

## A guide to Brexit for the UK fashion industry

In January 2017 Prime Minister May delivered the Government's 12 point plan for Brexit. On 13 March 2017, the UK Government formally triggered Article 50 of the Treaty on European Union and so initiated the process of leaving the European Union and the start of the two-year negotiation period with the other 27 Member States of the EU. More recently, the Government has published a series of position papers for the purpose of its negotiations with the EU Commission.

But what are the key aspects of the UK Government's Brexit plan and the likely implications for fashion businesses?

This guide:

- sets out a commentary on the UK Government's published plans for Brexit; and
- provides some practical steps for fashion companies.

### The UK Government's Plan for Brexit

#### 1. Leaving the Customs Union

*"It is time for Britain to get out into the world and rediscover its role as a great, global, trading nation"*

The Prime Minister wants the UK to leave the customs union and to increase its trade with fast growing export markets. In practice this means the Government negotiating new customs agreements whilst seeking to maintain tariff-free trade with the EU. The fashion industry will be concerned that, in particular, deals with China, India, Vietnam and Bangladesh - key countries for production and manufacturing - are achieved. A deal with the US - an important export market - will also be crucial.

*Comment*

*Most favoured nation clauses in existing trade agreements are likely to impact on the UK's ability to make bilateral deals with various trading partners, and in any event trade deals will take time to negotiate. The longer it takes to negotiate new trade deals, the longer the UK's period of uncertainty will affect businesses and increase speculation as to what will happen next.*

#### 2. Free trade with the EU

*"We will pursue a bold and ambitious free trade agreement with the European Union"*

This is confirmed by the Government's position paper. The Prime Minister wants to negotiate a Free Trade Agreement (FTA) and customs agreement with the EU as soon as possible within the two-year negotiation period initiated by Article 50. The FTA could be similar to the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU.

*Comment*

*CETA took seven years to negotiate. Each of the 27 Member States of the EU must agree on the terms of the FTA and the Prime Minister was adamant that "no deal for the UK is better than a bad deal for the UK".*

*It is therefore possible that no deal is achieved by the time the UK leaves the EU. In such circumstances, the UK's trade with the 27 Member States of the EU would operate under the World Trade Organisation's (WTO) rules.<sup>1</sup> These are legal 'ground rules' for international commerce by which members of the WTO (such as the UK) have agreed to trade. A core principle of the WTO rules is non-discrimination. This means that goods traded between the EU and UK, as well as between the UK and non-EU countries, would be subject to customs tariffs based on the WTO's most favoured nation (MFN) rates.*

*In addition, the UK will need to reach separate trade deals with each of the countries with which the EU has negotiated preferential trade deals (over 50 of which have been ratified or are awaiting ratification). Until it does so, the WTO's MFN customs rates will apply, to the disadvantage of the UK fashion businesses.*

*The final terms of a FTA with the EU and preferential trade agreements with non-EU countries will determine whether the free trade of fabric, textile and garments will continue between the UK, EU and countries with which the UK, through membership of the EU, had the benefit of preferential trade deals, or whether fashion businesses' supply chain arrangements will be faced with increased tariffs and customs duties following the UK's exit.*

### 3. Rules of origin

If the UK does not agree a FTA and a new customs agreement with the EU, British fashion companies will also be concerned that national rules of origin will apply to their products. Rules of origin refers to the criteria which determine the national source of a product. They are used by governments to decide which tariffs and import duties to apply to a product. Generally, the rules distinguish between products which are of single country origin (they have been sourced and produced in one country) and products which have been sourced elsewhere but sufficiently worked or processed in order to qualify as originating from the country from which they are exported. However, the practices with regard to rules of origin vary between different national governments.

#### Comment

*Currently, as the UK is a member of the EU single market, fashion businesses which export their products from the UK are able to apply a "made in Britain" label to their products, even where they have been sourced from other countries. Their products will still be considered sufficiently "British" and can benefit from a reduced or zero rate of duty when exported to the EU and to non-EU countries with which the EU has preferential arrangements as to rules of origin.<sup>2</sup>*

*Following Brexit, how much of a product is produced in the UK could become very important to determine, having regard to customs duties and issues concerning rule of origin. Fashion businesses which currently use the UK as an entry point to the EU will need to rethink their supply routes and may choose to bypass the UK altogether. The customs checks which the UK Government would need to introduce in order to enforce the rules of origin would also present an administration cost and a burden fashion business may seek to avoid.*

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<sup>1</sup> [https://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](https://www.wto.org/english/docs_e/legal_e/legal_e.htm)

<sup>2</sup> [Council Regulation \(EC\) N° 1207/2001; http://ec.europa.eu/taxation\\_customs/business/calculation-customs-duties/rules-origin/introduction\\_en](http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/introduction_en)

## 4. Immigration

*“Brexit must mean control of the number of people who come to Britain from Europe”*

The Prime Minister’s proposal means that all EU nationals seeking work in the UK will require a permit. The preference is towards highly-skilled workers and students.

In respect of EU citizens currently residing and working in the UK, the Prime Minister is seeking a reciprocal deal to guarantee the rights of EU citizens in the UK and UK citizens in the EU. In a proposal before the EU Parliament she explained that EU citizens in the UK would be able to obtain “UK settled status” if they have been legally residing in the UK for over five years. The UK Government has since published detailed proposals outlining how it intends to protect the rights of EU citizens in the UK and UK nationals in the EU.

### *Comment*

*Despite the UK Government’s published proposals, a deal is yet to be agreed with the EU Parliament. For UK fashion businesses relying on workers from the EU, restrictions on the ease of movement of workers may lead to shortages of labour, and consequently increased labour costs due to demand. This will have an effect on profit margins and operating budgets of fashion businesses.*

*In addition, as Andrew Groves (fashion designer and Course Director for BA Fashion Design at the University of Westminster) has pointed out, restriction on movement could be career-limiting. He admitted that he has been advising his students who have been receiving job offers in the UK and has often pushed them to move abroad and knock on the doors of French fashion houses; he now fears that he will no longer be able to give that advice.*

## 5. Competitive tax structures

*“We would be free to change the basis of Britain’s economic model”*

The Prime Minister included a veiled threat to implement new competitive tax structures in order to attract and retain businesses operating in the UK if it is excluded from accessing the EU single market.

The UK already has one of the lowest corporate tax rates compared with other major economies such as Germany and the US. Changes to its economic model, which would create an even more competitive tax structure, could have a positive effect on foreign investments, all other things being equal.

### *Comment*

*The weight that this threat will have in the negotiations with the EU remains to be seen. If followed through, it could lead to a “race to the bottom” in which major countries seek to outdo each other by introducing further competitive changes to their tax structures.*

## 6. Control of laws

*“Leaving the European Union will mean that our laws will be made in Westminster, Edinburgh, Cardiff and Belfast”*

The Prime Minister has impressed that Brexit will mean that the UK will control its own laws and the Court of Justice of the European Union (CJEU) will cease to have jurisdiction in the UK.

## Comment

*The fact that a UK based business is no longer required, as a matter of English law, to comply with EU law does not mean that EU law no longer applies to the UK business. For example, in order to continue trading with businesses in EU Member States, products will need to meet EU standards. It is therefore unlikely that product liability regimes, consumer protection laws, Working Time Regulations, and data protection laws will change. In addition, it remains to be seen what will happen in the case of pan-European intellectual property rights such as trade marks, designs and patents.*

*In theory, in a post-Brexit world the UK Government would be able to give preferential treatment to UK businesses and favour them over their EU counterparts. However, this scenario is likely to be viewed as counterproductive as EU Member States could potentially apply reactive measures to put the UK at a disadvantage.*

*In addition, contracts which refer to EU laws will need to be reviewed as to whether the relevant law referred to will continue to apply. This will depend on the context and purpose of the relevant clause in the contract, and the commercial background.*

## Practical steps for businesses

### 1. Financial implications

Fashion businesses will need to consider the financial implications for their businesses if a free trade deal with the EU is not agreed, as well as the implications of the outcome of trade deals with non-EU countries.

Commercial agreements being negotiated should be reviewed in the context of tariffs for import and export of goods to and from the EU which could apply after Brexit. The financial impact of trade arrangements with countries outside the EU, with which the UK will need to renegotiate tariff rates, should also be addressed.

Supply and labour costs may therefore increase and fashion businesses will need to decide how to cope with the additional costs – can they be passed on to the customer? Will fast fashion business in particular be prejudiced?

The issues arising from increased supply costs will very likely have a greater impact on emerging designers who source their materials from outside the UK and produce their garments in other EU countries. This could have a great impact on emerging designers but could potentially encourage a new “Made in Britain” culture where companies will be looking to source within Britain in order to avoid exchange rate differences. Costs may also be incurred where the restriction on movement of workers creates a shortage of workers and increases labour costs.

### 2. Commercial contracts

Fashion businesses should identify their key contracts – do they provide enough protection in respect of Brexit; do they require renegotiating or amending?

Contract termination dates should be checked, as contracts expiring before March 2019 may not need amending.

Existing contracts which include material adverse change provisions should be reviewed insofar as if the financial impact from Brexit is sufficiently serious, it could trigger a right to invoke the material adverse change provisions in the contract.

Steps may need to be taken to future-proof new contracts by including express provision for the financial impact of Brexit such as exchange rate variation and inflation clauses, and express provisions dealing with tariffs for imports or exports to and from the EU and additional customs procedures.

New contracts which reference EU law will also need future-proofing by including an express provision for whether the EU includes the UK after Brexit. Contracts will also need to provide for modification or repeal of European legislation.

The position remains uncertain as to what will happen to EU-wide registered intellectual property rights, in particular to EU trade marks (EUTMs) and licences granted to cover such rights.

It is unclear whether EUTMs will be enforceable in the UK, and whether the UK will decide to recognise an EUTM as if the UK was still part of the European Union. It could be the case that new UK trade marks will be created from the current EUTMs or there could be a reform to the whole EUTM system that would allow non-EU states to be covered by the unitary regime of EU trade mark rights.

Given the uncertainty surrounding what will happen to current registered EUTMs, the same will apply to EUTM licences. Will such licences automatically cover the UK territory or will the terms need to be renegotiated in order to ensure full protection?

Issues of enforcement may arise as the rules governing licences of UK trade mark licensees in the UK differ from those governing EUTMs. For instance, UK trade mark licensees (both exclusive and non-exclusive) have the right to bring proceedings in its own name, unless the licence provides otherwise.<sup>3</sup> The position is different for licensees of EUTMs as such right is only available to exclusive licensees. Consequently, existing non-exclusive EUTM licences may not contain an express exclusion in respect of the right of the non-exclusive licensee to bring proceedings in its own name.<sup>4</sup>

### 3. Operational issues

Fashion businesses may wish to consider establishing EU based subsidiaries which could provide continued tariff free or reduced tariff access to the EU and could provide companies with flexibility depending on

- the source of manufactured products; and
- the eventual nature of the trade deals the UK may be able to negotiate with the EU and non-EU countries.

Supply chain arrangements may need to be reviewed and businesses may consider routing products through countries with more favourable tariffs. In doing so, the savings will need to be weighed against the additional time it will take in getting the product to its destination.

Existing supply contracts may have strict deadlines with financial penalties for failing to meet them. New supply agreements will need to be flexible to absorb the impact of operational changes as a result of Brexit.

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<sup>3</sup> Trade Marks Act 1994; s.30 (2) and (3)

<sup>4</sup> EU 2016/0345 Article 25 (3)

## 4. The industry's response

Despite the initial shock of the Brexit vote, Caroline Rush (chief executive of the British Fashion Council) has spoken positively about the potential impact of Brexit on the fashion industry as an opportunity for a thorough market and industry analysis and chance to focus on what is really important for the fashion industry in order to find the sources of potential growth.

Robin Walker, the Minister for Brexit, also spoke at February's LFW, emphasising how British fashion plays a fundamental role in the growth of the UK economy overall contributing £28bn and 880,000 jobs in the industry across the country.

Lobbying for (i) tariff-free trade in the EU and (ii) the rights of businesses and individuals to work and stay in the UK are only some of the ways in which the fashion industry can ensure the post-Brexit world can work for the industry. Zero, or low, tariffs would allow for industry growth and clarifying businesses' and individuals' rights of movement would ensure healthy competition by continuing to attract foreign talent to the UK.

As Federico Marchetti (Founder of Yoox and CEO of YOOX Net-a-Porter Group) pointed out in his response to the June 2016 referendum results: "The reaction is more important than the issue".

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