whether to support other Government measures on an issue by issue basis.

The need for this arrangement gives the DUP far more influence than its ten MPs would normally enjoy, at least if the other parties represented in the House of Commons are organised and united in their opposition to the Government.

Without DUP support, the Government could struggle to secure the passage of legislation through Parliament. The Government's small majority (even with the DUP on board) also gives power to backbench Conservative MPs since it would take only five of them to rebel against the Government in order to extinguish the Government's majority (again, assuming a united opposition). This has the potential to make the process of government unstable.

Conservative MPs opposed to the EU have a long history of challenging their own Governments by siding with the opposition on key votes, most notably during Prime Minister John Major's Governments of 1990 to 1997, and it was internal Conservative Party friction that led to the Brexit referendum.

The UK parties' position on Brexit

None of the main parties is seeking to challenge the EU referendum result. The consensus is that the 51.9% vote in favour of Brexit on 23 June 2016 means that the UK must leave the EU. The Liberal Democrats' manifesto for the 2017 general election advocated a second referendum, but (despite increasing its number of MPs from eight to twelve, on a reduced share of the vote) this did not obtain much traction with the electorate. The main parties are committed to delivering Brexit. The question is what Brexit means.

The Conservative's policy set out in its manifesto for the 2017 general election was, unsurprisingly, the same as the previous Conservative Government's, i.e., withdrawal from the EU's single market and customs union, control over immigration, and the removal of the UK from the jurisdiction of the Court of Justice of European Union (CJEU). The Conservatives also stressed that they would seek a "deep and special partnership" with the EU, while also maintaining that "no deal is better than a bad deal for the UK."

Any reliance on the Conservative manifesto by the Government will now have to be governed by the politics of the possible. If a measure won't secure support in the Commons, it will be "pruned" in the words of a senior Government minister. Whether this means that the Government will be more open, for example, to staying in the customs union, either as an interim measure or permanently, or softening its policy on immigration remains to be seen, but the Government will be susceptible to pressure from those favouring a softer Brexit, as well as to pressure from those who want a clean break with the EU.

The Labour Party's manifesto, equally unsurprisingly, condemned the policies of the previous Conservative Government, but its approach overlapped in practice. "We will… have a strong emphasis on retaining the benefits of the Single Market and the Customs Union" (a deep and special partnership?) but "[we] will reject "no deal" as a viable option and if need be negotiate transitional arrangements to avoid a "cliff-edge" for the UK economy." Seeking to retain the benefits of the single market and the customs union is not the same as seeking to stay within them. The Labour Party does not want to remain in the single market, though comments from some senior figures may, perhaps, indicate a more flexible approach to the customs union.

The DUP's manifesto for the 2017 election was more aspirational than specific (13 pages, against the Conservatives' 88 and Labour's 128). It said that the DUP would seek "ease of trade with the Irish Republic and throughout the European Union," a "frictionless border with the Irish Republic for those working or travelling in the other jurisdiction," a "comprehensive free trade and customs agreement with the European Union," and to make "Northern Ireland… a hub for trade from Irish Republic into the broader UK market" with "no internal borders" in the UK. At the same time it also wanted "progress on new free trade deals with the rest of the world" and "customs arrangements which facilitate trade with new and specific markets."

Press comment has argued that the Prime Minister may be forced to soften her attitude to Brexit – most MPs were opposed to Brexit and are likely to favour a gentle departure slope rather than a more vertiginous drop. A former leader of the Conservative Party, Lord Hague, even suggested that a cross-party commission should be set up to take charge of Brexit, an idea also floated by some Labour politicians and by the SNP. That is probably unlikely: What Government would willingly cede control of the main political and economic issue affecting the country? But, the arithmetic in the House of Commons may force the Government to explore what form of Brexit will actually secure a majority, which will require at least consideration of the views of opposition MPs, even discussions with them (whether formal or informal). The European Communities Act 1972 was only passed by the then Conservative Government in the face of Labour Party hostility with the aid of a significant number of europhile opposition MPs.

The EU's position on Brexit

What the UK's political parties would like Brexit to mean is, of course, only half the story (if, indeed, it is that much). The withdrawal agreement, customs union, the single market and any other "soft" deal with the EU must be agreed with the EU (and possibly others), and a deal must be struck before 29 March 2019 (and, in reality, well before that) if there is to be an agreement at all. Absent agreement, the UK will leave the EU at midnight on 29/30 March 2019, trading with the EU on World Trade Organisation terms (though departure can be delayed if the UK and all members of the EU agree to put back the date). Time is not the UK's friend. Negotiations between the EU and the UK began on 19 June 2017. The EU laid down three initial priorities for the negotiations, which it demands be resolved (or, at least, "sufficient progress" be made) before it will move on to trade talks. These priorities are EU citizens in the UK and vice versa, money and the Irish border. The EU's chief negotiator, Michel Barnier, has reiterated since the election that the sequencing of negotiations is non- negotiable. At the same time, the EU has taken its customary approach to all negotiations, namely that they should be "conducted as a single package" in which "nothing is agreed until everything is agreed".

It is hard to believe that a deal cannot be reached on citizens' rights. It may well be unacceptable to create what one former judge of the CJEU described as "a super-privileged caste in the future UK (as will the UK migrants in the EU Member States)" with special rights enduring forever, but there is a mutuality of interest between the UK and the EU in ensuring the fair and equitable treatment of their respective citizens who have exercised their rights to live and work in other EU member states. Even with the UK's stated desire to control immigration, with goodwill a deal can be found.

Money is more difficult. The EU's negotiating guidelines demand a "single financial settlement… [covering] all [the UK's] legal and budgetary commitments as well as liabilities, including contingent liabilities". There are legal uncertainties as to what, if any, liabilities the UK might have on withdrawal from the EU (see Clifford Chance's March 2017 briefing entitled *Brexit: Will the UK have to pay to leave the EU?*) but demands by the EU for an upfront payment in a sum even approaching that quoted in the press (up to EUR100 billion) could prove politically difficult even for the most europhile politicians in the UK.

The sequencing required by the EU for the money discussions could exacerbate this problem. UK politicians may feel able to agree to pay something to the EU in return for a satisfactory trade deal, but being forced to agree what that payment should be at the outset — the ultimate zero sum game —without knowing what, if any, trade agreement will be achieved could be more difficult.

This is not to say that money cannot be agreed. For example, whether and, if so, what the UK is obliged to pay the EU and vice versa could be treated as a legal issue and, as such, referred for resolution to an international tribunal, whether an existing one or an ad hoc tribunal established for the purpose, though this may require some finessing of the CJEU's requirement that it be the ultimate arbiter of EU law. Negotiations on other matters could then take place in parallel with the legal proceedings. However, the EU may be reluctant to relinquish this negotiating card. Legalising the money issue in this way would remove the political and economic pressure on the UK as to the price for departure, which could (given that international legal procedures are seldom fast) create a hole in the EU budget as early as 2019.

The position of Northern Ireland and the Irish Republic could also pose problems for the negotiations, particularly given the Conservative Government's reliance on the DUP. If the UK leaves the EU with no deal, prima facie there will be a hard border between Northern Ireland and the Republic at which customs duties will be payable on imports going in both directions. The EU's negotiating guidelines say that "flexible and imaginative solutions will be required, including with the aim of avoiding a hard border, while respecting the integrity of the [EU's] legal order." If the UK were to join the customs union, that might solve the problem, as might offering some sort of special status to Northern Ireland (though whether either of these would be compatible with the DUP's manifesto is open to question). Alternatively, technological solutions may be available to avoid the principal objections to a hard border.

The triple issues of citizens, money and the Irish border pose significant challenges for both the UK and the EU. It is possible that negotiations could break down on one or more of these issues before discussions even touch on trade issues. Equally, with goodwill, it may be possible for the negotiators to resolve those three issues and move on to agree to transitional arrangements (an "implementation phase," as the Conservatives call it) or even substantive agreements as to the future. But what the negotiators agree will then need to be returned to the politicians to enact.

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Conclusion

The UK's general election has not (so far) called Brexit itself into question, but it has reopened debate within the UK as to what Brexit means, adding to the numerous uncertainties already surrounding Brexit. It is questionable whether there is a majority within the House of Commons for any one particular form of Brexit. For business, the only prudent planning assumption is that Brexit will happen and that the landing may be hard.

Currently, Brexit would mean that UK asset managers will no longer qualify for a passport under existing EU legislation, which would affect those asset managers who rely on a passport (whether for marketing or managing services) to conduct their business. This may mean UK managers raising capital from EU investors may face more difficulties, and may also affect EU investor appetite for investing with UK managers.

About the Author

Owen Lysak is Partner at Clifford Chance LLP

