Brexit and commercial contracts

The path for the next few years for the UK’s relationship with the EU and the rest of the world is very unclear. The main political parties are in turmoil as they appoint new leaders, the Leave Camp have not set out a proposed pathway, and the EU is currently offering no compromise. We may end up with a general election or even a second referendum to give a mandate for the specific proposals.

That might mean that nothing will change (we end up staying in the EU), or little change but loss of influence (the Norway model), or significant change in specific areas (the Swiss model), or a lot of changes (the Canada model)!

However, that exit and uncertainty is probably not going to have a fundamental impact on most commercial contracts. Most commercial contracts will survive and operate post-Brexit. This is different to Grexit where the change of currency from the Euro to a new Drachma risked introducing so much legal uncertainty that contracts might not survive (see my earlier Grexit alert).

There are, however, a number of areas of risk that will need to be borne in mind. Set out below are the key issues that we think need to be considered in looking at the impact a Brexit could have on your contracts.

Immediate Actions

- The immediate impact on international contracts with exchange risk will be changes in exchange rates. This is not a new risk but currency volatility is high. Important contracts with exchange rate risk should be reviewed to see if they deal with substantial shifts in exchange rates.

- The main impact on contracts will be a commercial one, not a legal one, as exchange rates shift and appetite to do business changes.

- Existing Contracts: There is no immediate impact on most contracts. You therefore have the time to consider (and worry about!) the potential impact of an EU exit on contracts. Contracts
are likely to survive. Important contracts (i.e. the high value, high risk, long-term or otherwise strategically important contracts) should be reviewed to consider the impact of the issues set out below.

- New contracts:
  - Trading with other members of the EU while the UK negotiates an exit will become much more uncertain, and therefore unattractive, as there will be concerns about the exchange rate risk and also the potential for future barriers to trade. During that exit negotiation process, doing long-term cross-border contracts with members of the EU will be unattractive.
  - Trading with non-members of the EU will also be uncertain. Where the non-UK country has an EU trade deal there will be uncertainty while the UK negotiates a new trade deal. Any non-UK/EU party will have concerns if their objective is to gain access to the EU.

Risk of Recession

The uncertainty is likely to cause a slowdown in economic activity and possibly a recession. Therefore the usual recession agenda will need to be considered:

- **Focussing on decreasing costs.** Procurement arrangements will need to be reviewed. That will be challenging given that with a weak pound imports are more expensive which will drive up raw material costs.

- **Reviewing solvency risk in supply chain and customers.** This means considering contingency plans. Dealing with a supplier's or customer's insolvency is always challenging. You should ensure that your contracts have clauses allowing you to terminate on insolvency (which is permitted under English law) to ensure you have some options.

- **Credit might well tighten given increased risks.** Check your funding arrangements – is it secure, what happens if the base rate increases? Additionally a big issue in the 08/09 recession was withdrawal or tightening of credit insurance leading to cash flow getting harder – so consider your exposure.

- **Look for the silver lining.** It is not necessarily all gloom. UK suppliers sourcing in the UK will, with the weak pound, have an advantage over importers. Good businesses may be available for acquisition cheaply and competitors may be distracted.

Fundamentals – will my contract survive a Brexit and can it be enforced?

- Most contracts will continue to be in force.

- In some contracts, force majeure clauses or the doctrine of frustration may apply. This will be the case where Brexit has caused contract performance to be much harder or impossible.
This feels unlikely for routine goods and services contracts. And note that a typical force majeure clause is unlikely to protect against swings in exchange rates or changes in the cost of materials.

This is probably going to be more relevant to heavily regulated businesses. For example a UK regulated financial services business may not be able to do business in the EU following a Brexit.

- Currently within the EU, contracts can be readily enforced with EU laws stipulating which law and which court applies. That brings helpful certainty. Post-Brexit (depending on the negotiated trade deal with the EU), some of that certainty falls away. Contracts are likely to continue to be enforceable, but there will be more risk and cost. Going forward consideration should be given to using arbitration.

New barriers to trade

- Exporting within the EU is currently pretty easy. There is no need to work out customs regimes and duty arrangements.

- Stepping out of the EU will mean that exporting to our neighbours will become more difficult and more like exporting, for example, to the USA. This means grappling with customs and duties.

- And employing people from the EU will probably become harder, potentially impacting the provision of services.

Territory references to the EU

- Supply/distribution arrangements and IP licences might refer to the contract territory as the "EU". Does that mean the EU as it is on the date of the contract? Or does it mean EU as from time-to-time. It will depend on the exact words – certainly a source of potential debate and therefore risk.

Change of Law

- Existing Agreements. Longer term agreements often include provision for change of law. The change of law clauses should be revisited to consider how costs arising from a change of law is allocated.

- New Agreements. Give there is a significant risk of change of law which could impact costs (e.g. new import duties) a clause dealing with change of law risk should be considered.

Compliance with "EU Laws"

- In some contracts the parties are obliged to comply with all EU laws. Following a full Brexit that may no longer be appropriate.
Intellectual Property

- Brexit will impact intellectual property.  See our Brexit IP alert.

Red tape bonfire?

Our long membership of the EU means we have accrued plenty of EU originating legislation which inevitably impacts contracts:

- **Product safety** – Our product safety legislation is an EU system. Establishing common product regulations across the EU has been a key part of forming the single market.
  
  o Regardless of the EU, the UK will need for its own purposes product safety legislation. After all before the EU legislated in these areas the UK had similar legislation. And given the enormous amount of legislation to review, the default position is likely to be that we keep what we have.
  
  o Any exports to the EU will need to comply with EU law in order to gain access to that market.
  
  o If the UK strikes a deal with the EU for free movement of goods then it is probable the UK will agree to comply with EU product safety laws.
  
  o And note that if we are not in the EU, but have to comply with EU law there is a risk that without the UK's close involvement in creating EU law, EU law might become less suited to UK business operations.

- **Data protection** – Data protection is an ever increasing headache for businesses. But exiting the EU will not take it away – data will be flowing to and from the EU, and any business in the EU will still need to comply with EU requirements. And although a headache, individuals appear to highly value data protection – we may have the choice to relax data protection in the UK but will we choose to do so?  See our Brexit data protection alert.

- **Antitrust** – Antitrust law regulates many commercial agreements especially where there is some form of exclusivity or restriction. Antitrust law is established at an EU level so that we could choose to adapt or do without it. However, is that likely? All reputable jurisdictions have some form of antitrust laws. And doing business in the EU will mean we still need to comply with EU laws.  See our Brexit antitrust alert.

- **Sector regulations** – There is plenty of EU derived sector regulation – e.g. financial services, life sciences, automotive etc. We could choose to drop those regulations but if we are to trade with the EU we will need to comply. We can choose for domestic businesses to have different regulations.

- **TUPE** – TUPE is European derived legislation to protect employees when businesses are sold or on outsourcing. We could choose for it not to apply in the UK. However, upsetting well established arrangements in outsourcing will be seen by some as unwelcome as it will change the risk profile on which the contract is based.
• **Consumer law** – Again we could choose in the UK to have different rules to those in the EU on issues such as being able to return goods. However, the substance to much of these EU laws is often UK inspired or derived. It feels unlikely that there will be material changes in the short-term.

• **Commercial agents protection** – Under EU legislation commercial agents have certain protections, especially on termination. We could scrap this legislation. And if we do, that will lead to some uncertainty to agency appointments, while at the same time potentially promoting a possible increase in agency appointments. Many agency appointments will not have their fundamentals affected – the contracts are likely to survive.

• **Temporary workers protection** – The recent regulations relating to protecting temporary/agency workers is EU derived. It adds cost and complexity to using temporary workers. Post-Brexit that could be removed, if it is something the UK wants.

• **Late Payment Protection** – The legislation seeking to control late payment is EU inspired. With freedom it is unclear which way the UK might go – retain existing protection, embrace the free market and drop the legislation, protect SME's by enhancing the legislation.

So, in summary, contracts will survive. But there will be uncertainty and that uncertainty will depend on the detail of the contract, the parties and the sector.
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