Brexit and Commercial Contracts

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Outline

- Do I need a Brexit clause
- Objectives of a Brexit clause
- Key types of Brexit clauses
- Usefulness of standard provisions
- Usefulness of the common law
- Possible effects of Brexit
- Specific drafting issues
- Wider contractual issues
Do I need a Brexit clause?

- Which contracts need to deal with Brexit?
  - in force post-Brexit
  - affected by Brexit-related developments

- Is doing nothing an option?
  - continue to perform
  - breach of contract and facing termination for default and an action for damages

- Keeping the status quo
  - confidence and certainty
  - risks of doing nothing are not as great as the risks which come from introducing a Brexit clause
  - short-term contracts
  - rights to terminate without penalty on short notice
What would a “Brexit clause” achieve?

- “If/then” clause

- Actual impact is still uncertain:
  - may offer is a binding requirement that the parties will attempt to renegotiate relevant aspects of the contract
  - may be possible to specify consequences of certain events

- Not a silver bullet which will solve all Brexit-related issues and problems
Key types of Brexit clause:

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<tr>
<th>Type of Clause</th>
<th>Risk</th>
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<tr>
<td><strong>Specific event, specified consequence:</strong></td>
<td>Different or additional events</td>
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<td>- A specific event occurs (for example, currency exchange rates fluctuate).</td>
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<td>- A specified consequence follows (for example, the price of the products or services is adjusted).</td>
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<td><strong>Trigger, renegotiation, termination:</strong></td>
<td>The party not affected by Brexit faces the choice of accepting less favourable terms or early termination</td>
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<td>- A trigger occurs (for example the imposition of tariffs, a change in regulatory requirements, a party’s costs increasing).</td>
<td>The affected party may find the trigger too narrow</td>
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<td>- The affected party may request renegotiation of the contract.</td>
<td>No certainty that parties can reach a new deal</td>
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<td>- If no deal can be reached, the affected party can terminate.</td>
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Usefulness of standard provisions which may already be included in a contract
Event is only outside the control of a party if that party has taken reasonable steps to mitigate - should have planned

- A change in economic or market circumstances affecting the profitability of a contract – not FM

- Temporary situations
Material adverse change (MAC) clause

- Not as standard an inclusion as FM clauses

- Appear regularly in:
  - lending transactions
  - corporate acquisition agreements

- Depends on drafting

- Usually unable to rely on a MAC clause on the basis of circumstances it knows about
Compliance with law clauses

- Express obligation to comply with law

- Definition of "Law"
  - as at date of contract
  - as may be amended from time to time

- Not clear – rules of statutory interpretation (1 January 1979)

- Obligation to comply with law "from time to time"

- Long term contracts e.g. outsourcing contracts
Change control clause

- Long term contracts e.g. outsourcing contracts
- Procedure to follow
- “Agreement to agree"
- Definition of "Mandatory Change".
- Allocation of costs
Hardship clause

- Deal with which party should bear the burden of increases in costs of supply, fluctuations in interest rates or exchange rates, and other changes to factors that the parties took into account when they made the deal.

- Whether such a clause can be invoked depends on drafting.

- Even if it can be invoked - may only offer limited assistance:
  - will changes be agreed according to an agreed mechanism or simply be negotiated?
  - what will happen if no changes can be agreed?
Termination rights

- Notice period
- Cost
- Used as negotiating leverage
Usefulness of common law
Frustration

- Will release both parties from any further performance of a contract

- Frustration may be difficult to apply:
  - courts apply a high threshold
  - event was within the contemplation of the parties at contract formation - not enough that the event was merely unexpected
  - event does not make further performance impossible, illegal or radically different - not enough that the contract is merely more expensive to perform
Rules of contract interpretation and implied terms

- Courts reluctant
- Business sense
- Not the same as saying Courts will relieve a party from the consequences of their imprudence or poor advice - if departs from “natural meaning”
- Fairness of a proposed implied term or the fact that the parties would agree to it is (by itself) insufficient grounds for implying it
- Regard to the background knowledge reasonably available to the parties at the time they entered the contract
- Query the point at which Brexit (and its effects on the contract) became something the parties could have been expected to cater for?
- If the parties fail to specifically provide for Brexit they may be taken to have accepted that any additional costs and risks should lie where they fall
Assessing whether to include a Brexit clause

- What could happen?
  - Consider how Brexit may affect the parties’ performance and cost

- What the contract currently says
  - Who would bear the additional responsibilities and costs as the contract is currently drafted e.g. who is responsible for compliance with law?
  - Could any force majeure, MAC, price adjustment and change control clauses be invoked?
  - Would it be possible to argue frustration?

- How do the termination rights operate?
  - The prospect of termination could be used to encourage renegotiation

- Specific events and specified consequences
  - Are there any specific events for which the parties feel confident about providing specified consequences?

- Trigger, renegotiation, termination
  - Is it in a party’s interest to have a clause allowing for renegotiation and, if that fails, termination, on the occurrence of certain triggers?
Drafting Issues
What possible effects of Brexit should I be thinking about?

- Brexit has the potential to directly or indirectly affect most transactions:
  - possible impacts on own ability to use goods or services purchased under an agreement
  - how the market for own products may be affected
- Trade tariffs on goods
- Freedom to provide services
- Licences and consents
- Freedom of movement for workers
- Changes in law
- Currency exchange rates
- Other financial factors
How should Brexit be defined?

- Composition of the UK at Brexit
  - Possible that Scotland (and also Wales and Northern Ireland) may cease to be part of the UK before the UK’s withdrawal from the EU
  - Consider whether the clause should be capable of being invoked even if the UK has shrunk by the time Brexit occurs

- Defining Brexit
  - How Brexit will happen is not yet clear
  - Article 50 of the Treaty of the European Union
  - Depending on how Brexit occurs - debate as to when “the UK ceases to be a member of the EU”
Should the parties be able to invoke the clause before Brexit

- Allowing the clause to be invoked at any time
  - could be invoked whenever a party suffered an adverse impact (including at any time before Brexit)
  - could be combined with a requirement to prove that the adverse impact (or likely adverse impact) was caused:
    - by the UK’s decision to leave the EU
    - simply by one of a limited set of events which it is anticipated may follow from such decision

- Allowing the clause to be invoked after a particular date or known event

- Should there be an end date for invoking the clause?
  - May be risky, given that the after-effects of Brexit are likely to be felt for many years
### Causation

- Must the party invoking the clause show that Brexit has caused the problem?
  - Brexit may be the reason the parties decide to use the clauses - doesn’t necessarily mean the clause must necessarily mention Brexit

- The problems of requiring causation
  - Proving that a particular adverse impact on a party (an increase in costs, a new requirement for a licence or approval) has been caused by Brexit may be difficult
    - if a dramatic change in exchange rates precedes the UK’s exit from the EU, is it caused by Brexit?
    - if all EU-based law is temporarily preserved at exit, is a later change caused by Brexit or by other reasons?

- Stricter requirements for causation
  - Directly caused
    - would not be possible to invoke the clause if there was some intervening cause between Brexit and the adverse impact
  - Solely caused
    - would not be possible to invoke the clause if another cause, in addition to Brexit, contributed to the adverse impact
What are the triggers: what problems will allow a party to invoke the clause?

- What triggers allow invocation of the clause?
- 2 different approaches – long form and short form
- Long form: a specific type of event occurs
  - Seek to encompass the most likely results of Brexit, such as changes in law, the imposition of tariffs and the loss of licences
- That event causes a specific type of adverse impact on a party
  - An inability to perform or an increase in the costs of performance
  - The party seeking to invoke the clause will have to prove the adverse impact was caused by one of the specific events
  - Ease of proving depends on circumstances:
    - imposition of tariffs will increase costs
    - a change in immigration law has driven up labour costs
- Short form simply requires that a party suffers a specific type of adverse impact, again, such as an increase in the costs of performance
  - No need to show causation by a specific event - it will be easier for a party affected by Brexit to invoke the clause
  - Be easier for a party to invoke the clause for a non-Brexit related cause
Specific events (1)

- General observations
  - Further categories could be added
  - Specific events which the parties have foreseen and catered for could be expressly excluded
  - Other clauses, such as force majeure, cannot be invoked on the occurrence of these event

- Change in law
  - all types of binding rules and common law
  - includes a situation where an existing law does not, of itself, change but becomes applicable or ceases to be applicable e.g. the rules on tariffs in other countries
  - reference to laws of other jurisdictions, since the UK leaving the EU may prompt other countries to change the rules on how transactions with UK businesses are handled
  - cover issues like changes in employment, taxation and customs rules

- Check existing definition of “Law”
Specific events (2)

- **Trade tariffs**
  - delivery and payment arrangements
  - where INCOTERMs are used their provisions should be carefully checked

- **Licence or consent**
  - consider what existing licences are currently in place and could be lost, and where new licences could be required

- **Currency fluctuation**
  - The rate of exchange between sterling and the currency in which prices are set and payment is made may fluctuate:
    - a reference exchange rate should be specified to reduce the risk of dispute, such as the daily spot exchange rates published by the Bank of England
    - a reference to the change continuing for a minimum period could be used to address the risk of brief isolated extremes
Specific events (3)

Other change to the business or economic environment in which a party operates

- Too broad?
  - increases the chances that the clause could be invoked to renegotiate the contract simply because a party realises it made a poor decision commercially

- Only unforeseeable changes?
  - changes could be restricted to those which were unforeseeable at the time the contract was entered into, to make it harder to invoke the clause
  - term “unforeseeable” suggests an element of objectivity – would parties in a similar position to the parties to the contract have provided for the possible occurrence of an event of the type in question?

- Exclude events already provided for
  - if it is only intended that fluctuations which exceed a specified limit can be a trigger, then currency fluctuations in general should be excluded from this category
  - exclude any specific events for which specified consequences have been provided and events which the parties have agreed shall have no consequences
Adverse impacts

- Ability to perform
- Increase in costs of performance
- Price too low
- Price too high
- Customer cannot use/sell
How great should the impact be?

- **Metrics**
  - percentages can be set
  - to reduce dispute it may be appropriate to specify which costs can be taken into account and how these will be established
  - include a mechanism for establishing a market price and what count as similar products could be defined

- “**Substantial**”
  - subjective
  - whether or not an impact was substantial would only be capable of final determination by the courts
Other issues

- What if the other party makes more profit
- Should both parties be able to invoke the clause
- Renegotiation: what measures can be taken to encourage agreement
- Renegotiation: additional considerations for public contracts
- How much time should the parties be given to negotiate
- How much notice of termination should be given
- Making alternative arrangements
- Performance during the notice periods
- Can either party terminate if negotiation fails
- Expiry of right to terminate
- Consequences of termination
Wider contractual review

- Does the contract contain any references to the EU?
- Does the contract expressly refer to any EU legislation?
- Could Brexit make enforcement of an English judgment more difficult?
Questions?

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