BREXIT AND COMMERCIAL CONTRACTS
ASSESSING THE IMPACT

Georgina Kon and Lindsey Brown of Linklaters LLP assess how the UK's decision to leave the EU will affect businesses' contractual obligations.

The Prime Minister, Theresa May, announced on 2 October 2016 that Article 50 of the Treaty on European Union will be triggered before the end of March 2017, and that the next Queen's Speech will include a Great Repeal Bill (the Bill) to repeal the European Communities Act 1972 (*see box "Hard or soft Brexit?"*).

While Brexit will have a very limited impact on English contract law, save in respect of consumer, agency and other specialist contracts which are outside the scope of this article, its impact on the substantive obligations under contracts may be more significant (*see box "Dealing with common problems"*).

Businesses should review key existing contracts and future-proof new contracts to prepare for Brexit. This article considers the following three key issues:

- Brexit could have significant commercial implications, such as the imposition of tariffs, restrictions on the freedom of movement of people or further changes in exchange rates. This could result in financial hardship. However, in the absence of express contractual provisions, parties are unlikely to obtain relief.
- Brexit could raise questions over the meaning of contracts; in particular, whether references to "the EU" will continue to include the UK after Brexit. The answer will depend on how the reference is used and the relevant context (*see boxes "Reviewing existing contracts" and "Future-proofing contracts"*).
- It may be more difficult to enforce a judgment by the English courts in some EU member states if the UK ceases to be covered by the recast Brussels Regulation (*1215/2012/EU*) and replacement arrangements are not made.

COMMERCIAL IMPACT

Businesses need to consider how their contracts will be affected by the commercial implications of Brexit (*see News briefs "Brexit briefing paper: further clarity but no answers", www.practicallaw.com/5-633-7673; "Brexit: what next for boards?", www.practicallaw.com/6-631-2460*).

General interpretation

Brexit could have a significant effect on the commercial substance of some arrangements (*for background, see Briefing "Contractual obligations: testing the limits in a downturn", www.practicallaw.com/9-422-4191*). The contractual ramifications are likely to turn on the interpretation of the contract.

The English courts have started to take a much stricter approach to interpretation. In *Arnold v Britton*, the Supreme Court emphasised the importance of the language of the contract and warned that the mere fact

that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, is not a reason for departing from the natural language (*[2015] UKSC 36; www.practicallaw.com/9-616-5783*).

Similarly, in *Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Limited and another*, the Supreme Court took a restrictive view of the circumstances in which a term will be implied into a contract, emphasising that the court should only intervene where the term is so obvious that it goes without saying or is necessary for business efficacy, and even then should proceed with appropriate restraint (*[2015] UKSC 72; see News brief "The modern law on implied terms: no rescue from uncommercial terms", www.practicallaw.com/1-622-1146*).

The result of this is that parties will be bound much more tightly to the words of their contracts. There will be limited relief for those who have made a bad bargain or are adversely affected by Brexit.

Financial hardship

The commercial effect of Brexit could be felt in many ways, for example:

- There could be further changes in exchange rates, such as were seen immediately following the result of the referendum in June 2016 when the pound fell sharply against the dollar and the euro.
- Tariffs could be applied to goods and services provided to and from the EU following Brexit. Similarly, there could be changes in tariff rates for trade with countries outside the EU or changes to the VAT treatment of payments under contracts.
- If the UK ceases to be part of a customs union with the EU, customs checks will be needed for goods entering and leaving the EU. This could impose additional costs and delays.
- Restrictions on the freedom of movement of people could lead to labour shortages or drive up the costs of labour, or both. This could affect businesses in certain sectors, such as construction and care, that are heavily reliant on workers from the rest of the EU.
- A business may no longer need the benefit of a contract following Brexit; for example, it might want to relocate its operations and therefore no longer need premises or plants based in the UK.

These events could lead to a contract becoming loss-making or more difficult to perform. However, it is unlikely that parties will obtain relief from the consequences of these changes in the absence of express provisions.

In particular, it is unlikely that a party will be able to rely on a standard force majeure clause in order to seek relief from its obligations. While force majeure does not have a precise meaning under English law, relief as a result of force majeure is normally limited to obligations that are rendered impossible to perform, whether actually or legally, as a result of that force majeure event (*see "Impossibility" below*).

The fact that economic hardship will be suffered is not normally sufficient to claim relief (*Tandrin Aviation Holdings Ltd v Aero Toy Store LLC and another [2010] EWHC 40 (Comm)*). However, this depends on the exact wording of the applicable clause and it is possible that some types of clauses, for example, material adverse change clauses, could be wider than a standard force majeure clause and could potentially be triggered by financial hardship suffered in the lead up to, or following, Brexit.

The best way to future-proof against Brexit is therefore to include express provisions to cater for these events; for example, provisions to protect against movements in exchange rates or to pass on cost increases from the imposition of tariffs. Alternatively, the contract might contain an express right to terminate on Brexit or, instead, expressly state that Brexit does not give a right to terminate (*see box "A Brexit termination clause"*). It may also be possible to mitigate the risk in other ways, for example, by hedging against currency movements.

Impossibility

The position would be different if Brexit makes performance impossible or removes the very purpose of the contract. This is likely to be relatively rare, but might apply in some cases; for example, a financial institution that loses passporting rights and so is unable to provide financial services either to or from the UK after Brexit.

This situation is more likely to constitute a force majeure event but, again, this depends on the exact wording of the clause (*Czarnikow Ltd v Centrala Handlu Zagranicznego Rolimpex [1979] AC 351*). Force majeure clauses typically include circumstances beyond the reasonable control of either party. These words are likely to have their natural and broad meaning, and are not normally construed according to the *eiusdem generis* rule of construction; that is, where a general word or phrase is assumed to be qualified by preceding examples which are of a common category. On that basis, where Brexit makes performance impossible, it may be a force majeure event.

The counter argument is that force majeure events do not normally encompass events which one party reasonably foresees will

Hard or soft Brexit?

This article assumes that there will be a "hard" Brexit in which the UK ceases to be part of a customs union and is no longer obliged to comply with EU law.

It is possible that there might be a softer exit; for example, the UK might become part of the EEA, join a customs union or obtain some sort of associate membership status (*see feature article "International trade post-Brexit: getting the goods", this issue*). A softer exit might avoid some of the issues identified in this article, however, until these issues become clearer, the cautious approach is to assume a hard Brexit (*see Briefing "Britain's new relationship with Europe: what could the future look like?", www.practicallaw.com/5-623-5405*).

There is greater certainty over the timing of Brexit, which is likely to be March 2019. However, the exit agreements could include transitional arrangements to ease the shock of Brexit, so some of the more substantive changes may not take place immediately.

Dealing with common problems

	Issue	Position under existing contracts	Future-proofing
Financial hardship	A contract has become unprofitable due to changes in exchange rates or the imposition of tariffs after Brexit. Performance will become more difficult due to loss of freedom of movement of goods and services. A contract is no longer needed after Brexit.	It is unlikely that the contract will provide any relief in the absence of express provisions. In particular, it is unlikely that these situations will be covered by a general force majeure clause. Frustration will only be relevant in rare cases where Brexit radically alters the obligations under a contract. It will not apply simply because there is financial hardship.	Consider: • Including express drafting to deal with these changes. • Including a termination right on Brexit. • Taking other risk mitigation measures, such as hedging.
	Performance of a contract has become impossible.	If performance is truly impossible, this might be a force majeure event or it may frustrate the contract.	
	The business needs to know whether the Transfer of Undertakings (Protection of Employment) Regulations 2006 (*SI 2006/246*) (TUPE 2006) will continue to apply.	It seems likely that TUPE 2006 will continue to apply to service contracts in the UK in the medium term.	It may be possible to include contractual clauses to replicate some aspects of TUPE 2006. However, it seems unlikely that this would be needed in most cases.
References to the EU	Whether contracts covering the EU will include the UK after Brexit.	It depends on the context in which the reference is used and the wider circumstances.	Clarify if references to "the EU" include the UK after Brexit.
	How contract obligations derived from EU law will apply after Brexit.	It is likely that this will include any domestic legislation succeeding that specific EU law in the UK, but this depends on the circumstances.	Make it clear how references to "EU law" should be interpreted after Brexit.
Governing law and jurisdiction	The effect on contracts that are subject to English law.	English contract law is largely unaffected by Brexit, save in respect of consumer contracts and other specialist contracts. Following Brexit, English courts can generally be expected to uphold the parties' choice.	-
	The effect on contracts that give the English courts jurisdiction.	In some cases, it might be harder to enforce an English judgment in some other EU member states.	Take local law advice on enforcing in that member state or use arbitration.

inevitably come into operation, so the date of the contract and the timing of Brexit may be relevant to the application of force majeure to contracts.

The law of frustration may also be relevant, but the English courts construe this narrowly. Frustration arises where something occurs after the date of the contract, without the fault of either party, that either transforms the obligations into something radically different or makes it physically or commercially impossible to fulfil the contract (*Davis Contractors Ltd v Fareham UDC [1956] AC 696*). Supervening illegality or a change in law can frustrate a contract but inconvenience, hardship or financial loss will not be sufficient. Again, much depends on the context.

EU REFERENCES

Another potential difficulty is whether references in a contract to the EU will continue to include the UK after Brexit. The answer will depend on the purpose of the clause and the context in which the term is used. For example, it might be used:

- To define the territorial scope of a right or restriction, such as a trade mark licence that covers the EU.
- In a restriction on transferring personal data outside the EU.

The starting point is the express terms of the contract. If the contract defines the EU by reference to its member states "from time to time", that strongly indicates that it will not include the UK after Brexit. In contrast, if the contract defines the EU as "Austria, Belgium ...and the UK", that indicates that it

Reviewing existing contracts

As a practical measure, most organisations should:

- Consider how Brexit could affect their business and their commercial arrangements with third parties.
- Identify the key contracts governing those arrangements and assess if they provide sufficient protection against Brexit, or are at least clear about the implications of Brexit.
- Consider whether to try to renegotiate or amend those contracts to deal more clearly with the implications of Brexit. The timing of Brexit is relevant to this analysis. If the contract is likely to expire before March 2019, no changes may be necessary or the expiry date will at least provide the appropriate opportunity for any renegotiation to take place.
- Take care when discussing this issue with third parties. Unequivocal statements that certain action will, or will not, take place on Brexit could lead to arguments that the contract has been varied or that a party is estopped from exercising its rights.

will continue to include the UK. Any express provision dealing with member states leaving the EU would be decisive.

If the language is not clear, the purpose of the clause and the contract, the wider commercial background and commercial common sense become more relevant. These will vary greatly and will be specific to the facts. For example, in the case of a trade mark licence covering "the EU", the following factors would be relevant when assessing if the licence continues to apply to the UK:

- The trade marks identified in the contract, including the presence of UK trade marks.
- The geographic regions in which the trade marks are primarily used, including use in the UK.
- The payment structure, including the payment of any upfront lump sum for the licence.

While subsequent events are normally irrelevant to the interpretation of a contract, they might still affect the ability of the parties to exercise their rights. For example, a licensee may seek to rely on estoppel if it has expended time and money defending a trade mark in the UK in reliance on the understanding that the licence covers, and will continue to cover, the UK.

The interpretation of "EU" in other contexts will be very different; for example, where it is used in a restriction on transferring personal data outside the EU. The purpose of this provision is to ensure compliance with EU data protection laws, so there is a stronger argument for a dynamic interpretation that will cease to include the UK if it leaves the EU (*see Briefing "Brexit and data protection: between a rock and a hard place", www.practicallaw.com/2-628-4586*). However, this will depend on all the circumstances, including the location of the parties.

The best way to future-proof against this uncertainty is to state expressly in each case whether the definition of the EU includes the UK after Brexit. It may also be sensible to deal expressly with other possible changes in the membership of the EU, and indeed in the membership of the UK.

Incorporation of EU law

Another concern is whether references to "EU law" will include any implementing or successor legislation in the UK following Brexit, given that EU law is likely to cease to apply in the UK.

For example, a contract might define VAT as a tax levied in accordance with the Principal VAT Directive (*2006/112/EC*). Will that capture the Value Added Tax Act 1994 (VATA) or any successor sales tax regime in the UK, following Brexit? In most cases, this will be addressed by the express terms of the contract, which might, for example:

- Extend the definition of VAT to also include "any other similar tax levied by reference to added value or sales". This extension would clearly capture VATA or any other domestic sales tax regime after Brexit.

Future-proofing contracts

Most organisations should now future-proof their contracts against Brexit. The nature of those provisions will depend on the circumstances but are likely to include:

- Expressly providing for the commercial impact of Brexit; for example, changes to tariffs, exchange rates or customs procedures.
- Expressly stating whether references to "the EU" will include the UK after Brexit.
- Making it clear if references to "EU law" include legislation succeeding that law in the UK.
- Assessing if Brexit could make enforcement of an English judgment more difficult and, if so, whether arbitration is a suitable alternative.
- Considering if there should be an express right to terminate on Brexit.

Finally, Brexit may not be the end of the story. It is possible that other member states could leave the EU in the future, or that a second independence referendum in Scotland could take place leading to a break-up of the UK. At the time of writing, these events do not appear likely, but the same could have been said about Brexit and any future-proofing may want to cater for these possibilities.

- Include provisions to deal expressly with modification to legislation; for example, by stating that references to a law include any modification, re-enactment or consolidation of that law or by incorporating the Interpretation Act 1978 to similar effect. In some circumstances, this might indicate that references to EU law include successor domestic law, particularly if the Bill transposes the relevant EU law into English law.

There may also be a good argument that the purpose of the clause (in this case, to provide a VAT inclusive or exclusive price) would override the strict literal meaning of the definition. However, this would depend on the facts.

Changes in law

The risks associated with changes in law are not unique to Brexit. However, change is more likely, and potentially more significant, as a result of Brexit. For example, while agency contracts are outside the scope of this article, the government might use Brexit as an opportunity to revoke the Commercial Agents (Council Directive) Regulations 1993 (*SI 1993/3053*) (1993 Regulations), which implement the Commercial Agents Directive (*86/653/EU*). This would have a significant effect on the commercial substance of affected arrangements and would raise difficult questions about how to interpret contract provisions that address the 1993 Regulations, such as the selection of an indemnity or compensation.

Of greater relevance are the Transfer of Undertakings (Protection of Employment) Regulations 2006 (*SI 2006/246*) (TUPE 2006). TUPE 2006 implements EU law so could, in theory, be revoked after Brexit. Given that TUPE rights are deeply embedded in current employment practices, it seems more likely that the most the government would do is tweak certain aspects of the law, such as restrictions on post-transfer harmonisation of terms and conditions. However, for certain contracts, for example, ones where the workforce is an important factor, parties might want to consider if a synthetic contractual TUPE mechanism might be helpful as a fall back.

GOVERNING LAW AND JURISDICTION

There is no reason to think that English law will be any less attractive as a choice of law following Brexit. However, businesses should consider whether English jurisdiction clauses will continue to be suitable.

Choice of law

English contract law is mainly derived from the common law. Commercial contracts are subject to limited statutory intervention, and that intervention largely originates from UK statute. The only intervention by EU law of any significance is the Directive on Late Payment in Commercial Transactions (*2011/7/EU*), which replicated existing law in the UK in any event.

This means that English contract law will be largely unaffected by Brexit, particularly when used in a commercial contract. The advantages of English law remain, such as its predictability, depth of judicial precedent and emphasis on upholding and respecting parties' commercial bargains. There is no reason to think that English law will be any less attractive as a choice of law after Brexit.

The parties' choice of English law will still be respected after Brexit. Member states' courts would be obliged to respect that choice of law under the Rome I Regulation (*593/2008/EC*) in relation to contractual obligations and the Rome II Regulation (*864/2007/EC*) in relation to non-contractual obligations, subject to limited exceptions unrelated to Brexit (*for background, see Exclusively online article "Choice of law and forum selection: impact of Rome I and II", www.practicallaw.com/6-501-4353*).

Even if the UK does not implement similar rules in its domestic law, the result before the

A Brexit termination clause

As the Prime Minister, Theresa May, has said, Brexit means Brexit. However, the key to any Brexit termination clause will be to create a less ambiguous definition of Brexit. One choice is to tie this to Article 50 of the Treaty on European Union (Article 50), so the trigger date is the date of entry into force of the withdrawal agreement agreed under Article 50 or, failing agreement, two years after the Article 50 notice is served, subject to any extension. This assumes that the UK finally exits using the Article 50 mechanism, so a more general definition might be better such as the date that the UK "withdraws from the EU" or "ceases to be subject to the EU Treaties".

All of these options are likely to give a relatively clear answer in the case of a hard Brexit but could be less clear if there is a soft Brexit or phased withdrawal from the EU and its associated treaties. Similarly, a clause drafted using these options could be triggered if the UK remains part of the EEA, which might not be appropriate in the circumstances.

Commercial impact

Given the uncertainty about Brexit, there may be value in tying any termination right to the commercial impact of Brexit on the parties. This could either be general, such as where Brexit causes a material adverse effect, or tied to particular events, such as the UK exiting from the customs union or losing passporting rights.

Similarly, it is important to be clear if the clause will operate on a unilateral basis in favour of one party or bilaterally, giving both parties the right to terminate.

Consequences of termination

The clause should also consider the consequences of termination; in particular, whether:

- The contract will terminate immediately or after a certain period of time.
- There is any obligation on either party to compensate the other on termination.
- There should be an obligation to try to renegotiate the contract before terminating it, accepting that an obligation of this type will be largely unenforceable.

Unfortunately, there is no single answer to these issues. Each termination clause will, in all likelihood, have to be specifically tailored to the contract in question.

English courts would generally be the same. Under the common law, the English courts would uphold the parties' choice of English law. Although the position in relation to non-contractual matters is largely untested, the English courts would be likely to uphold the parties' choice in that respect as well.

The impact for some specialist contracts could be more significant. For example, consumer contract laws are heavily influenced by EU law, as are some agency contracts. However, these specialist contracts are outside the scope of this article.

Jurisdiction clauses

The English courts will be largely unaffected by Brexit. EU law has limited influence over the English judiciary and England's civil procedure rules. The core attractions of the English courts remain, including the independence and expertise of the judiciary, the speed and flexibility of proceedings, and the range of powers of the court.

However, within the EU, jurisdiction and the regulation and enforcement of civil judgments is principally governed by the recast Brussels Regulation (*see feature article "The recast Brussels Regulation: implications for commercial parties", www.practicallaw.com/9-591-5525*). Among other things, the recast Brussels Regulation allows contractual parties to choose which courts will have jurisdiction, subject to certain exemptions, and makes provision for the recognition and enforcement of judgments as between the member states. This raises three jurisdictional issues:

- Whether parties in member states can still give the English courts jurisdiction over their contract. This is very likely to still be possible. Even if the recast Brussels Regulation ceases to apply to the UK, the English courts would generally accept jurisdiction on the basis of the parties' choice under English common law.

- Whether other member states' courts will respect an exclusive jurisdiction clause in favour of the English courts. If the recast Brussels Regulation ceases to apply to the UK, the UK will become a third country for the purposes of the recast Brussels Regulation, which will result in greater complexity and increased inconsistency in the treatment of that exclusive jurisdiction clause. However, this risk may be offset by more freedom for the English courts to protect their jurisdiction following Brexit, principally by way of anti-suit injunctions, which are not currently possible under the recast Brussels Regulation.

- Whether judgments of the English courts will be enforced in other member states. This issue requires more caution. If the recast Brussels Regulation ceases to apply to the UK, enforcement will be subject to national procedural laws, which may be less streamlined, and to national substantive tests, which may afford less favourable treatment to English judgments. If an English judgment is likely to require enforcement in a member state after Brexit (for example, where a counterparty is domiciled there), the conservative approach would be to do either or both of the following:

  - assume that national law will apply and take local advice on the implications of enforcing an English judgment in that member state;

  - use arbitration, possibly specifying London as the seat of the arbitration. Arbitration is likely to be unaffected by Brexit as arbitration law is generally regulated by national law (the Arbitration Act 1996 in England) and the New York Convention, which is a non-EU international instrument. An arbitral award made in the UK should remain recognised and enforceable in member states, and vice versa, on the basis of the New York Convention.

The UK will also cease to be party to the Lugano Convention and the Hague Convention on Choice of Court Agreements on Brexit (*see Briefing "Hague Choice of Court Convention: gaining momentum", www.practicallaw.com/7-619-7898*). This means that the same issues will arise in respect of those conventions, including before third countries that are party to them, such as Switzerland in the case of the Lugano Convention.

It is possible that alternative measures may be put in place; for example, the UK might attempt to negotiate an independent accession to the Lugano Convention. However, none of these alternative measures are necessarily foolproof or guaranteed to happen.

Georgina Kon is a partner, and Lindsey Brown is an associate, at Linklaters LLP.

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