EU withdrawal under the 2018 Act, & its impact on Commercial Contracts

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A. Introduction

At the time of writing the political status of Brexit remains maddeningly uncertain. Whilst business leaders have emphasised the damage which the continued uncertainty might cause to the economy, the plight of lawyers, faced the advising commercial clients has been perhaps under-emphasised.

B. This lecture will consider three issues:

What are the possible adverse effects on existing contracts of a particularly hard or no deal Brexit?

What if any escape routes might be available or arguable as a means of providing leverage for the party suffering hardship?

What can be done now to protect the interests of clients against such risks?

C. The Problem: The Potential Risks of Hard or No-Deal Brexit

Without inviting accusations of participating o Project Fear and acknowledging that economic drivers are complex and sometimes contradictory, Brexit plainly does have the potential to destabilise and cause significant impact to British business. In particular long term agreements could become less profitable or more onerous in the absence of any ability to revise the price or the terms for the supply of goods or services.

Possible adverse factors might be:-

- Changes in the value of GBP
- Delays in delivery, as a result of changes to export and import controls
- Increases in production costs or overheads
- Labour Shortages
- Increased Insurance Costs
- The imposition of customs duties or tariffs
- The costs of compliance with different regulatory regimes
- Domestic tax Increases in the rates of VAT or Corporation Tax through political changes.

D. Are there any Escape Routes?

Force Majeure Clauses and MAC Clauses

In the event of hardship the first port of call for the lawyer advising her client would be to examine the existing contracts. They might contain a *Force Majeure* clause or Material Adverse Change (MAC) clause

A *force majeure* clause is designed to enable a contracting party to be excused from, or in some cases, suspend, performance of all, or part, of its contractual obligations upon the occurrence of certain defined events which are acknowleged to be outside that party's control.

MAC clauses are similar, but are often broader in scope, and commonly appear in in acquisition or lending agreements. They are intended to relieve a party from performance in the event that there is an unforeseen adverse change in the target company or borrower's circumstances.

The existence of such clauses might well afford leverage, in an attempt to renegotiate the relationship. but whether or not they would be effective to relieve the party of its obligations would depend very much of the particular words used in the clause and the specific circumstances which led to the clause being invoked.

Whilst it is impossible to be prescriptive, a general shift, such as a fall in sterling or the application of tariffs or border controls themselves, are not likely to afford grounds to trigger the typical boilerplate *Force Majeure* clause or MAC clause.

Frustration

Apart from contract terms, a potential escape route is the doctrine of frustration as a means of terminating a contract. The application of the concept does not depend on the express provisions of the contract but potentially might be invoked when a supervening event occurs which renders performance of the contract illegal or impossible, or which transforms the obligation to perform into a radically different obligation from that originally undertaken at the time the contract was entered into.

Canary Wharf (BP4) T1 Ltd and ots v. European Agency Medicines Agency

[2019] EWHC 335 (Ch)

One case has reached the High Court in which Brexit as a frustrating event has been argued.

In 2011 the European Medicines Agency took a 25 year lease of premises in Canary Wharf. It claimed that the effect of Brexit and a 2018 EU regulation were that it had to move its headquarters to Amsterdam. EMA argued that Brexit had not been foreseen by the parties at the date the entry into the lease and inevitability of EMA's relocation discharged EMA under the doctrine of frustration.

EMA advanced two principal arguments: frustration resulting from supervening illegality and frustration for common purpose.

The illegality issue related to whether or not EMA would have any capacity post-Brexit to meet its obligations under the lease. EMA argued that, as a matter of law, any EU agency had to be headquartered in a Member State and so it would, not post-Brexit, have the capacity to meet the usual incidences of the lease including the rent obligations.

Marcus Smith J rejected that argument. Although there were good political reasons for EU agencies being based in a member state there was no legal requirement for it to be so. Further, the performance of the lease itself was not rendered illegal by Brexit. He also decided *obiter* that such form of claimed illegality, based on capacity under the law of the place of incorporation, did not operate to frustrate the contract which was to be performed in England under English law.

The judge then turned to the broader concept of whether or not the lease had been terminated by reason of a "frustration of common purpose". He did not lightly dismiss the argument, but rather examined the position of the respective parties at the time of entry into the lease. It appears that the parties had considered the possibility that the EMA might relocate during the term and EMA had tried to introduce a break clause but the landlord had not been willing. It was also relevant that the landlord's interests were to maximise its rent yield and to protect itself from EMA seeking to relocate mid-term. Conversely EMA had obtained an incentivised rent arrangement which it could not have had without a long lease, and with protections for the landlord against early termination. Accordingly, the parties did not have any common purpose beyond the terms of the lease. They had indeed envisaged the possibility of EMA's relocation and had adjusted the terms of the lease accordingly.

It is interesting to note that the frustration for common purpose argument was decided in such a fact specific manner in the EMA case. In theory this leaves open the possibility for other litigants to argue on the specific facts of their case that Brexit is a supervening event which frustrates the common purpose of the contract. A plea of frustration remains ambitious not least because:

- Frustration is predicated on changes in circumstances which were entirely *unforeseen* and not merely *unexpected* and so is unlikely to have an application to contracts entered into after Brexit became a possibility.
- Frustration does generally apply to changes in economic or regulatory conditions.
- The burden on proof is on the person asserting frustration
- In reality it is a narrow doctrine and not commonly applied in the context of commercial contracts, hence *force majeure* and MAC clauses.
- The Court will be alive to hindsight arguments and be concerned about opening up floodgates by treating Brexit as a frustrating event.

Whilst it cannot be ruled out and might play a role in re-negotiating unprofitable or onerous contracts, the doctrine of frustration would appear to have a limited application.

E. What can be done now?

Review Existing Terms

The best advice is to encourage clients to review their existing contracts and anticipate how the different variants of Brexit might impact upon their legal obligations and upon the economic hinterland in which they operate.

Some supply contracts do allow suppliers to increase the prices of goods and services following notice to the customer. Customers with bargaining powers might be looking for price rise caps.

Suppliers might wish to include new provisions for calculating exchange rates and pass on the risks to their customers and vice versa.

More flexible time stipulations are likely to be introduced.

Suppliers would be less likely to agree to time being made of the essence or to be liable for onerous liquidated damages whilst uncertainty looms.

In many instances, contractual dates for delivery might be capable of being enlarged or renegotiated to allow for changes to export and import controls.

Brexit Clauses

Some firms are offering to their clients the service of providing bespoke Brexit clauses, designed to cater for the specific post-Brexit impacts on costs of performance or ability to perform. These clauses have to be industry specific and if capable of agreement would have to be proportionate to the risk and to the parties' respective bargaining powers.

In principle, Brexit clauses are a possible protection for clients but they demand considerable acumen and precision of drafting skills to achieve their purpose. The trigger events to activate the termination or modifications of the contract would need careful definition and the law of unintended consequences would need to be paramount to avoid professional risks.

Other Clauses

A more ubiquitous and therefore less controversial stipulation would be to introduce a limitation or exclusion clauses so as to allocate risk so that for example in the event that a component or product became no longer available in the UK through no fault of the parties the full cost would not fall on the party in default.

Another issue which might arise is choice of law and jurisdiction in the context of cross-border trading. This might be particularly important in the context of regulated industries where EU Law is commonly stated to apply.

Perhaps softer options such as good faith or renegotiation clauses might be commercially easier to achieve. In the context bilateral pre-contract negotiations those might be sensible objectives for each of the parties.

Conclusion

We are currently living through a period of great uncertainty and none of us know will be in 12 months' time.

There are pitfalls, traps and, yes, opportunities, for commercial lawyers, as we assist our clients to navigate through the Brexit labyrinth. As the blind lead the blind, tread carefully.

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