VDMA position paper

VDMA position paper on the exit of the United Kingdom of Great Britain and Northern Ireland (UK) from the European Union ("Brexit")

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I. Introduction

The United Kingdom of Great Britain and Northern Ireland (UK) and the German and European mechanical engineering industry are closely integrated economically. With a total market volume of around 40 billion euro, the UK is one of the four largest markets for mechanical engineering products in the European Union, and one of the ten largest worldwide. Furthermore, the British mechanical engineering industry is the fourth-strongest in the EU, after Germany, France and Italy. EU-27 represented the largest market for the British mechanical engineering industry in 2016, with total exports of 11.6 billion euro. Exports to Germany accounted for 2.6 billion of this figure. In the other direction, the UK was the German mechanical engineering industry's fourth-largest export market, after the USA, China and France, with total exports of 7.4 billion euro. Total exports of mechanical engineering goods from EU-27 to the UK amounted to 20 billion euro.

71 mechanical engineering firms in the UK, employing around 20 thousand people, are majority-owned by German investors, and 61 mechanical firms in Germany, with a workforce of more than 16 thousand employees, are majority-owned by British investors. German and UK direct investment (FDIs) in the other country's mechanical engineering firms are in the high two-figure billion-euro range.

These figures already clearly indicate the extent to which the mechanical engineering industry will be affected by the UK's decision to leave the EU. The economy is already concerned about the uncertainty regarding future investments and conditions for the access of goods, services, capital and persons from the EU-27 to the UK. Trade and commercial barriers will suddenly increase unless the parties can agree immediately following the exit on a horizontal agreement applying in the same way across all sectors of the economy. The aim must therefore be to create readily predictable conditions as quickly as possible, and following the UK's exit, to prevent the possibility of the long-term divergence of market conditions, through a comprehensive free trade agreement.

In this context, the VDMA explicitly shares the view that economic cohesion of the EU-27 and unity of the EU must take precedence over the relations of the EU to the UK. The VDMA does not support the conclusion of specific agreements for individual business sectors that would lead to a weakening of the EU's internal market rules, and in particular the unity of the four fundamental freedoms of the EU. From the perspective of the mechanical engineering industry, a horizontal exit agreement is the only viable approach for avoiding some, altough not all, of the potential trade and commercial barriers.

II. Preliminary general remark

This VDMA position paper describes the specific consequential damage from Brexit for the mechanical engineering industry in the following areas: *(I) trade in goods and services, (II) the UK as a production location – competition*, *(III) the UK as an integral part of value-addedchains, and (IV) free movement of persons*. Throughout the paper, the VDMA recommends and urges the UK and the EU to take action to prevent the consequential damage, where already possible in an exit agreement or at a later stage in a future partnership and free trade agreement.

Some of the potential consequential damage impacts – particularly in area (I) *trade in goods and services* – could be prevented or at least prevented if the UK were to remain a member of the Customs Union, since a customs union would have the effect of maintaining some important trade facilitation arrangements between the EU and the UK.

According to the content of the UK's declaration of 29 March 2017 of its intention to exit from the European Union, however, at this stage it has to be expected that the UK will leave the EU internal market and the Customs Union, and EU treaties and European Court of Justice precedents will no longer apply to the UK. While the result of elections of the House of Commons on 8 June 2017 could lead to a moderate British position in the negotiations, at present time it still has to be assumed that there will be a complete exit ("hard Brexit"), given that the British have not yet moderated their hard line in the negotiations.

In order to provide as comprehensive a description as possible of this "worst case" scenario, i.e. the version of Brexit with the most severe consequences for the mechanical engineering industry, this position paper takes a "hard" Brexit as its point of departure. This form of Brexit would also have the effect of a divergent development of regulatory arrangements, including legislation, in the EU and UK as from day one following the exit from the EU. This would still be the case if, as foreshadowed by the British government in the "Great Repeal Act", EU legal acts that had already been implemented would initially remain in place.

Following Brexit, the VDMA therefore urges the the EU and UK to negotiate a comprehensive partnership and free trade agreement to prevent the creation of new obstacles to trade, investment and economic activity in general. The cornerstones of such an agreement and the transitional provisions should be negotiated during the two-year negotiation phase, in order to avoid major upheavals. From the VDMA's perspective, the following concrete measures should be considered:

(1) **Trade in goods and services**: For the mechanical engineering industry as an especially export-oriented sector, the free trade in goods and services is an absolutely priority. In particular, the customs requirements associated with the exit of the UK from the Customs Union and the likely divergence of technical regulation would have a significant detrimental impact on machinery exports to the UK. If the UK does exit the Customs Union, the VDMA furges the EU and the UK to create facilitation arrangements specifically for these areas in a free trade agreement. Concrete proposals are provided in the relevant sections below.

(2) **The UK as a production location – consequences for competition**: The measures foreshadowed by the British Government towards making the UK more attractive as a place to do business do not represent an acute risk of relocation of mechanical engineering production to the UK. The possibility of relocation in the long term cannot, however, be excluded. An agreement should be concluded between the EU and the UK setting down clear fair competition rules for the benefit of both parties.

(3) **The UK as an integral element of value-addedchains**: There are close economic interrelationships and cooperation links between mechanical engineering firms in the EU and the UK. Brexit will inevitably lead to disruptions in these cooperative relationships. The aim must be to reduce such disruptions as far as possible in an agreement, and if applicable to look for compensation options.

(4) **Free movement of persons**: The EU and the UK should reach agreements in particular to ensure the free movement of employees after Brexit.

III. Trade in goods and services

A. Customs procedure

Following Brexit, the UK would have to be treated as a “third country”. Irrespective of the future treaty relationship between the UK and the EU (e.g. customs union, free trade agreement) and the levying of import duties, customs clearance would be required for supplies to or from the UK. This means that VDMA member companies will incur a processing expense in terms of money and time. Even preferential treatment under an agreement then in place would not be able to fully eliminate the customs bureaucracy since businesses would be required to submit support documents. And a sales tax (import VAT) would certainly be charged on imports.

VDMA urges as follows:

To reduce to the maximum extent possible the administrative expense for supplies to and from the UK, the VDMA urges that self-assessment according to Art. 185 Union Customs Code should be permitted in trade between the EU and UK.

B. Rules of origin

Following a Brexit, goods materials with UK origin would no longer constitute goods of EU origin under the various free trade agreements of the EU. EU businesses that currently use goods of UK origin for their production operation could therefore lose preferential origin of goods for their products.

With regard to future bilateral free trade agreements between the UK and third countries: in the case of a production process in the UK using raw materials of EU origin, such agreements should include provisions for the declaration of a “UK” origin of the goods.

There would be massive disruptions to established value creation chains.

VDMA urges as follows:

The EU should incorporate in the rules of origin in existing and future free trade agreements the cumulation of goods of UK origin.

The rules of origin should be based on the existing provisions of the EU’s agreements with the EFTA states or the Mediterranean states.

C. Relationships with third countries

The European Union (EU) has already concluded more than 60 bilateral free trade agreements, and Great Britain benefits from these. In addition, the EU unilaterally grants certain developing and emerging countries preferential conditions for imports into the EU (general system of preferences). Sometimes the EU grants so-called “ad hoc” preferences for imports into the EU to third countries for political or other reasons.

Brexit will affect supply chains in which the EU, Great Britain and third countries are integrated. In this context, it is possible that according to the structure of flows between the EU, Great Britain and third countries, some preferences may cease to apply. This could have impacts in particular on subsidiaries of VDMA member firms in Great Britain that currently source supplies from Indonesia or India, for example.

In addition, the EU is currently negotiating bilateral free trade agreements with further partners. The exit of Great Britain from the EU could prompt these partners to modify their offers, and thereby have a major impact on the outcome of the negotiations.

VDMA urges as follows:

If the UK does not remain part of the Customs Union, it would have to act promptly to conclude its own bilateral free trade agreements, and during a transitional period it would have to ensure that no detriment to local companies in Great Britain arises.

D. What changes will there be in VAT?

The EU states have a harmonised sales tax system. The framework legislation is the "Common VAT System Directive" (CVSD), whose content has been implemented in British law. The central principle of Community VAT law is that supplies between EU states are carried out tax-free as "intra-community supplies". Instead of a turnover tax on imports, an "acquisition tax" applies to the customer in the country of receipt.

On the UK's exit from the European Union, it becomes a third country territory within this system. In the absence of a transitional agreement reached between the EU and the UK, goods supplied from Germany to Great Britain would become export supplies to be declared for customs purposes in the ATLAS electronic export process. Proof of VAT exemption would then be provided in the form of the customs export notice. An entry certificate or forwarder certificate would no longer be sufficient. In the other direction, supplies from the UK would become imports, which are subject to the turnover tax on imports. Acquisition tax would not apply anymore, as well the intrastate and the European Sales Listing for sales to the UK.

For supplies taking place directly in Great Britain, e.g. delivery of work with installation on site, British law applies. It remains an open question whether Great Britain will maintain the current rules (e.g. the reverse charge process). In any event, Great Britain would no longer be bound by the Common VAT System Directive following an exit.

The same applies to cross-border services. Great Britain may keep the current rules in place (see the "Great Repeal Act"), but will not necessarily do so.

Great Britain's exit would also render directive 2008/9/EC without effect. There would no longer be any input tax refund in Great Britain for German entrepreneurs or for British entrepreneurs in Germany, unless the two states renegotiated the refund of input tax between them.

VDMA urges as follows:

To ensure trading in goods with the UK can continue to operate smoothly following the exit, the customs administrations must be suitably prepared and will have to increase their capacities. German suppliers will require rapid export and import processing. In addition, a bilateral agreement on input tax refund should be reached in good time with the UK, to avoid having a period without any refund mechanisms.

E. Export controls and sanctions

Following Brexit, EU exports to the UK will be subject to the same export controls as in other third countries outside the EU. The UK would have to transfer into national British law all EU export control regulations that are based on international agreements. It remains to be seen whether the UK will also transfer into national British law the EU export control regulations that relate solely to EU policy decisions – after all, the UK will no longer have any direct influence on the content/modification of EU export controls or EU sanctions.

This would have the following consequences for EU businesses:

- Higher internal administrative expense for controls of (re-)exported goods to the UK.
- Significant unfair competition in terms of competition from the UK can not be identified at this stage.

VDMA urges as follows

For export control purposes, the EU should apply a similar treatment to the UK as with the existing less onerous processes for Switzerland, Norway, the USA, Japan, etc.

F. Consequences of Brexit in the area of public procurement

Consequences could rapidly become evident in Europe-wide internal market contract awarding and review processes, since after Brexit British courts may no longer follow the precedents of the European Court of Justice (ECJ), and could apply and interpret national provisions in a manner that is no longer in accordance with [European] directives. In addition, the British law on awarding of contracts, which is based on EU directives, could be changed. Great Britain could issue protectionist provisions. In some cases it might even become no longer possible to apply existing provisions following an exit (e.g. use of European communication platforms).

VDMA urges as follows:

The UK should join the WTO GPA (Government Procurement Agreement). The VDMA also urges the inclusion in a free trade agreement between the EU and Great Britain of provisions on equal treatment in public tender processes according to the Canadian model (CETA).

G. Requirements for products

The internal market for products is fully integrated. Products of the mechanical engineering industry are comprehensively regulated, and are subject to European technical provisions, known as the “New Legislative Framework” (NLF). Directives and

regulations based on the principles of the NLF, operate in a similar manner: they set down basic legal minimum requirements for all products in the relevant domain, which are later filled out in greater technical detail via harmonised European standards for individual product groups. The application of these harmonised standards triggers the "presumption of conformity" with legal provisions. In other words, when a harmonised standard has been applied, it is assumed that the product meets the legal requirements. Compliance with these directives and regulations is the basis for the CE marking of products.

The internal market for products in the area of mechanical engineering has been completed: whether directives or regulations are involved, national provisions are no longer permitted to depart from the product technical requirements under fully harmonised EU provisions. Goods that meet the legal requirements can circulate in the internal market without having to clear any further bureaucratic or financial obstacles. In the mechanical engineering sector, the regulatory domain comprises the machinery directive 2006/42/EC and further directives in the areas of safety, radio frequencies, electromagnetic compatibility and product-related environmental requirements[1]. The internal market for products is a European achievement whose integrity and operation must in no circumstances be jeopardised by the exit of the UK.

As a result of the UK's exit from the internal market for products, in future different legal requirements for products could apply in the EU on the one hand, and in the UK on the other. In addition, there could be increasing divergence in the manner of application of existing rules, once the UK is no longer part of European bodies, agencies or committees[2] . It is in these bodies, for example, that guidelines are set down for the uniform application and practical implementation of existing provisions. In the area of technical legislation, it is also likely that the absence of ECJ jurisdiction for the internal market acquis in the UK will lead to the divergent interpretation and further development of existing provisions. This alone could cause divergent regulatory development in the EU and the UK.

Divergence in the development of the European internal market and the British market would inevitably have economic consequences for the mechanical engineering industry. If different requirements, application and enforcement practices and jurisdiction rules to those in Europe come to apply, this will result in increased expense for mechanical engineering businesses, and production operations may even have to be modified for

[1] 2011/65/EU – RoHS, 2009/125/EC – Ecodesign Directive; 2003/10/EC – Noise (safety and health of workers at work); 2000/14/EC – Outdoor-noise; 97/68/EC – pollutants from internal combustion engines; 2006/95/EC - LVD (Low Voltage Directive); 2006/66/EC - Batteries and accumulators containing certain dangerous substances; 2004/108/EC - EMC (electromagnetic compatibility); 2003/10/EC - Noise (safety and health of workers at work); 2002/44/EC - Vibration (safety and health of workers at work); 2000/14/EC - Outdoor-noise (noise emission in the environment by equipment for use outdoors); 97/68/EC - Emission of gaseous and particulate pollutants from internal combustion engines; 97/23/EC - PED (Pressure equipment Directive); 94/9/EC - ATEX (equipment and protective systems intended for use in potentially explosive atmospheres); 90/396/EEC - Appliances burning gaseous fuels; directive 2014/53/EU on the making available on the market of radio equipment; Directive 2014/33/EU relating to lifts and safety components for lifts; Directive 2014/32/EU relating to the making available on the market of measuring instruments;

[2] REACh: ECHA; market surveillance (ADCOs)

the UK. In addition to the application of the Directive and Regulation on the CE marking of products, another critical consideration is the application of harmonised standards (EN standards) in mechanical engineering.

Further possible non-tariff trade barriers could be created through additional technical product requirements, special types of conformity assessment, national test marks, through to official product licensing processes.

VDMA urges as follows:

To have maximum control over regulatory divergence, there should be a partnership and free trade agreement setting down common principles for regulatory approaches. Close links could also be ensured by maintaining information exchanges at as many points as possible. VDMA sees potential in this context at the non-legislative level of standardisation, market surveillance and accreditation.

i. Type conformity assessment procedure

At present, the UK avails itself of the European NLF for determining conformity assessment procedures. All product regulations under the NLF must specify under which procedure the fulfilment of legal minimum requirements (“conformity”) by the manufacturer is to be demonstrated. A range of procedures are available for these purposes, as set down in the NLF framework provisions, decision 768/2008/EC in relation to regulation 765/2008/EC. Most product directives accept “module A”, whereby the manufacturer conducts the conformity assessment procedure itself according to the requirements set down in module A, and documents and declares conformity on its own behalf (“self-declaration”).

In the case a small number of product groups (explosion protection, pressure vessels) where the safety of the equipment is of exceptional importance, additional documentation procedures are set down for the manufacturer, for which external testing bodies review the firm’s internal assessment process (certification by external testing bodies (notified bodies), external testing of the technical design).

The UK traditionally tends to favour modules including notified bodies. This would be problematic for the mechanical engineering industry, since about 80% of procedures are currently carried out via self-declaration. Based on the experience of VDMA, the UK could in future evolve towards the increased use of modules with third-party testing. This would involve higher financial and resource expense for machinery manufacturers.

VDMA urges as follows:

A section on joint regulatory principles in a free trade agreement should stipulate that both parties will continue to rely mainly on the manufacturer's self-declaration regarding product requirements. Any wider use of third-party testing would mean an enormous increase in financial and bureaucracy expense and time delays for bringing products onto the British market.

ii. How the accreditation process will function

The accreditation system is relevant for testing bodies wishing to certify conformity assessment procedures or other products, processes, tests, services, etc. In the interests of uniform application and quality assurance, testing bodies must be accredited by the relevant national competent body, according to defined standards, thereby establishing their competence. The establishment of the national bodies carrying out the accreditation process also follows clear rules, which are laid down in the NLF regulation 765/2008/EC. The regulation requires that there is to be only one accreditation body for each member state. In the UK, this is the United Kingdom Accreditation Service (UKAS). The regulation also states that all national accreditation bodies are to join the European Co-Operation for Accreditation (EA). This organisation is only open to accreditation bodies from EU member states, EFTA states and so-called 'neighbour states'. Involvement in this organisation is important, since the EA ensures that accreditation is carried out in a uniform manner in the EA member states. This also includes the formulation of guidelines, application instructions, etc.

The UK is also active in two international accreditation organisations, the International Laboratory Accreditation Cooperation (ILAC) and International Accreditation Forum (IAF). It is a signatory to the "general multilateral agreement" (MLA), which should ensure the continued mutual recognition of the test results of accredited bodies. However, this agreement is far from being as binding as the legally established structure of the EA.

VDMA urges as follows:

Given the international agreements in place in this area, the accreditation system is not expected to give rise to any significant technical trade barriers. The process would be facilitated if UKAS were to be placed on the list of countries participating in the European Co-Operation for Accreditation, on a 'neighbour state' basis. This would make it possible to ensure that the accreditation practices of the EU and the UK do not diverge.

iii. Which notified bodies or authorities should be involved in conformity assessment procedure

In cases where the normal manufacturer's self-declaration is not followed, and third-party certification of products or processes takes place in accordance with a legally specified conformity assessment procedure, currently there is certainty that all test results of notified bodies are mutually recognised in the internal market. Notified bodies have been either accredited or "authorised" by the member state. The mutual recognition of the test results of UK notified bodies would no longer be certain after Brexit.

VDMA urges as follows:

To prevent additional technical trade barriers, it would be helpful if a future partnership and free trade agreement would include provisions on the status of the test results of notified bodies. The test results of bodies that are accredited but not notified should be accepted in the internal market through a simple recognition process. Conversely, it is a prerequisite that the test results of notified bodies from the internal market are not subject to any further procedures.

iv. What impacts Brexit has in standardisation (harmonised standards)

Harmonised standards play a key role in the internal market for products, and for the mechanical engineering industry in particular, whose products are comprehensively regulated at European level. Most legislation relevant for the mechanical engineering industry follows the NLF, and therefore does not lay down detailed legal requirements, merely describing the regulatory objective in qualitative, product-neutral terms. The product-specific detail that defines correct compliance with legal requirements is formulated in industry-driven standardisation processes by technical experts from industry and occupational safety entities. The application of harmonised standards prompts the presumption of conformity. Accordingly, it is assumed that through application of the harmonised standard, the requirements of the legislation in question have been met.

Regulation 1025/2012/EU forms the basis for the European standardisation system. There are three European standards organisations, responsible for the formulation of standards in mechanical engineering (CEN), electrical engineering (CENELEC) and telecommunications technology (ETSI). National standardisation bodies (NSB) are members of CEN and CENELEC.

The mechanical engineering industry is represented via the Mechanical Engineering Industry Committee (*Normungsausschuss Maschinenbau, NAM*) in the German Standards Institute (DIN). NAM is organised and funded by VDMA.

DIN is a direct member of CEN. Along with all EU member states, Macedonia, Serbia, Turkey, Iceland, Norway and Switzerland are members of CEN.

The mechanical engineering industry sees the UK representatives as strong allies in the standardisation committees, due to the relative significance of the British mechanical engineering market.

Standardisation has the potential to play a major role in maintaining close relationships in the internal market for products. As long as standardisation continues to concern itself with technical details, irrespective of political interests, and to contribute to the opening of global markets, it is very much in the interest of the EU and the UK to continue working together on the level of European standardisation.

VDMA urges as follows:

The functional viability of the European mechanical engineering industry, as fully regulated within the EU internal market, is predominantly based on harmonised standards. In other words, the British Standardisation Institution's (BSI) continued membership of CEN and CENELEC would make sense if future British legislation remains closely linked with technical standardisation. This is a desirable scenario from the perspective of the mechanical engineering industry, and one that has the potential to prevent the two markets from drifting apart. The transferability of European standards to the global level makes it even more desirable for the UK to continue to participate in European committees. It is therefore essential this continues to be the case.

v. Market surveillance aspects

At present, market surveillance in the UK is carried out on the basis of regulation 765/2008/EC. This does not contain detailed rules on how market surveillance is to be organised. Market surveillance in the UK is therefore nationally focused, operating with around 200 local agencies and several national bodies (such as HSE/HSENI and NMRO).

To facilitate and boost the effectiveness of consistent enforcement Europe-wide, electronic databases (RAPEX and ICSMS) have been introduced, enabling market surveillance agencies to view data on products that have been tested in other member states, and where applicable, have been declared as non-conforming. At present, this data is accessed by British market surveillance agencies, along with those of other states.

In addition, national market surveillance agencies regularly exchange information on surveillance activities on European platforms. If the UK were no longer taking part in these platforms after Brexit, it is to be expected that enforcement practices in the UK and the internal market would diverge. This could mean, for example, that products are

tested twice, or could lead to uncertainty on the part of manufacturers as to how the British agencies will proceed.

According to the level of rigour of official oversight in the UK after Brexit, machinery manufacturers could be disadvantaged by enforcement practices and interpretations of technical requirements that differ from those in the EU.

VDMA urges as follows:

Cooperation on the administrative level could be facilitated through the participation of the UK in the RAPEX and ICSMS information systems, as a third country with which certain understandings were in place on cooperation in the area of market surveillance. In addition, information exchange on market surveillance practices in the EU and the UK should be kept in place, in order to contain the tendency for the two parties to drift apart.

H. Intellectual property rights

In the area of intellectual property, the main issues arising are in the area of the scope of European intellectual property. On this point, Brexit will definitely require rules to be formulated and, if applicable, action by intellectual property holders.

For example, the ‘union trademark’ – formerly called the ‘community trademark’ – clearly raises the issue of its application in Great Britain: whereas at present the registration of a union trademark gives the intellectual property owner trademark rights in Great Britain (Art. 1 par. 2 (EC) No. 207/2009), it is not clear what consequences the exit will have on its application. It is scarcely conceivable that there could be a “hard” transition, whereby the property right was extinguished in Great Britain without the right-holder having the possibility of obtaining national protection, having regard to the priority of the union trademark. This would lead to a race for the rights that would then have to be re-obtained.

In the area of patent protection, there is (currently) no comparable protection right to that of the union trademark. However, the European patent with unitary effect (unitary patent), which would perform a similar function, is about to be introduced: following ratification of the relevant regulation by twelve of the required thirteen states, only the – admittedly essential – ratifications by Germany and Great Britain remain. Brexit raises numerous issues in this context, all of which could significantly delay the introduction of the unitary patent.

The mere fact that one of the central chambers is to be located in London highlights the problems that the unitary patent will face following Brexit. At present, however, there is nothing to indicate what direction the ratification process might now follow. But the President of the European Patent Office (Benoit Battistelli) is assuming that the UK will complete its ratification, as promised, by June 2017, and that the unitary patent court will be able to go into operation at the start of December 2017.

For licensors and licensees, there will also be issues of territorial application in cases where the licence agreement refers to the territory of the European Union as a whole. Licence agreements could therefore be subject to some uncertainty; for example, it would be questionable whether rights had been granted in Great Britain if the licence did not explicitly state this. On this point, the contracting parties will now have to be very attentive to exactly how the territory of the agreement is defined.

Firms whose IP portfolio is administered by departments located in the United Kingdom may also have to accept that their authorised representatives there are no longer entitled to appear for the firm before the EUIPO. On this matter, at present there is no indication of how the exit negotiations might be able to arrive at a facilitation arrangement.

And finally, issues regarding European provisions on design law (community registered design) will arise, similar to those already outlined on the union trademark.

VDMA urges as follows:

The VDMA calls for the rapid implementation of the EU unitary patent, so that details such as the entitlement of British attorneys-at-law and patent attorneys to represent clients before the unitary patent court can then be clarified. From the perspective of the VDMA, all other options would unnecessarily delay or even jeopardise the introduction of the unitary patent.

In any event, it is essential to prevent the continued application of rights being called into question. The VDMA therefore urges that current right-holders should at least be given the possibility of the “nationalisation” of their existing property rights having regard to the priorities of the former property rights.

I. Contract law

The general expectation is that Brexit will have only minor impacts on commercial contracts with contractual partners in the UK. However, in cases where contract provisions are based on British national law implementing European directives, it remains to be seen whether, and in what way, this law may be amended or replaced with different provisions. In addition, while Brexit is not likely to have any direct impacts on fundamental British national contract law, since it has remained largely unchanged by European legislation, the detailed consequences are difficult to predict.

Questions of applicable law, over which courts have jurisdiction and the international enforcement of judgments, are resolved in a series of EU regulations (Rome I regulation, Rome II regulation, Brussels regulation). These EU regulations currently apply to all (or almost all, see the exception of Denmark, not further discussed here) EU states. If the Rome I regulation no longer applies after Brexit (and is not replaced), it can be expected that for the UK, national provisions on the applicable law will be based on contractual

obligations, in the same way as the former European provisions (i.e. the content of the Rome I regulation), and election of law clauses will generally be recognised.

And last but not least, Brexit is relevant to the issue of what is meant when a contract (e.g. distributor, commercial agent or licence contract) refers to the territory of the “EU”. Will this still include the UK or not? Such contracts may have to be modified.

VDMA urges as follows:

Following Brexit, the above EU regulations should continue to apply for transactions performed during the term of validity of these regulations (such as election of law agreements) for a period of time to be determined by an international law declaration between the UK and the EU.

IV. The UK as a production location – consequences for competition

A. Fundamental consequences for competition conditions between EU-27 and the UK

European integration has ensured that businesses compete in Europe under almost the same conditions. For example, European Union treaties prohibit anti-competitive state aid in the form of favourable tax treatment for particular businesses or economic sectors. General exceptions are set down in EU legislation, and are subject to individual review by the European Commission.

In addition, there are numerous production location-related regulatory provisions (environmental law, occupational safety, data protection regimes, etc.) that are at least partially harmonised in the EU. As a result of Brexit, the UK would no longer be bound by the restrictions imposed by European law on state aid and harmonised regulatory provisions.

The UK has therefore already given notice of its intention to make the UK more attractive as a business location, and for production in particular, for example through a highly favourable tax regime. While there is no short-term prospect in the mechanical engineering industry of production operations relocating to the UK because of favourable tax treatment or low environmental/occupational safety standards, other location factors, such as the availability of a skilled workforce, play a major role in the mechanical engineering industry. And in the long term, the possibility of displacement effects cannot be excluded, particularly in newly developing sectors (digitisation of industry). In the negotiations, the EU should therefore insist on the inclusion in the agreement with the UK of a control mechanism to avoid distortions of competition.

B. Distortions of competition through subsidies and tax measures

The announcement of intent by the British government – and indeed the attitude taken towards the Japanese automaker Nissan, which has clearly received generous promises from the UK in return for keeping its production operation in the UK – show that there is a real risk of distortions of competition through state aid or taxation policy.

VDMA urges as follows:

In the view of the VDMA, a future partnership and free trade agreement between the EU and the UK should include provisions on state aid, favourable tax treatment and subsidies, so as to ensure uniform and fair competition conditions between the EU and the UK. A partnership and free trade agreement should stipulate equal treatment of businesses from Great Britain and the European Union in both markets.

This partnership and free trade agreement could still take account of the UK's aspiration towards independent legislation as expressed in the Brexit vote. In the partnership agreement, the European Union need not insist on EU provisions on state aid remaining in place in Great Britain. Competition-distorting state interventions could instead be prevented by an investment protection agreement and provisions prohibiting unfair trade practices.

C. Environmental protection in the business sector

Environmental protection has not yet been fully harmonised in the EU. In other words, the relevant directives on air quality (industrial emissions directive, IED), waste water treatment and waste treatment are implemented in national law, and may exceed European minimum requirements or take account of regional specificities.

For example, the IED was implemented through the Environmental Permitting (England and Wales) (Amendment) Regulations 2013. In Scotland and Northern Ireland, it was implemented though the Pollution Prevention Control (Scotland) Regulations 2012 and the Pollution Prevention and Control (Industrial Emissions) Regulations (Northern Ireland) 2013. Permits are issued by DEFRA.

Accordingly, it is not clear whether, and to what extent, the UK will diverge from European permit-issuing practice. However, it is clear that there will continue to be provisions on environmental protection in the business sector.

VDMA urges as follows:

No major changes are expected in the area of environmental protection in the business sector.

D. Occupational safety and health

In the area of occupational safety and health, in Europe there are a series of framework directives (for example, for workplaces, safety marking, personal protective equipment). At EU level, there is an Advisory Committee on Safety and Health in the Workplace (ACSH).

For occupational safety and health, only minimum requirements are set down at European level, without complete harmonisation at this time. This is partly due to the different national occupational safety and health systems. In the UK, the Health and Safety at Work Act is the relevant act. Since the EU has just begun to consider the occupational safety and health acquis, it is not clear whether further harmonisation will take place.

In addition, the UK is closely engaged with occupational safety and health systems (OSHAS 18001). That is to say, businesses operating in the UK either have such a management system or are involved in one in their supply chain. This will remain the case in future.

For VDMA members outside the UK, there will not therefore be any material consequences from BREXIT for occupational health and safety.

E. Data protection and Industry 4.0

The term “Industry 4.0” denotes the digitalisation of export-oriented, globally connected industry. It involves not only cross-border exchanges of data, but also trade of the new products and services of a digitalised industry. The mechanical engineering industry is simultaneously a supplier of Industry 4.0 production equipment, a supplier of data-supported products, and a user of data services. This means it is subject to multiple possible Brexit-related impacts.

Data and information are not an end in themselves in Industry 4.0 – rather, by providing a digital mapping of reality, they boost efficiency and enable businesses to offer new products and services.

For this to operate satisfactorily, there must be compatible rules and services, not only for the digital dimension, but also for tangible Industry 4.0 goods and services. Capital investment in digital production technology requires sufficient economies of scale. Uniform legal provisions and rules, in the EU internal market and as far as possible on the international level in trade with third countries, are therefore a required condition for the success of Industry 4.0.

At the present time, however, many of the requirements for legal frameworks cannot be definitively formulated, because of the dynamic nature of ongoing development in this area. At present, there is no indication of any need for urgent action and the current EU

legal framework seems to be adequate. Accordingly, it can be used as a guide for drafting the digital aspects of a Brexit agreement.

There is, however, a possibility that new production technologies, integrated, intelligent products, data-based services and the increasing elimination of boundaries between products and services will become a regulatory challenge in the future. It will therefore be important to monitor developments during and after the Brexit negotiations.

The broad aim should be far-reaching harmonisation of general conditions, particularly as regards the protection of personal data.

Successfully achieving the aim of the general data protection regulation (GDPR), i.e. to create a “level playing field”, with a uniform legal framework regarding data protection, is likely to be called into question following Brexit with regard to the United Kingdom. This could generate advantages particularly for British businesses, who might be able to gain benefits from taking a different approach to the handling of personal data. In addition, the UK as a third country would be excluded from privileges of the intra-European data communication, i.e. it would be treated in more or less the same way as the USA. This would certainly make data communication significantly more difficult in some circumstances.

In this context, for businesses in Germany it would become important to ensure compliance with the provisions of Art. 4b and Art. 4c of the German Federal Data Protection Act (BDSG). In other words, it would be important to ensure an adequate level of data protection in the state of destination. The Brexit white paper of the British government emphasises the importance of data exchange. This suggests an interest in ensuring mutual acknowledgement of the substance of the data protection regulation. The UK should take steps to ensure a form of data protection similar to that of the GDPR, with the aim of creating a level playing field.

VDMA urges as follows:

Great Britain should maintain the data protection level of the EU GDPR after Brexit and observe the conditions of the EU legal framework in the areas of Industry 4.0 and digitalisation, so as to facilitate the access of British businesses to the EU internal market and that of EU businesses to the British market.

V. The UK as an integral part of value-added chains

Thanks to the internal market, over the last few decades close links have been formed between mechanical engineering businesses on either side of the Channel. UK businesses now form an integral part of value-addedchains in the mechanical engineering industry. The task here is to reduce as far as possible the unavoidable Brexit-related disruptions to these cooperation relationships.

A. Company law

After Brexit, the freedom of establishment for British businesses should no longer apply. The freedom of establishment makes it possible to set up a firm in one EU state and have a branch establishment in another EU member state. According to the freedom of establishment, a British company is entitled to be recognised in the state of the branch establishment. If the freedom of establishment no longer applied, the effects in Germany would be relevant for companies in the form of the British Ltd., Ltd. & Co. KG [= limited partnership with a Ltd. as general partner], plc & Co. KG [= limited partnership with a plc. as general partner] and LLP entities having their factual centre of administration in Germany, but their registered office according to the articles of association in the UK.

Up to now, the determination of the law applicable to the company in question has been based on the “incorporation theory” (“Gründungstheorie”), as being in accordance with the freedom of establishment. This means that the law of incorporationapplies to the company. After Brexit, the UK would have to be treated as a third country. According to the German Supreme Court (BGH), for such third countries the “seat theory” applies.

For the entities referred to above, this would mean being subject to the law of the state in which they have their “real seat”, in this case German law. This would lead to an unlimited liability of the partners, since the firms would necessarily become GbRs (non-trading partnerships) or OHGs (general partnerships) under German law.

Furthermore, companies in the form of a European company (SE) with seat in Great Britain would lose their legal recognition in Great Britain on the completion of Brexit, and would be (compulsorily) converted into a British legal form.

They would have to relocate their seat to an(other) EU member state, since European company forms such as the SE normally have to have their seat in the internal market. From the tax perspective, Brexit could lead to a change of legal form, and hence to the taxation of hidden reserves within the company’s assets.

VDMA urges as follows:

The EU and the UK should grant affected businesses a transition period of several years to adjust the company parameters to the post-Brexit situation.

B. Company taxation

As a result of the so-called “hard Brexit”, in the absence of a successor agreement, the tax benefits provided by the mergers directive, the parent-subsidiary directive and the interest and royalties directive would no longer be available. The British provisions on the implementation of these guidelines would nonetheless remain. Following the exit, legislative initiatives would have to be introduced in the UK to correct the implementation of EU directives. It is quite possible that the UK would keep some harmonising provisions in place.

The omission of the above stated directives would have negative impacts on companies:

- The EU parent-subsidiary directive provides for full exemption from capital gains tax or withholding tax on dividend payments within a European company group. The most important requirement for this directive and its application is that of an at least 10 percent direct shareholding of the parent company in the subsidiary of at least 10 percent, and the continuation of that investment ratio for at least two years. The withholding tax reduction to 5 percent provided for in the Double Taxation Treaty between the UK and Germany (*DTT GB*) will still apply in the event of the Brexit (Art. 10 par. 2 letter a *DTT GB*). *DTT GB* is not tied to the EU membership, i.e. even in a Brexit scenario the *DTT* would remain in place and govern the allocation of taxation rights.

- Enterprise restructuring can be undertaken tax neutral under the mergers directive within the EU. Since there is no final waiver of taxation in the case of cross-border restructuring, though taxation can be postponed until sale. In a Brexit scenario, a cross-border amalgamation between Great Britain and Germany, for example, would no longer be possible, since the resident company limited by shares in the UK would no longer be within the scope of application of the German Reorganisation Tax Act (*UmwStG*).

- Within a European company group the interest and royalties directive allows full tax exemption from the withholding tax on interest and royalties payments on condition of a direct or indirect minimum capital share of 25 percent for a period of two years. The Double Taxation Treaty between the UK and Germany currently does not have withholding tax payments on interest and royalties (Art. 11 par. 1 and Art. 12 par. 1 *DBA GB*At the Brexit, there would be no impacts on cross-border interest and royalty payments between companies in the UK and Germany.

VDMA urges as follows:

The EU and the UK should grant the affected companies a transition period of several years to adjust the company parameters to the post-Brexit situation.

C. Protection of investments in the UK

In the internal market, the priority of EU law and uniform precedents from the ECJ ensure equal treatment for natural and legal persons, irrespective of origin, legal seat or ownership structures.

Following the exit, the UK would no longer be bound by EU law. Even if the EU acquis was transferred, in the final analysis decisions on the interpretation of the law would be made no longer by the ECJ, but by the British courts.

This could gradually and insidiously lead to divergent views of the law, including that on the principle of equality and the protection of investments.

The UK has concluded investment protection agreements with some EU member states (not including Germany). These do not, however, ensure the continuation of EU law in the UK.

VDMA urges as follows:

A future free trade agreement should therefore provide for effective legal dispute resolution for the protection of investments. Ideally this would be along the lines of current ECJ practice in terms of judgments, procedural law and costs.

D. Antitrust and competition law

Brexit could have some severe impacts on antitrust law. An example is the lack of binding effect of European legislation and judgments, which could have far-reaching consequences in antitrust law, with regard to differing judgments or interpretations by the courts, for example. Mergers between businesses could also be affected, leading to increased legal uncertainty and significantly increased expense outlays.

For example, it has been possible for mergers with Europe-wide implications for competition to be notified to the EU Commission. That process would obviously no longer be possible in the event of an exit by Great Britain. Also, the application of the so-called “group exemption regulations”, whereby specific agreements and forms of behaviour are exempted from the general antitrust prohibition, would no longer apply. This would lead to increased expense or duplication of antitrust reviews.

E. Research & Development (Horizon 2020)

27 rather than 28 – this formula does not suggest any particularly drastic loss – particularly not in an area such as research policy, which has no direct impact on company business performance, and in which there is an obvious solution to the problem in the form of “associated membership” of the EU framework programmes. In reality, however, an important pillar of European cooperation is about to be lost.

A quick glance at the number of cooperations and project involvements shows the true size of the problem: at around 13%, the UK, along with Germany (also at around 13%) is the leading actor in EU research, and one of the “big 5” (D, UK, IT, ES and F), who together account for around 50% of all activities.

EU research without the British would therefore represent a loss for Germany: with around 7000 research cooperations (2015/2016), the UK is the country with which German researchers and businesses work most often in Horizon 2020.

British organisations also make a real contribution in qualitative terms: it is not only the renowned universities of Oxford, Cambridge and London that will no longer be involved – many product research organisations will also cease their participation, such as Nottingham University or the “High-Value Manufacturing Catapult” centre. Thanks to their international focus, British technology leaders from industry will clearly have other forms of access to international research – but many SMEs and start-ups will be left high and dry.

There is no doubt that a lot of expertise and much vaunted “excellence” would be lost. Even more serious, however, is the fact that one of the few countries with an industrial base and the associated appreciation of applied pre-competitive industrial research would also be lost to the research environment.

The “Factories of the Future” projects in particular have shown how constructive and important this collaboration is.

A good example is the “QCOALA” project, in which the German firms Precitec and Volkswagen have collaborated with the UK partners TWI and “Computerised Technology” to further develop quality assurance for laser welding. Or the “AMAZE” project in the area of additive manufacturing processes, with six partners from Germany and ten from the UK, including Airbus, Trumpf, BAE-Systems and the University of Cambridge.

The “associated partnership” concept does indeed provide a tool that generally allows non-EU states to participate fully in EU framework programmes. However, the putting on ice of negotiations with Switzerland in 2014 because of free movement of persons issues illustrates the fact that it will not be possible to separate the highly controversial issue of the free movement of persons from that of research policy.

Irrespective of research and incentives policy, Brexit also represents a reduction in the innovation capacity within the EU internal market. Particularly for innovative manufacturing technologies and Industry 4.0, the effects of scale available in the internal market make a key contribution to keeping up in the innovation race with the big economies. It will therefore be important on the one hand to largely maintain access to the UK market, and on the other to protect the common market that remains from negative influences from the Brexit debate.

The main responsibility here lies with the politicians, who instead of treating research policy as something to be negotiated over in the Brexit talks, should see it as an area of policy in its own right, which is of crucial importance for Europe, and which must continue to be responsibly managed in the post-Brexit era.

VDMA urges as follows:

The aim should be to conclude a partnership and free trade agreement along the lines of the Swiss and Norwegian models, but without jeopardising the integrity of rules on the free movement of persons and the internal market. As a “plan B”, alternative options should be created, in the context of third-country cooperations or international research programmes independent of the EU.

VI. Free movement of persons

A. Posting of employees and managers

A sale agreement for machines, components and plant generally also includes commissioning and installation, repairs and service. In practice, this means that technicians carrying out these activities will have to travel to the UK.

In addition, German companies have subsidiaries in the UK, ranging from service and distribution offices right up to production operations. In this context, the posting of German employees to British plants and vice versa is a frequent occurrence.

VDMA urges as follows:

Free access for technicians from mechanical engineering companies of the EU-27 to the UK and the freedom to post staff to own foreign branches in the UK.

B. What impacts has the employee taxation?

Employee taxation issues are essentially governed by the UK Double Tax Treaty (*DTT GB)*. This agreement rules which state is entitled to levy taxes on wage and salary income and how double taxation is to be eliminated. However, all national tax benefits in Germany and the UK that are tied to EU membership will cease to apply. The UK would be treated as a third country.

This would apply for example to a British citizen with unlimited tax liability in Germany when applying for joint assessment and income splitting with his/her spouse, even if the spouse is a resident in another EU/EEA state.

The possible counterfactual situations for employees are very extensive. Generally, a higher tax burden has to be estimated/calculated. Companies that post employees from the UK to Germany or from Germany to the UK must also expect higher costs.

C. Do employees risk less favourable staff welfare conditions?

EU regulations 883/2004 and 987/2009 protect the social security entitlements of employees staying and working in another member state. In particular, they specify what social security provisions apply to employees in cross-border situations. This would mean that in the absence of a transition provisions, A1 certificates could no longer be issued for a stay in the UK and their validity would expire automatically on the cutoff date.

VDMA urges as follows:

Posting should be possible under the same conditions as before. The first step should be to formulate transition rules lasting for several years.

VII. Summary

Brexit will lead to market barriers, competitive disadvantages for businesses resident in the EU and UK, a significant decrease in legal certainty, and additional bureaucracy-related costs. Great Britain's announced intention of leaving the internal market and customs union, no longer recognising precedents of the ECJ, and fully reclaiming its own legislative authority indicates an inevitable process of disintegration, and hence to negative economic consequences.

Great Britain's decision has to be accepted. However, the VDMA also believes that there should be no special rules that would allow the UK to claim the benefits of the EU without fulfilling the associated obligations. This being the case, it is incumbent on the EU and UK to formulate rules for their future collaboration in a partnership and free trade agreement that limits the negative economic consequences of Brexit to the maximum extent possible. The following are the areas of greatest importance for the mechanical engineering industry:

- Simplification of customs procedures and no customs duties;
- Prevention of the divergence of technical provisions, in order to prevent technical trade barriers;
- Prevention of competition distortions through state interventions;
- Ensuring the free movement of employees.

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