

Commercial contracts

BRIEFING:
Brexit

The impact of Brexit on contracts

In the wake of the referendum, firms need to plan for uncertainty. What first steps should you take now?



David Davis, the Secretary of State for Exiting the European Union, has signalled he intends to serve notice under Article 50 of the Treaty on European Union and begin Brexit negotiations in early 2017. Once notice is given, the UK will leave the EU on the earlier of a withdrawal agreement taking effect or two years from the date of the notice.

On this basis, we can assume that the earliest the UK could complete its withdrawal from the EU is December 2018, although agreeing a new trading relationship with the EU is likely to take longer.



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Legislative impact

Until the UK completes its withdrawal from the EU, it remains a member state, accepts supremacy of EU law and is governed by EU rules. Unless the UK amends or repeals legislation stemming from the EU in potential breach of its treaty obligations before Brexit, it seems unlikely that there will be any great change in the legislation underpinning commercial contracting prior to Brexit.

Upon Brexit, EU laws which are directly applicable without further UK legislation or which are implemented by secondary legislation under the European Communities Act 1972 will fall away, unless re-enacted by Parliament. EU laws enacted into UK law through primary legislation will continue to apply until Parliament amends or repeals them.

Deciding which EU laws will continue to apply in the UK will take many years and the UK's attitude to new EU laws will depend on the withdrawal negotiations. Over time, UK and EU law will diverge. More uncertain is to what extent business will face tariffs and quotas on EU exports and imports, potentially increasing the cost and time of performance or their ability to freely provide services across the EU.

Market risk

Market or commercial conditions are an issue for business now. Sterling has fallen. Fixed price arrangements with no currency fluctuation provisions will be most affected. Financial market and exchange rate volatility may in turn result in higher risk premia in credit and equity markets and consequential impact on investor confidence.

What should you be doing now?

There are three steps prudent businesses can take now in relation to their commercial contracts:

- Review your business activities to understand how Brexit and the possible future UK/EU trade structures impact them;
- stress-test existing contracts to understand how Brexit-related impacts are dealt with to determine your current level of Brexit risk; and
- consider how existing and future contracts could better protect against those risks.

What to look out for

Brexit is unlikely to be expressly dealt with in many contracts. However, there are many contractual risk-allocation mechanisms which could be relevant.

Consider areas such as:

- Do price adjustment mechanisms give you the right to adjust prices to reflect the application of tariffs or exchange rate fluctuations?
- Is a right to terminate triggered and could that be used (by either party) as leverage to negotiate amendments to reallocate Brexit-related risks between the parties?
- It is unlikely that the referendum result or market uncertainty would qualify as force majeure, but widely drafted clauses could be triggered by a change in law affecting or delaying performance.
- Whether contracts contain change in law or material adverse change provisions which could be triggered by Brexit impacts and what the consequences of that would be.
- How will references in a contract to the EU be dealt with post-Brexit (or even references to the UK, should Scotland or Northern Ireland leave the UK)?
- The current harmonised EU dispute resolution regime means parties often opt for litigation rather than arbitration when contracting with an EU entity. We do not know whether, post-Brexit, the UK will remain part of this regime and so alternative dispute resolution procedures may be more appropriate.

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