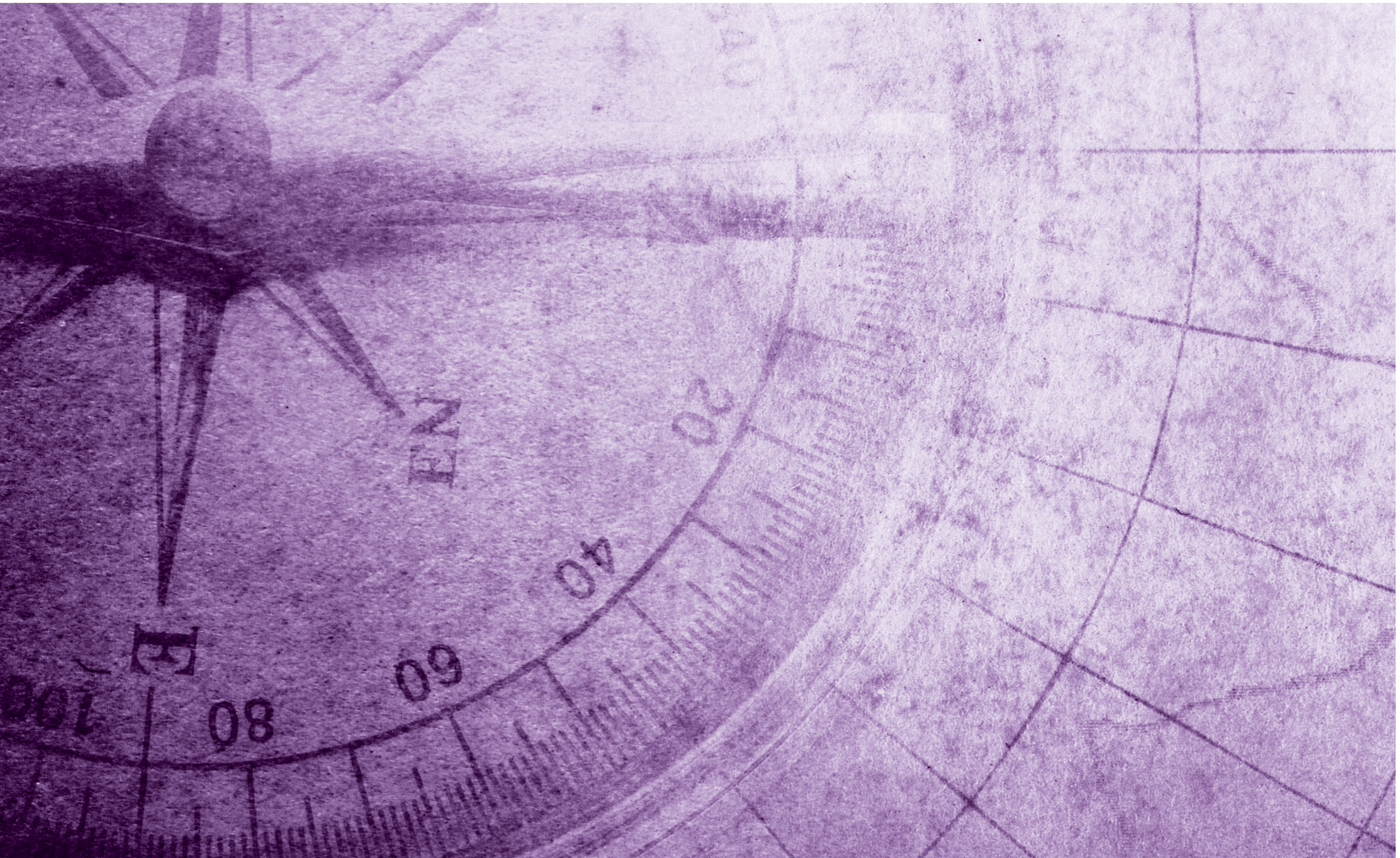
SQUIRE PATTON BOGGS

RetailEconomics

Navigating the Road Ahead: Are You Prepared?

Third Quarterly UK Retail Brexit Trade Review – November 2018



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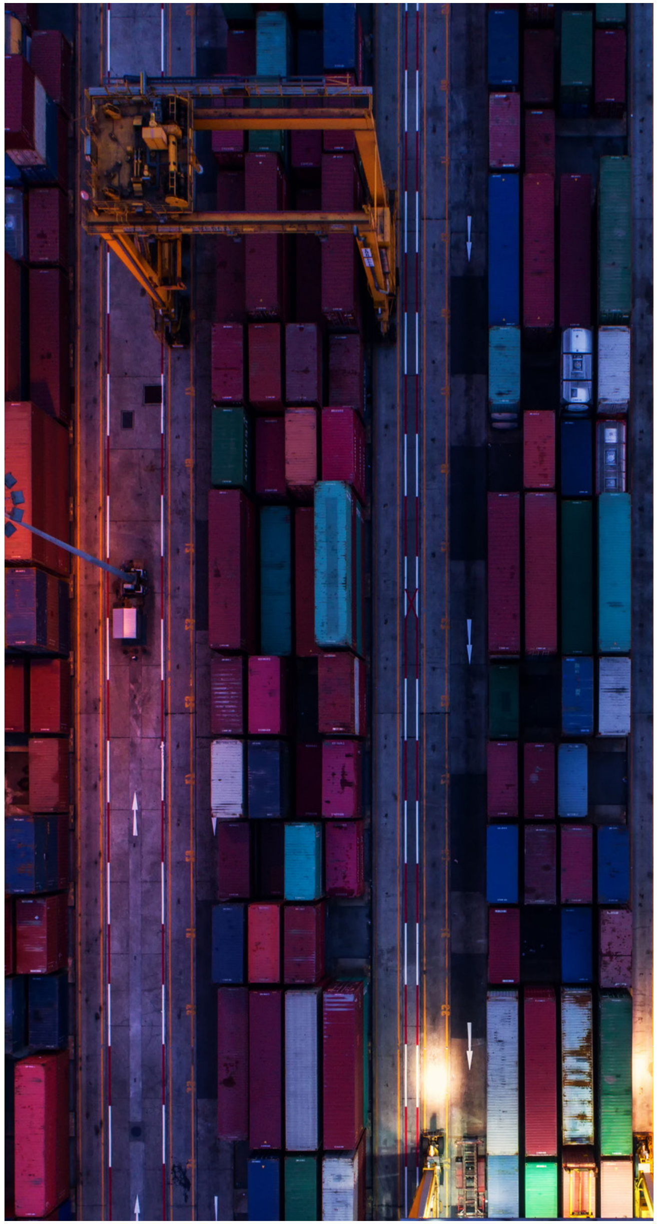

Introduction: Third Quarterly UK Retail Brexit Trade Review

Welcome to the Third Quarterly UK Retail Brexit Trade Review.

Since our last report in August, we have continued to witness unprecedented political infighting, upheaval and further cabinet resignations. In this edition, we focus on two areas:

1. **UK Retail Brexit Trade Benchmark** – How prepared are retailers in comparison to their peers?
2. **Preparing for a Hard Brexit** – A tangible risk of new costs and administrative burdens will likely emerge.

UK Retail Brexit Trade Benchmark

On 24 October 2018, Squire Patton Boggs and Retail Economics hosted more than 50 meetings between the UK's leading retailers and Brexit and trade experts. Throughout the meetings, it became apparent that retailers are keen to know how their Brexit preparations compare with others in the sector.

We conducted an industry-wide anonymised online survey to further gather and quantify retailers' opinions. The results of the survey are featured in this report to provide UK retailers with the opportunity to benchmark their Brexit preparedness against their peers and key areas such as immigration, supply of goods, customs red tape and tariff costs.

Preparing for a Hard Brexit: Sourcing Goods From Overseas

Following the agreement reached at the special EU Summit on 25 November, there are now three possible outcomes to the Brexit process:

1) Rejection by Parliament and/or the electorate of the Brexit deal followed by a hard Brexit
2) Implementation of the Brexit deal negotiated between the government and the EU
3) A reversal of the Brexit decision to allow the UK to remain in the EU

The possibility of a no-deal scenario remains a credible threat to the UK retail industry. In the event of a no-deal Brexit, retailers will need to tackle a raft of changes to the regulatory framework in which they operate. A tangible risk of new costs and administrative burdens will likely emerge. Nowhere will this be more evident than in costs and procedures for importing goods.

A hard Brexit means that from 29 March 2019 at 11 p.m., any goods arriving into the UK from the EU will be treated as if they had arrived from China, the US or any other World Trade Organization (WTO) member that does not have a trade agreement with the UK.

We provide a methodology to help prepare retailers for the impact of additional costs, covering three primary stages:

Stage 1	**Stage 2**	**Stage 3**
Calculating the Cost of New Tariffs	Mitigating the Effects of New Tariffs	Influencing UK Trade Policy

We also set out how retailers can get ahead of the Brexit benchmark, the actions that retailers should be taking and the support that Squire Patton Boggs and Retail Economics can provide.

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UK Retail Brexit Trade Benchmark

A Third of Retailers Have Done "Little to No Preparation" or Feel "Very Underprepared" for a Hard Brexit in March 2019

The crucial need for UK retailers to be "Brexit-ready" is becoming ever more urgent. We have continued to witness unprecedented levels of upheaval punctuated by political infighting and cabinet resignations.

On 24 October 2018, Squire Patton Boggs and Retail Economics hosted more than 50 meetings between the UK's leading retailers and Brexit and trade experts. Throughout the meetings, it became apparent that retailers were keen to discover how *their* Brexit preparations compared with *others* within the sector.

We conducted an industry-wide anonymised online survey to further gather and quantify retailers' opinions. The retailer survey was conducted between 10 and 21 November and includes results from 24 large retailers, including supermarkets and department stores, with a combined turnover of more than £100 billion in the last financial year.

Our findings revealed a polarised industry. Some retailers have conducted extensive preparations for a "no deal" Brexit, while others indicated they have executed no preparatory action whatsoever.

The debate about the Withdrawal Agreement continues in earnest, as does the uncertainty all this brings. The actual outcome should become clearer within the next few weeks. However, despite the UK's Brexit deal being agreed by EU leaders, in light of the political dynamic, contingency planning for no deal has to be a priority.

At a Glance

In the event of a no deal Brexit in March 2019, our survey showed that:

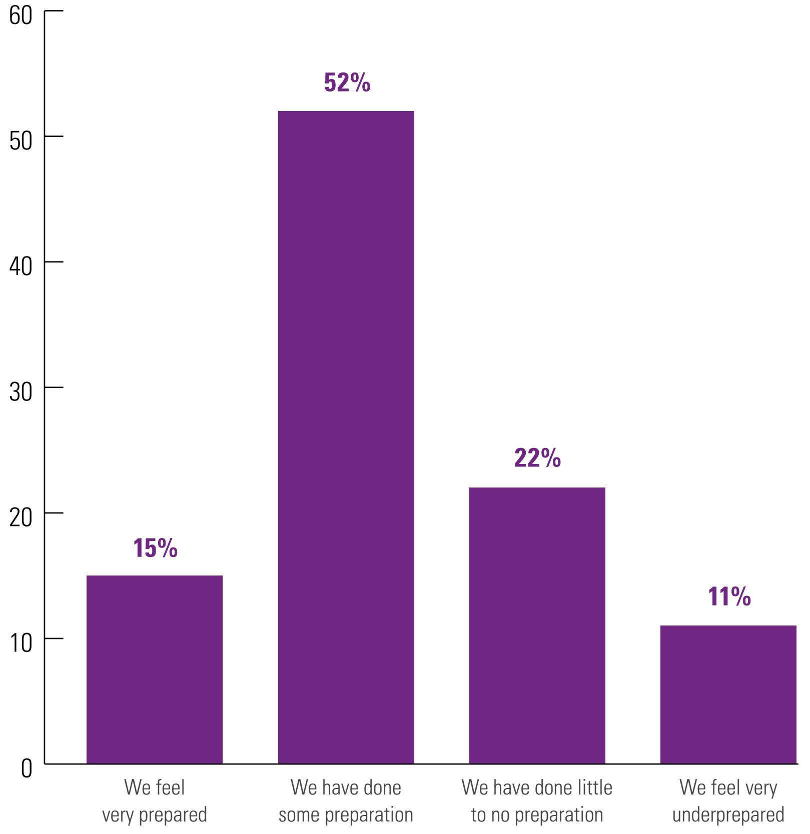
- **More than a third** of retailers indicated they have "done little to no preparation" or feel "very underprepared" for a hard Brexit. The majority (52%) of retailers had done "some preparation" and just 15% indicated that they "feel very prepared".
- **The majority of retailers surveyed (73%) have conducted some analysis** attempting to quantify impacts of additional duties that would apply under a World Trade Organization framework. This leaves more than a quarter of retailers having undertaken no analysis at all on potential additional costs.
- **Almost a third of retailers (32%) said they would face "significant additional costs"** in the event of a no deal scenario, and all of them suggested that a no deal would have detrimental impacts on sourcing costs.
- Retailers feel that the top three concerns are: (1) supply chain management and logistics issues (67%); (2) labour availability and cost (56%); and (3) tariff costs (48%).
- More than two in five retailers (41%) have failed to identify actions that would help avoid new costs.
- Retailers who have identified cost avoidance action, their measures include **switching supply chains to the UK, stockpiling, currency hedging and employing temporary workers.**
- 92% of retailers said that they had not participated in any government-run consultations.

Methodology

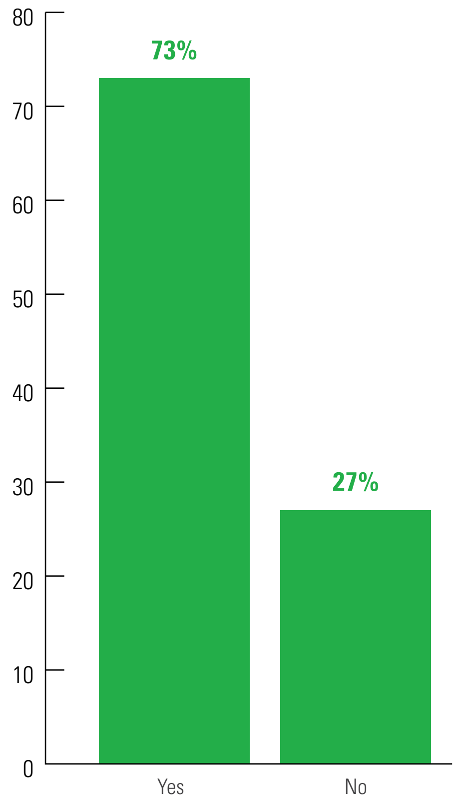
The retailer survey was conducted between 10 and 21 November and includes results from 24 large retailers, including supermarkets and department stores, with a combined turnover of more than £100 billion in the last financial year.

UK Retail Brexit Trade Benchmark

Question: Overall, thinking about how prepared your business is for a no-deal Brexit in March 2019, which statement best describes your position:



Question: Thinking about the "no deal" Brexit scenario in March 2019, has your business undertaken any analysis to quantify the impact of the cost of sourcing from abroad? (E.g. calculating the cost of additional tariffs applied to imports from the EU across all product lines).

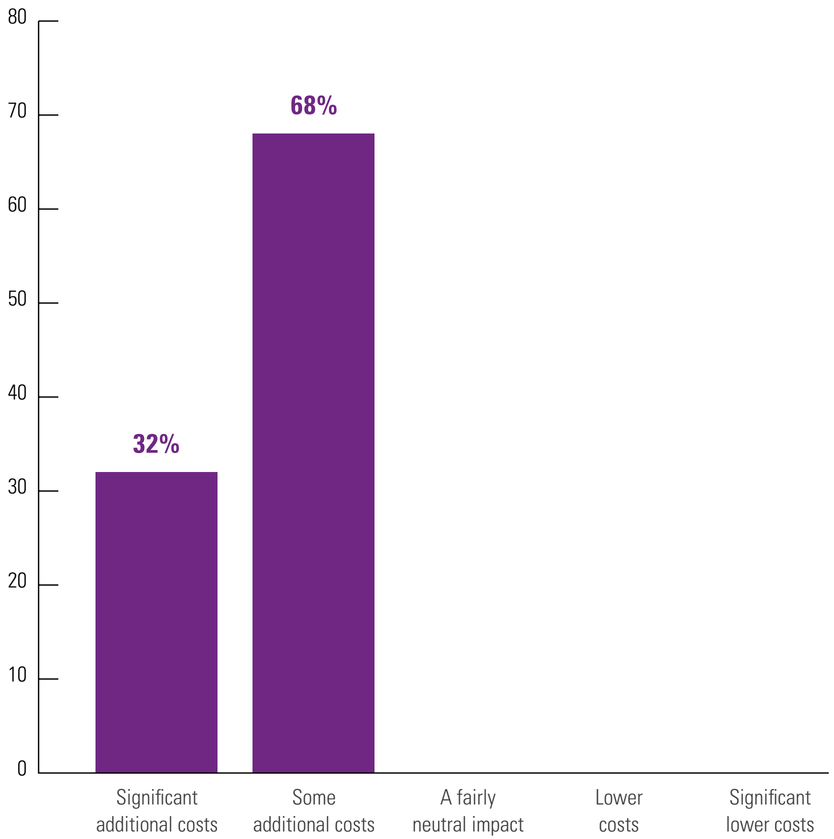


33% Of retailers said that they had done "little to no preparation" or that they felt "very underprepared".

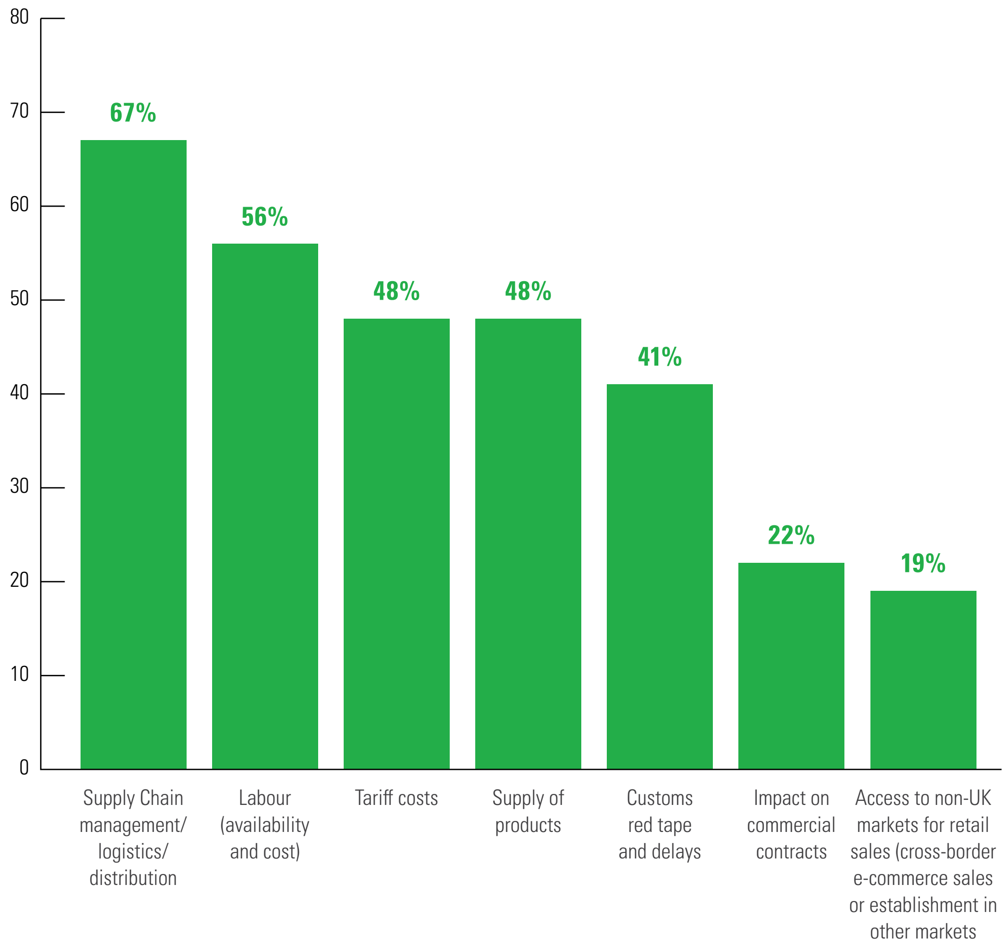
73% Of retailers have undertaken some analysis on the cost of sourcing from abroad in no-deal scenario.

UK Retail Brexit Trade Benchmark

Question: Which statement best describes your assessment of the impact of sourcing costs on your business? There will be...



Question: Which areas are of greatest concern to your business in the event of a no deal Brexit in March 2019? (Tick your three biggest concerns)

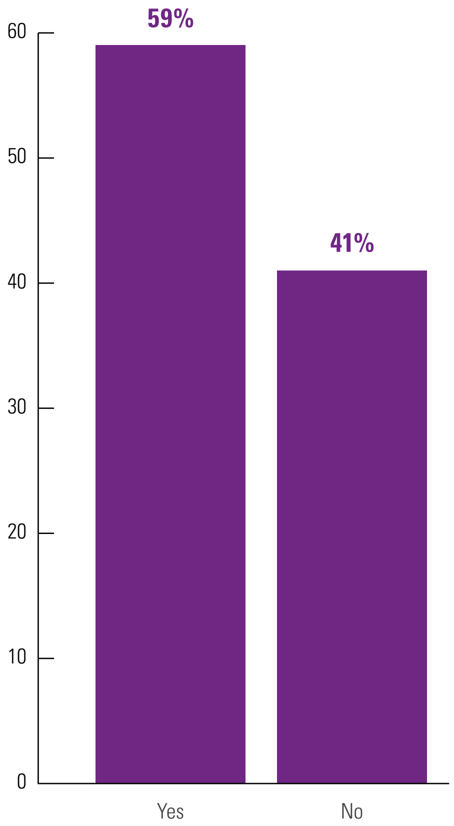


32% Of retailers suggested there will be "significant additional costs" in the cost of sourcing

67% Of retailers suggested that "supply chains" were the area of greatest concern

UK Retail Brexit Trade Benchmark

Question: Has your business identified any mitigating actions it could take to avoid new costs that might arise as a result of a no deal Brexit?



41% Of retailers said that they had not identified any actions to mitigate against these additional costs

Question: Has your business identified any mitigating actions it could take to avoid new costs that might arise as a result of a no deal Brexit?

Sample of Anonymised Quotes

Retailer A "Looking at alternative sources of product, options vs EU"

Retailer B "Switch supply chains, more sourcing in UK, stockpiling, currency hedging"

Retailer C "A wide range including stockpiling where possible; different routes across the Channel; signposting support for EU workforce"

Retailer D "Changing supply locations"

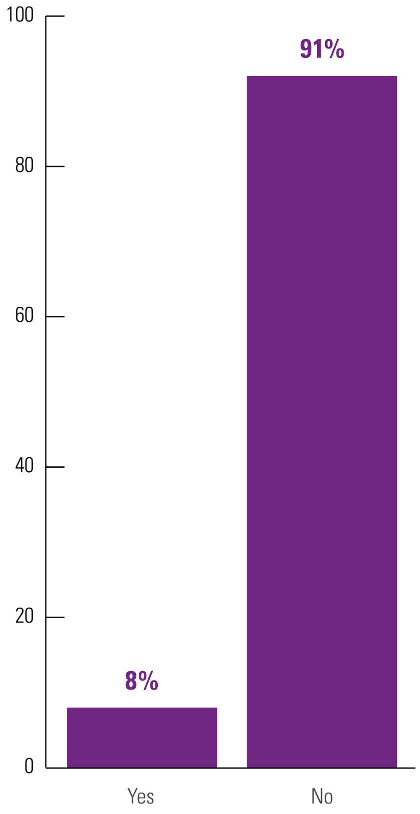
Retailer E "Sourcing from alternative suppliers in the UK"

Retailer F "Potential buffer stock; Engagement with supply chain regarding their mitigation: engagement with temporary workforce agencies"

Retailer G "Stockpiling in respect of disruption, for employees HR team is widely investigating ways of making Retailer G more competitive (including paying registration fees, non-monetary benefits)."

UK Retail Brexit Trade Benchmark

Question: Has your business participated in any government-run consultations on the impacts of Brexit or on the direction of UK policy post Brexit?



92% Of retailers said that they had not participated in any government-run consultations

Note

Sample consists of 26 multiple retailers accounting for a combined turnover of more than £100 billion. Conducted between 10 and 21 November 2018.

Getting Ahead of the Brexit Benchmark

No matter where you are in your Brexit preparations and where you sit against the benchmark, you need to be fully ready for all of the potential outcomes of the UK's negotiations with the EU. Given that a no-deal outcome remains a real possibility, companies need to be ready to mitigate against the potentially serious and immediate ramifications of Brexit and have gained a deep understanding of the range of implications on their businesses.

Squire Patton Boggs and Retail Economics can get you Brexit ready. We set out below the crucial potential impact areas, the action you need to take and the support available to you.

Impact Area	Action Needed	Support Available
Brexit Status and Risk	Undertake a risk assessment on the significant areas of your business. We then present an outcomes report and a "roadmap" that sets out business priorities in relation to navigating you through Brexit while mitigating the risks.	A "where are we now" report that identifies the key legislative risk, together with scenario planning, to identify the steps that can be taken to mitigate the most significant risks to your business.
Trade Impact	Undertake a Trade Impact Assessment to give you a clear understanding of your trade position in light of Brexit. Once mapped out, you will have a clear picture of the impact of Brexit and the consequences to your business. Once the assessment is complete, implement any potential mitigating actions.	This report advises on the impact of each Brexit scenario – WTO most favoured nation hard Brexit terms, a free trade agreement or a customs union-style "soft Brexit" – and the potential consequences for your business. In practice, this will detail what companies can expect from additional costs and paperwork derived from the imposition of customs duties on UK-EU imports, along with matters such as dealing with valuations, rules of origin, INCOTERMS, exports processes, freight forwarding, shipping and so on. In particular, we will include tips on mitigation strategies. The report can also highlight which customs procedures might apply in relation to different types of goods and how best to comply with rules of origin.
Customs	Ensure that your IT systems are updated to deal with the additional complexity of potential customs declarations. Develop contingency plans to mitigate delays at borders – such as stock piling and additional warehousing, if required.	If the UK does not enter into a new customs union, customs declarations will be required each time goods cross the UK/EU border. Any changes to the UK's trading relationship with the EU may require extensive work to reconfigure all manner of systems and to handle more complexity in terms of information held, the frequency of data submission and for customs declarations. We can advise you on the best course of action to take and help you to have a robust plan in place.
Rules of Origin	Consider how best to deal with rules of origin, such as any issues that arise in relation to any EU content not being recognised as being aggregated with UK content. In the long term, consider options such as reshoring manufacturing to the UK.	We can advise you on whether it is necessary to consider the origin of any raw materials, the country in which final substantial production took place and the value of the processing of goods in other countries. If goods are to qualify for tariff-free trade, they must satisfy the applicable rules of origin tests.

UK Retail Brexit Trade Benchmark

Impact Area	Action Needed	Support Available
Supply Chain	Undertake a detailed review of existing contracts and the development of a checklist to support the negotiation of new contracts to understand how Brexit might affect their viability and mitigate against future supply chain risk. In-depth planning at this stage will make it easier to identify any potentially adverse consequences of Brexit and will enable companies to adjust more quickly to the post-Brexit landscape and future opportunities.	Brexit could have an impact on both existing and future supply chain contracts and building in enough flexibility to accommodate uncertainty. Our focus will be to support you in ensuring that all parties understand their commitments, and how to mitigate any associated risks. We have created a methodology to consider the potential impact of Brexit on existing contracts and the strategies relating to the negotiation of new contracts, but also making enquiries of all suppliers to ensure that they will not be adversely affected by other parts of the chain.
Commercial Contracts	Undertake a review of Brexit vulnerable contracts in terms of flexibility, impact of possible customs delays or increased tariffs, contractual obligations involving the movement of people, VAT changes, data transfers or intellectual property (IP) issues, payment provisions and currency, regulatory changes and termination options.	We will provide a full contract review programme, including support on those that need renegotiating or terminating because of Brexit.
VAT and International Tax	Review your VAT and International Tax position, taking into account: • Intra-EU supplies of goods are generally subject to acquisition rather than import VAT. The government has indicated that its response to a no-deal Brexit would be to replace import VAT with acquisition VAT on any importation of goods, not just importation from the EU27. • Unlike VAT, direct tax is a competency of member states and there are likely to be consequences for the UK businesses that have a pan-European structure or even those that simply do business in the EU.	We can advise on the impact of potentially adverse cash-flow issues on their business and are able to undertake a review of current structures, operations and transactional flow through the business to help clients understand the consequences of Brexit.
People	Be prepared for both scenarios: • If a deal is agreed, EEA nationals and their families resident in the UK by 31 December 2020 will be able to continue living here under the EU Settlement Scheme. • Uncertainty remains, however, in relation to a no-deal scenario, new EEA arrivals to the UK from April 2019, UK citizens in the EU and the UK's future immigration system from January 2021.	We will help you to not only understand your position in relation to EEA nationals employed within your business, but also supporting them to understand their individual status. We have developed a Brexit immigration support offering to help clients communicate and support their affected employees, as well as plan for their future resourcing needs.
Environmental	It is expected that all EU-derived legislation will continue to apply during any transition period. However, following transition, there is potential for UK and EU environmental laws to diverge, which may affect the obligations that apply to retailers who operate in the UK. Be prepared for particular challenges, in relation to the prospect of parallel registration and regulatory regimes, duplication of cost and effort, and cross-border supply chain disruption. There are also many outstanding questions regarding environmental governance in the UK and how that will be structured and regulated going forward.	We will advise on areas of regulation that may be affected, any issues arising out of changes to regulatory requirements and the potential effects of divergence in environmental standards between the UK and the EU. We can assist with evaluation and assessment of environmental and product regulation risks and issues in existing supply chain arrangements, and advise on actions that could be taken, to facilitate effective contingency planning.

UK Retail Brexit Trade Benchmark

Impact Area	Action Needed	Support Available
Corporate and M&A	The expectation of Brexit is challenging many investment decisions. Retailers should prepare for core Brexit scenarios when they plan their M&A activity. There are a number of areas that require careful due diligence on a target's business in light of Brexit: • Consideration and adjustment • Key commercial contracts • Merger control • People and the effect on the workforce • Restrictive covenants • IP rights • MAC clauses • *Force majeure* • Seller limitation • EU grants and funding	Working alongside our Brexit team, our Corporate M&A team is able to consider the implications of Brexit in transactions and assist in scenario planning to ensure that risk is mitigated and a sound commercial outcome is achieved.
Finance	Brexit may place increased challenges on the finances of many businesses and their suppliers, especially in terms of trade finance. Undertake a review of current financing arrangements and clauses to ensure that they are "fit for purpose".	We are able to advise on negotiating finance arrangements and can assist suppliers that need to negotiate new financial arrangements.

UK Retail Brexit Trade Benchmark

Impact Area	Action Needed	Support Available
Intellectual Property (IP)	With respect to IP, we recommend that companies prepare for Brexit by considering: • Reviewing core IP agreements where the EU, or the countries in which the licensor has valid IP rights, is the defined territory • The impact of any changes to IP laws introduced • If existing IP portfolios should be supplemented with UK rights for core brands or products • Filing EUTM and UK trademark applications separately, either simultaneously or referring to convention priority in the second application – the same applies for design rights • Beginning to use EUTMs as widely as possible • Tackling ongoing infringements now while there is greater certainty	Progress is being made in relation to IP. We can provide a strategic impact assessment on your IP portfolio, followed by action to ensure your portfolio is fit for purpose, for example reviewing your core IP agreements and filing EUTM and UK trademark applications separately. After the transition period, owners of EU trademark Registered and Community Designs will automatically become the holders of a comparable registered and enforceable right in the UK. The same will apply in relation to unregistered design rights and database rights. Similarly, if international trademark or design protection was obtained on the back of EU designations, the international protection will be recognised as continuing post transition. The remaining issues relate to matters such as geographical indications and the precise mechanics for transition.
Data Protection	The European Commission has issued a notice to the effect that, in the absence of a decision on the adequacy of the UK's laws regarding data protection, a transfer of personal data will only be permitted from the EU to a post-Brexit UK where the data controller or processor has provided "appropriate safeguards". If you are a UK retailer with an EU interest (including through a parent company, subsidiaries, joint venture, customer or supplier relationships), you will need to ensure that you can either rely on specific derogations or that it has appropriate safeguards in place prior to the transfer of personal data.	The Withdrawal Agreement indicates that EU data protection law will continue to apply to the UK in relation to the processing of personal data until the end of the transition period. Retailers could become subject to separate EU and UK laws in relation to the processing of personal data in the UK. We will advise you of the best course of action, and support you to amend policies, procedures and processes.
State Aid	You will need to consider the extent to which you benefit from aid from the EU and the extent to which any such aid may continue after Brexit and/or be replaced with any sources of aid that are made available within the UK after Brexit. After Brexit, UK businesses will lose any right to challenge state aid provided by the EU to companies within the EU.	We have specific expertise in advising companies with respect to the EU rules prohibiting certain forms of direct and indirect state subsidies and the highly complex rules governing governmental tenders throughout the EU. We also advise national governments and awarding bodies, recipients of state support, bidders and third-party complainants, and regularly represent such parties before the European Commission and the European Courts in Luxembourg, as well as in procurement matters before national courts in the EU. Our team has considerable expertise in handling the core concepts of state aid, such as the market investor principle, quantification of financial advantages and the application of general and specific exemptions for allowable state assistance.
New Markets	As the UK establishes new free trade agreements with countries outside of the EU, new opportunities will arise for UK retailers in terms of access to new markets and talent. Companies operating in the UK will need to consider the opportunities and challenges that this may bring, as the UK opens its borders to third-party trade partners.	We can provide guidance on new market entry and the characteristics of customers in the markets of interest, particularly those countries, regions and continents that are to be the focus of new free trade agreements, such as China and the US.

Preparing for a Hard Brexit: Sourcing Goods From Overseas

Introduction: Preparing for a Hard Brexit: Sourcing Goods From Overseas

Retailers will need to tackle a raft of changes to the regulatory framework in which they operate if the UK leaves the EU without a deal – the hard Brexit scenario. A tangible risk of new costs and administrative burdens will likely emerge. Nowhere will this be more evident than in costs and procedures for importing goods.

A hard Brexit will mean that from 29 March 2019 at 11 p.m., any goods arriving into the UK from the EU will be treated as if they had arrived from China, the US or any other World Trade Organization (WTO) member that does not have a trade agreement with the UK.

UK businesses will require an Economic Operator Registration and Identification scheme (EORI) number to import EU goods. Individual consignments will need accompanying customs documentation and will become liable for customs duties. Food products will require further documentation to demonstrate compliance with relevant plant and animal health regulations.

Naturally, retailers want to know what the cost implications are and what options exist for avoiding or mitigating such costs. By applying EU most favoured nation (MFN) tariff rates to existing trade flows from the EU, we calculate that the overall customs bill for retailers sourcing goods from the EU will be at least £7.8 billion per year. However, costs will vary significantly for each retailer, depending on the type of products sourced and their origin.

We set out below a common methodology that, when applied, will help to determine the likely new costs:

Stage 1: Calculating the Cost of New Tariffs

Stage 2: Mitigating the Effects of New Tariffs

Stage 3: Influencing UK Trade Policy

Stage 1: Calculating the Cost of New Tariffs

The first stage in preparing for a hard Brexit outcome is to calculate its impact on the cost of importing goods from overseas. A hard Brexit means MFN tariffs on imports from the EU.

The EU and the UK are both members of the WTO, and any trade relationship they adopt must satisfy WTO rules. These rules state that in the absence of a free trade agreement or a customs union, WTO members who are developed economies *must* apply their standard MFN tariff rates to each other. The UK will be required to publish its MFN rates before it leaves the EU on 29 March 2019.

In analysing the impact of hard Brexit on **EU import costs**, retailers should base their calculations on the EU's existing MFN tariff rates.

Outside of the EU and its customs union, the UK can exercise sovereign rights to set its own MFN tariff rates. These rates have not yet been published, but they are likely to be very close (if not identical) to those operated by the EU.

On 24 July 2018, the UK submitted a confidential paper to the WTO in which it proposed to "replicate [EU tariff] concessions and commitments" upon withdrawal from the EU. In other words, the UK has proposed to adopt the same tariffs as the EU after Brexit because:

- The government wants to ensure predictability and certainty for traders during the Brexit process
- Any increase in UK MFN rates above the bound level notified by the EU would trigger requests for compensation from other WTO members who will argue that their trade has been adversely affected
- Any reduction in UK bound MFN rates below those notified by the EU would reduce the UK's "negotiating capital" for future free trade deals

In acknowledging the reality and practicalities, there is simply insufficient time to undertake a comprehensive review of 5,600 tariff lines before Brexit day. Adopting the EU's existing MFN rates is the only practical alternative.

Cumulatively, this means that in order to determine what tariffs would apply to various EU imports post-Brexit, retailers should simply refer to the EU's published MFN rates. To restate the significance, we calculate that the overall cost for retailers of these new tariffs will be **£7.8 billion per year** (based on 2017 trade flows).

Key Points

1. Food Retailers Will Face the Highest New Tariff Costs
2. Lower Value Meat, Dairy, Cereals and Wine Will Attract Proportionately Higher Tariffs Than Higher Value Meat, Dairy, Cereals and Wine
3. Retailers Will Tend to Pay Proportionately More Duties Than Others in the Supply Chain
4. The Tariff Analysis Exercise is Least Complex for Clothing and Footwear, but the Sector Encounters the Highest Average Tariffs for Non-Food Sectors
5. Health and Beauty Retailers Are Likely To be Least Affected
6. DIY Retailers Face the Greatest Challenge in Calculating the Impact of New Duties by New Tariff Costs
7. Tariffs May Also Increase on Imports From Some Non-EU Countries

Stage 1: Calculating the Cost of New Tariffs

Key Points

Although retailers must conduct a specific analysis to ascertain the potential cost of tariffs to their business, some key points can be made:

1. Food Retailers Will Face the Highest New Tariff Costs

Assuming that the UK replicates EU MFN tariff rates, we calculate that **food and drink duties would account for £6 billion of the £7.8 billion tariff bill** for all retailers.

- Some meat, dairy and cereal product lines will attract duties equivalent to 60%-70% of the value of the goods
- Fish and fisheries products will attract rates typically between 12% and 20%, and many vegetables will attract rates of 10%-14%

Even within fairly narrow confines, MFN rates can vary enormously. For example:

- Mango chutney has an MFN rate of 0%
- Preserved sweet peppers has an MFN rate of 5%
- Preserved mushrooms have an MFN rate of 16%

There is no "shortcut methodology" in analysing the tariff impact on food trade. It must be conducted on a product by product basis.

2. Lower Value Meat, Dairy, Cereals and Wine Will Attract Proportionately Higher Tariffs Than Higher Value Meat, Dairy, Cereals and Wine

Many food tariffs are expressed as a flat rate per weight or volume of product. These are termed "specific duties".

Specific duties apply to meat, dairy, cereals, sugar and wine. Such duties are designed specifically to protect European producers from lower cost competition. For instance, EU MFN duties for pork and pigmeat are expressed as a flat rate per weight:

Product	Duty Rate
Fore-ends and cuts thereof	€601/tonne
Loins and cuts thereof	€869/tonne
Bellies and cuts thereof	€467/tonne

Where specific duties are used, the actual value of the consignment is irrelevant (i.e. the same quantum of duty is applied to a tonne of the cheapest pork as to a tonne of the most expensive pork).

This contrasts to "*ad valorem*" tariffs, which are expressed as "a percentage of the value of the goods". *Ad valorem* is applied to all non-food imports and some food imports (e.g. fish).

Product	Ad Valorem Duty Rate
Atlantic blue fin tuna	16%
Cod	12%
Haddock	7.5%

Food retailers operating at the value end of the market will be disproportionately affected wherever specific duties apply.

3. Retailers Will Tend to Pay Proportionately More Duties Than Others in the Supply Chain

Generally, in any given supply chain, **tariffs are lowest for raw materials and highest for finished products**. This is true for both food and non-food and is called "tariff escalation". This means that retailers who source finished products from the EU tend to face a heavier tariff burden than domestic suppliers who source raw materials or intermediate products from the EU.

Tariff Escalation Example: Cotton Yarn, Fabric and Clothing

The EU's MFN tariff rates for textiles and clothing escalate as textile products become more processed:

Product	EU MFN Duty Rate
Cotton yarn	4%
Cotton fabric	8%
Men's cotton shirts	12%

4. The Tariff Analysis Exercise is Least Complex for Clothing and Footwear, but the Sector Encounters the Highest Average Tariffs for Non-Food Sectors

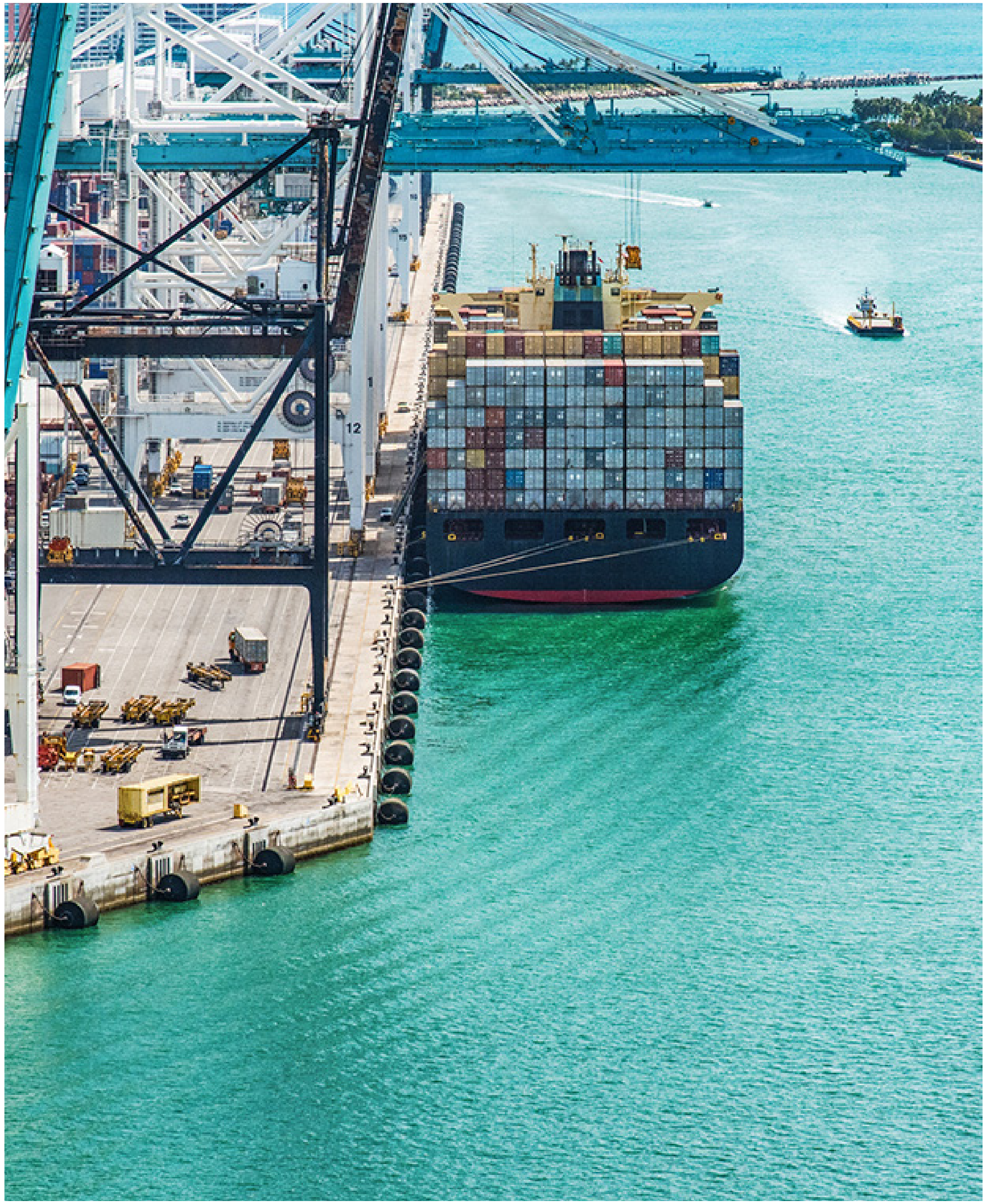
The good news for clothing and footwear retailers is that the tariff analysis for their products is relatively straightforward. All clothing is grouped together in two "chapters" (61 and 62) within the Harmonised System (HS) of customs classification, with footwear residing in chapter 64. Almost all clothing attracts the same rate of duty.

The bad news is that this duty rate is relatively high at 12%. Footwear attracts rates of 8%-17%.

5. Health and Beauty Retailers Are Likely To be Least Affected by New Tariff Costs

Most over-the-counter pharmaceuticals, beauty preparations and health products have MFN rates of 0%. They will not face new tariffs post-Brexit.

There are some odd exceptions, such as the 4% tariff on dental floss and 6.5% on shaving preparations, aftershave and deodorants.



Stage 1: Calculate the Cost of New Tariffs

6. DIY Retailers Face the Greatest Challenge in Calculating the Impact of New Duties

All international trade is classified and ordered through the HS of customs classification. HS codes fail to consistently align themselves with how retailers categorise their own products.

Product taxonomy for customs purposes is based on the intrinsic *features* of the product – *not the purpose* or context in which it is used. This creates a distinct challenge for DIY retailers who sell products that are scattered throughout the HS tariff.

Table 1 shows the tariff lines that a typical DIY retailer will need to analyse in order to calculate the impact of their new duties:

Table 1 – Chapter references and associated products in the HS tariff framework

Chapter Number	Products Classification
6	Live trees and other plants
25	Salt, sulphur, earth and stone; plastering materials, lime and cement
32	Pigments, paints, dyes, mastics, varnishes and putty
34	Soaps, surfactants, waxes, polishes and scourers
39	Articles of plastic
40	Articles of rubber
44	Wood and articles of wood
45	Articles of cork
46	Articles of straw, basketware and wickerwork
56	Wadding, felt, non-wovens, cordage, rope and cables
57	Carpets and textile floor coverings
68	Articles of stone
69	Ceramic products
70	Glass and glassware
73	Articles of iron and steel
74	Articles of copper
76	Articles of aluminium
82	Tools of base metals
84	Machinery and mechanical appliances
85	Electrical machinery
94	Lamps and lighting
96	Miscellaneous manufactured articles

7. Tariffs May Also Increase on Imports From Some Non-EU Countries

Imports into the UK from some non-EU countries currently face lower tariffs because of free trade agreements (FTAs) with the EU. **In the event of a hard Brexit, tariffs on these imports will revert to MFN rates unless the UK specifically agrees an extension of these FTAs to include the UK**. This currently applies to a relatively small number of countries (e.g. South Africa, Chile, Mexico, Canada, Japan and South Korea). Most of these countries have stated intentions to extend their FTAs to include the UK, but there is little time to enact these new agreements and if they are not ready by 29 March 2019, then WTO rules would require that trade reverted to MFN terms.

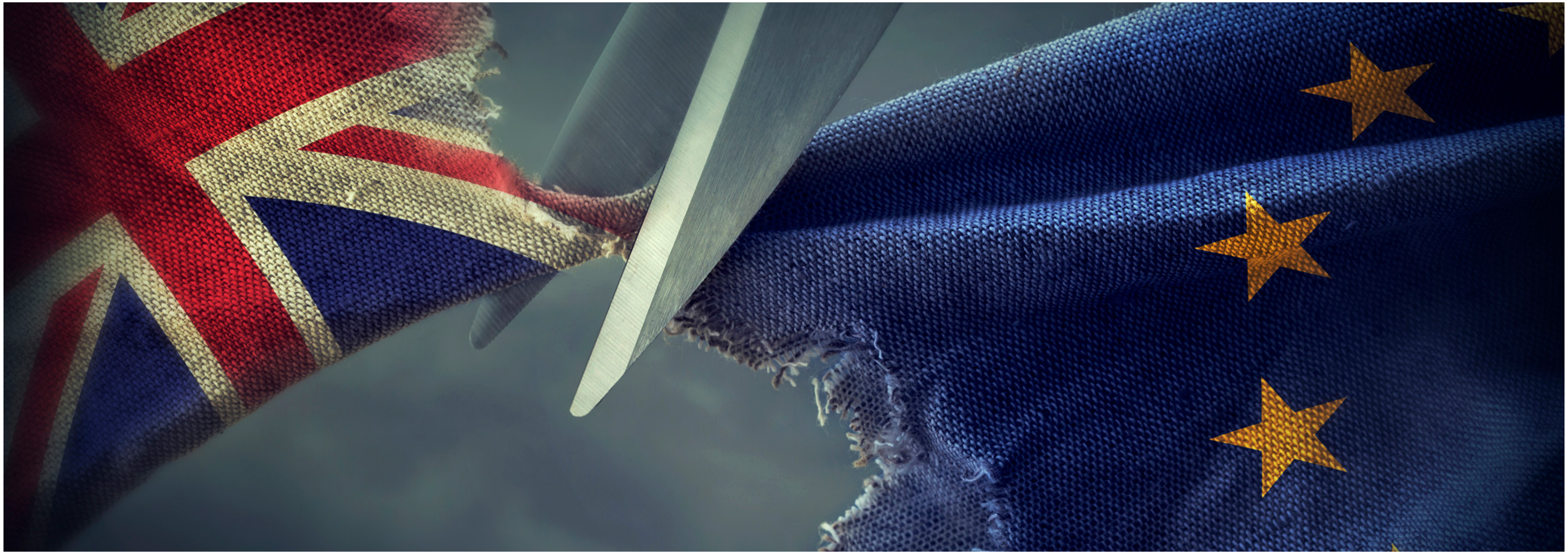
Trade with Turkey will be particularly problematic as there is no existing EU free trade agreement for the UK and Turkey to replicate – the current duty-free access to the UK is the result of Turkey's customs union with the EU, which is not a free trade agreement.

Stage 2: Mitigating the Effects of New Tariffs

Once individual retailers have completed the cost of new tariffs analysis described in stage 1, they should then have a clearer understanding of what new tariffs will mean on their costs of sourcing. This will support them in making informed decision whether to move to the next stage of preparation – which is to identify ways of mitigating or avoiding these new costs.

Key Points

1. Avoid High Tariffs by Switching to Domestic Sourcing
2. Avoid High Tariffs by Switching Sourcing to Countries That Attract Lower Tariffs
3. Imports From Developing Countries Will Continue to Enjoy Lower Rates of Duty Post-Brexit
4. Access Tariff Rate Quotas (TRQs) for Food and Drink Products
5. Take Advantage of Existing Schemes and Mechanisms That Provide Relief From Duties or Avoid Them Altogether



Stage 2: Mitigating the Effects of New Tariffs

Key Points

1. Avoid High Tariffs by Switching to Domestic Sourcing

The simplest and most obvious method for retailers to avoid new tariffs (and other customs costs) is to switch to domestic sourcing. Not only would domestic sourcing avoid tariffs and other customs costs, but it should also allow faster delivery times because consignments are extricated from potentially problematic customs clearance and port procedures.

However, there are certain constraints to domestic sourcing:

- Prices from domestic suppliers may not be sufficiently competitive, even accounting for the effect of tariffs on imports of competing products
- There may be inadequate domestic capacity to satisfy demand, particularly for various food and drink categories
- Costs for domestic suppliers may also increase when involving inputs/components/ingredients from the EU where tariffs are levied
- As other companies shift demand back to the UK, tighter levels of supply may lead to additional producer price inflation

Concerning the third bullet above, it would be relatively easy for retailers to confirm domestic supplier's claims of any price increases, as the associated duties their suppliers encounter are published in the UK's MFN customs tariff schedule.

2. Avoid High Tariffs by Switching Sourcing to Countries That Attract Lower Tariffs

In the event of a hard Brexit, EU imports will face the same level of tariffs as imports from *most* other countries; however, there are exceptions.

3. Imports From Developing Countries Will Continue to Enjoy Lower Rates of Duty Post-Brexit

The government has already stated that it will implement a scheme of unilateral tariff preferences for developing countries that is at least as generous as that operated by the EU. In practical terms, this will mean that imports from the very poorest countries (e.g. Bangladesh and Cambodia) will continue to be free of all customs duties under any Brexit scenario. Imports from more advanced developing countries (e.g. India and Pakistan) will enjoy rates of duty lower than the MFN rate, but they are unlikely to receive across-the-board duty-free treatment.

UK retailers will also be able to import at lower rates of duty from countries where the UK has specifically agreed to extend the terms of existing free trade agreements with the EU. This may include Japan, Mexico, Canada, Chile, South Korea and South Africa.

As with MFN rates, the precise rates of duty that will apply to imports from developing countries, and to countries that have a free trade agreement with the UK, will be published in the UK tariff schedule, enabling retailers to make informed decisions.

4. Access Tariff Rate Quotas (TRQs) for Food and Drink Products

TRQs are defined quantities of specific food and drink products that can be imported to the EU either free of customs duty or at rates below the standard MFN rate. Some of these TRQs are allocated to individual countries (e.g. New Zealand has allocated TRQs for lamb and dairy products). Other TRQs are available to imports from any country. Some TRQs offer significant discounts to the standard MFN rates of duty and tend to get consumed very quickly, while others offer only marginal reductions to the standard rate and are hardly used at all.

Under a hard Brexit, UK importers will no longer have access to the EU's TRQs and instead will have to replace them with national TRQs. In preparation for national TRQs, the UK and the EU have reached agreement on how the EU's existing TRQs should be split between the UK and the EU27 post-Brexit; a proposal was submitted to the WTO in July concerning this issue.

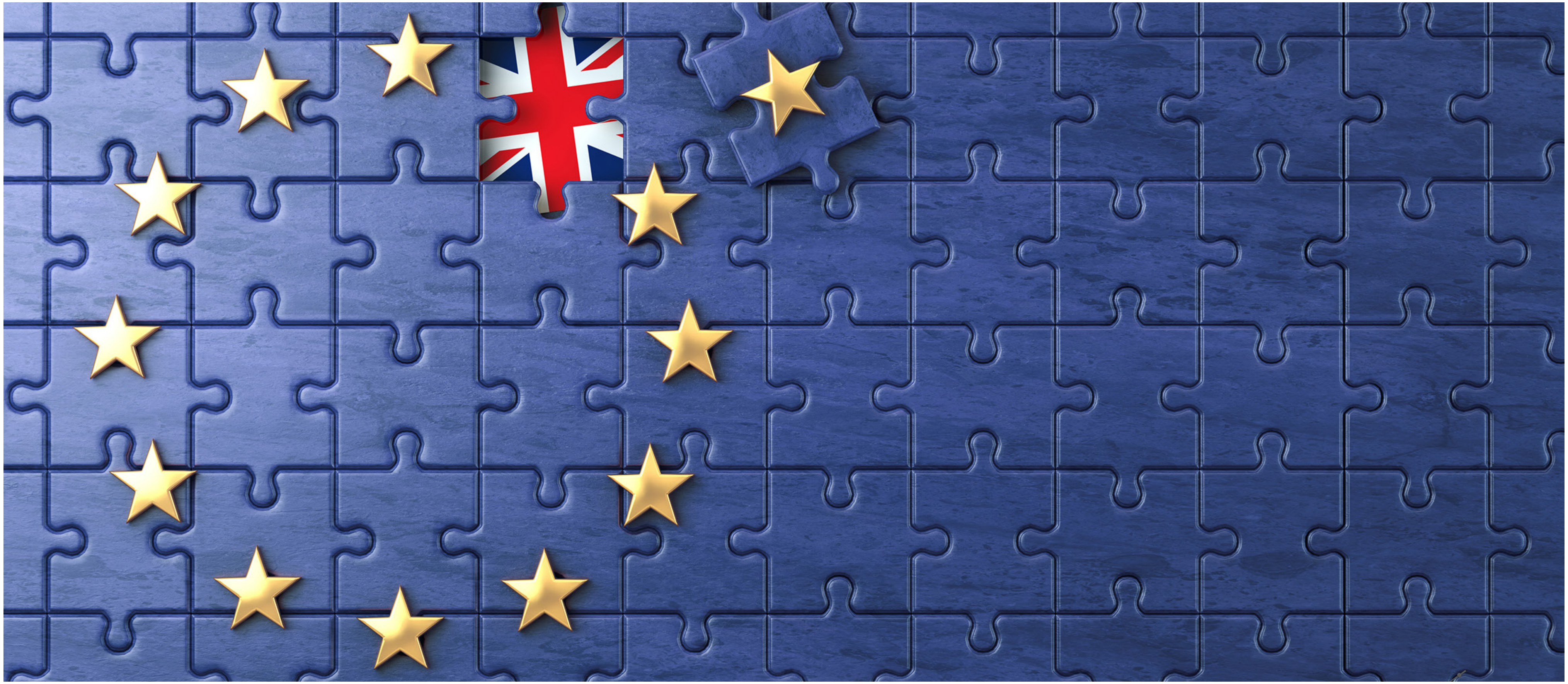
Retailers and other importers who access new UK TRQs will have a cost advantage over those retailers who do not.

Stage 2: Mitigating the Effects of New Tariffs

5. Take Advantage of Existing Schemes and Mechanisms That Provide Relief From Duties or Avoid Them Altogether

There are a range of mechanisms that the EU has introduced to help businesses avoid customs duties. These mechanisms will be re-established at a UK level, which include the following:

- **Inward processing relief** – Allows customs duties to be waived for imported components that are used in products that are subsequently exported
- **Duty suspensions** – Time limited and allow duty-free imports of very tightly defined products that are unavailable from domestic sources (these are often chemicals or very specific pieces of machinery or equipment)
- **Customs warehousing** – Allows goods to be physically landed and stored without facing customs controls or tariffs



Stage 3: Influencing UK Trade Policy

Some retailers may be unable to benefit from methods in avoiding or mitigating the effects of new tariffs within the constraints of the UK's new trade policy. These retailers may wish to move to the third stage of Brexit preparation, which is to make representations to the government for changes to its trade policies that reduce the cost of trade regulation.

Although the government has indicated adoption of existing EU tariff rates on exit, this is only likely to be a holding measure. Outside the EU and its customs union, the UK will be free to change its tariff rates whenever it wishes (though, WTO rules make it far easier for WTO members to reduce rates than to raise them).

This ability is recognised in the government's "classifying your goods in the UK Trade Tariff if there's no Brexit deal" technical note, which states: "the actual duty rates that will apply to each item imported into the UK may be different to the rates currently applied under the EU's Common Customs Tariff".

The government is consistent in its messaging that outside the EU, it will seek to pursue a different and more open trade policy than that of the EU, which will include:

- Negotiating new trade deals
- Operating its own trade remedies (anti-dumping)
- Establishing national tariff rate quotas (TRQs) for food
- Ensuring preferential access to the UK for imports from developing countries

The UK government will seek industry (including retailers) views in these areas, and there will be considerable opportunities for businesses to influence the direction of future trade policy.

Companies that actively engage the government as it develops new trade policies are increasingly likely to have their interests reflected in those policies compared to companies who do not engage.

The main areas where the government may act and where there will be an opportunity for retailers to make their case are:

1. Unilateral Reductions on Tariff Rates for Products Unavailable From UK Sources
2. Call for New TRQs on Food and Drink
3. Engage in Government Consultations About New Trade Agreements
4. Advocate for Lower Tariffs on Goods From Developing Countries

Stage 3: Influencing UK Trade Policy

1. Unilateral Reductions on Tariff Rates for Products Unavailable From UK Sources

If the UK adopts the EU's tariff schedule as it has proposed, it will mean applying tariffs to certain goods that are unavailable from UK sources (e.g. citrus fruits and juices, olive oil and bananas). In many cases, there may will be no economic rationale for these duties, which simply increase costs for traders and ultimately consumers.

Outside the EU and its customs union, **the government would be free to permanently reduce the MFN rate of duty (by notifying a reduction in the "bound rate" to the WTO) or to temporarily reduce the "applied" rate** on *any* product. The government may be persuaded to exercise its power to reduce MFN rates in cases where it can be demonstrated that there is no (or insufficient) alternative domestic supply.

The government has not yet announced any particular mechanism for considering requests for MFN tariff rates reductions, but that should not preclude retailers and other importers communicating their priorities to the relevant departments (e.g. Department for Trade, Treasury, DEFRA, BEIS).

2. Call for New TRQs on Food and Drink

Approximately half of the food consumed in the UK has overseas origins, with 70% of this from the EU.

In the event of a hard Brexit, much of this food will attract significant new tariffs. In some cases, these tariffs will be unavoidable, particularly where there is insufficient alternative domestic production and where other overseas sources are also subject to MFN duties.

In instances where emerging MFN duties would impose unavoidable new costs on importers (and ultimately consumers), **the government may wish to establish new TRQs that enable duty-free trade to continue**. These TRQs would be in addition to the national TRQs the UK will adopt as its "share" of existing EU TRQs (see above).

The government has not yet announced any particular mechanism for considering requests for new TRQs. This should not halt food retailers, ideally working in partnership with others in the food supply chain, from making their case to DEFRA, Treasury and DIT.

3. Engage in Government Consultations About New Trade Agreements

The Trade White Paper: preparing for our future UK trade policy signalled government intentions to pursue new trade agreements after Brexit. It identified the US, Australia and New Zealand as the leading candidates for new trade deals. It also raised the prospect of the UK applying to join CPTPP (the regional trade deal recently agreed between Canada, Mexico, Japan, Vietnam, Australia, New Zealand, Singapore, Chile, Brunei, Malaysia and Peru).

On 26 October, the Department of International Trade closed its public consultation on trade with New Zealand, Australia, the US and on CPTPP, but there will be further opportunities for retailers and others to make their views known to the government as preparations are made for these negotiations.

4. Engage in Government Consultations About New Trade Agreements

Preferential access for imports from developing countries is delivered through the EU's Generalised System of Preferences (GSP) with the precise level of preference determined by the application of a range of complicated economic (and sometimes political) criteria. Relevant measures include per capita GDP and the level of competitiveness of the exporting industry. The government is committed to maintaining at least the same level of preferential tariff access for least developed countries post-Brexit and it has indicated that it will seek to improve the effectiveness of unilateral preferences for other developing countries where possible.

Imports of everything but arms from the world's very poorest countries is already duty free and there appears to be little scope for improving terms of access for these countries. However, **access for imports from some larger developing countries could be significantly improved**. Improved access in the form of lower tariffs could be achieved through relatively small changes to the technical criteria for GSP. For example, in 2011, the EU changed (loosened) the preferential origin rules for clothing from least developed countries. In simplistic terms, this allowed countries such as Bangladesh to manufacture garments from Chinese fabric and export them to the EU free of duty. In turn, this led to an increase in the value of Bangladeshi garment exports to the UK from under €7 billion in 2010 to over €15 billion in 2017.

Post-Brexit, the UK will be free to change or vary the criteria it uses for determining preferential trade benefits for developing countries. Although the government has not yet announced a process for this, retailers should consider working with others (especially those in the non-governmental organisations (NGO) community) to identify technical changes that can be made to the criteria that would enable more imports from developing countries at lower rates of duty.

UK Retail Brexit Trade Service:

Supporting Retailers Navigate the Road Ahead

UK Retail Brexit Trade Service: Supporting Retailers Navigate the Road Ahead

The Squire Patton Boggs and Retail Economics UK Retail Brexit Trade Service provides retailers and those involved in the retail supply chain with support to plan, prepare and effectively implement changes to be "Brexit ready".

Our service provides crucial insight into Brexit's multi-staged policy implications. While focusing on key issues that affect you, we also understand the peripheral issues that impact the market as a whole.

For retailers – Risk levels are maximised for EU trade. Our service helps safeguard you against oversights in new costs and regulation arising from policy developments. We scenario plan and model for what the new trade deal could mean and highlight cost implications from customs duties on different products (e.g. sensitive products).

For companies selling services into the retail industry – Keeping abreast of how Brexit affects your core customer base is essential for sharpening your business strategy and recognising how best to foster key relationships during turbulent times ahead. Our service gives you this insight.

Who Will Benefit From the Service?

- Board, senior-level executives and legal teams at UK-based retailers or international retailers with UK interest
- Suppliers to the retail sector
- Companies involved in the retail supply chain
- Advisers with significant interest in the retail sector, such as manufacturers, logistics and many others

Services We Offer – How You Can Benefit

Retail Industry Analysis

We can provide tailored impact assessments based on robust economic and legal analysis and expert retail insight, relevant to your specific needs, that are actionable, reportable and support you in making sound business decisions.

Monitoring

We can implement a monitoring service to ensure that all key retail industry-related legislative, regulatory and policy developments arising from Brexit, specifically tailored to your requirements, are captured in an easy-to-read report. Areas of focus could include:

- Immigration
- Labour and employment
- Commercial contracts
- Distribution arrangements
- Data privacy and cybersecurity
- Intellectual property rights
- Industry-specific issues
- Trade and customs

UK Retail Brexit Trade Service: Supporting Retailers Navigate the Road Ahead

Services We Offer – How You Can Benefit

Planning and Preparation

- **Advisory** – Our retail Brexit specialists can advise on designing and implementing strategies for your UK and wider global operations, which will help mitigate the risks and uncertainties that stem from Brexit by planning and preparing contingency measures on Brexit-specific strategies.
- **Economic evaluation** – Our independent research provides concise analysis of the need-to-know economic factors affecting your business. Understanding the dynamic macroeconomic environment will be critical in implementing your Brexit strategy.
- **Scenario planning** – Whether you are just starting your scenario planning, have already made strategic decisions (i.e. taken risks and invested in new manufacturing facilities in the EU) or are looking to invest in infrastructure or develop new supply chains, we can help by advising on:
  - Cost changes from customs duties
  - Impact of transitional arrangements or changes to existing practice
  - Effect on commercial contracts and arrangements with suppliers
  - Whether a transitional EU-UK customs union will require customs declarations
  - Implications for your overseas sourcing costs

Engagement

We can support you when you need to engage with government. We can help to make the right introductions, influence policy and get the inside track on political conversations.

Added Value

We offer the following complimentary services:

Quarterly UK Retail Brexit Trade Review – The review will contain economic analysis on the size of trade and up-to-date narrative on the progress of UK and EU trade negotiations specific to the retail industry.

Pulse updates – Monthly briefings (in between the release of the quarterly reports) that will focus on specific elements of the Brexit process and are tailored to the retail industry.

Invite-only roundtables – Aimed at addressing the particular challenges the retail industry faces with Brexit. The roundtables will be interactive with involvement from key business influencers and policymakers.

About Us: Report Authors

About Squire Patton Boggs

With more than 1,500 lawyers and an industry-leading Public Policy team, we have decades of experience to support our clients through this legal and political uncertainty. Our global Retail and Brands & Consumer Products teams have a proven track record advising across the spectrum, including supermarkets, department stores, fashion houses, global health and beauty brands, manufacturers, distributors, logistics operators, technology businesses, property developers, landlords and investors.

Our Brexit and International Trade expert team includes former members of the UK Parliament, former Office of the US Trade Representative, members of the European Parliament and senior regulators, as well as European Free Trade Association officials, former ambassadors and national government ministers. They work collaboratively with our legal practitioners who master all relevant areas of law likely to be affected by Brexit, such as international trade, regulated industries (e.g. financial services), immigration, labour and employment, tax and competition.

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About Retail Economics

Retail Economics is an independent economics research consultancy focused on the UK consumer and retail industry. Our subscription service provides unbiased research and analysis on the key economic and social drivers behind the UK retail sector, helping to inform critical business decisions and giving you a competitive edge through deeper insights.

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Other UK Retail Brexit Trade Service Resources

- March 18 – 1st Quarterly UK Retail Brexit Trade Review
- May 18 – Pulse Update: Transition and What It Means for Retailers
- June 18 – How Do You, Your Suppliers and Customers Fare as Trade Tensions Escalate?
- July 18 – Pulse Update: Post Chequers Analysis
  2nd Quarterly UK Retail Brexit Trade Review
  Brexit Legal Blog
- August 18 – Pulse Update: Preparing for a Hard Brexit
- October 18 – US-EU: Export Controls and Sanctions Update

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