Hogan Lovells

Brexit and UK-related M&A

What might the impact of the referendum result be?

The outcome of the UK's referendum on its membership of the European Union creates a number of near-term uncertainties.

In this bulletin, we discuss some of the immediate legal issues and questions which arise following the result in relation to M&A deals involving the UK.

The current state of play

It is important to remember that whilst the referendum result may provide a political mandate for a Brexit, its legal status is only advisory and not binding. In addition, it provides no guidance about the form which the UK's future relationship with the EU and the rest of the world should take. The formal process for a Brexit would also not start unless and until the UK delivers a notice under Article 50 of the Treaty on European Union. This would trigger a two year transitional period for withdrawal arrangements to be agreed, at the end of which (absent an agreed extension to the process) the UK would automatically leave the EU. The difficulties inherent in agreeing the withdrawal arrangements in this time frame has already generated intense political discussion about when the UK should issue its Article 50 notice. Until it does so, a Brexit is not inevitable.

Assuming that an Article 50 notice is issued, the potential legal forms that a Brexit might take is covered in other Hogan Lovells bulletins. There are a range of possible alternatives, ranging from full European Economic Area ("EEA") membership (likely accompanied by continued free movement of people and an EU-budget contribution) to the UK being unable to negotiate a trade agreement with the EU and falling back on its World Trade Organisation ("WTO") membership and WTO default rules. It is clear that depending upon the model chosen, the outcome and related issues will be different.

Impacts on UK-related M&A

Commercial

From a commercial perspective, the uncertainty flowing from the referendum result is likely to create both risks and opportunities for buyers and sellers of UK and European assets. For example, concerns around the uncertainty about the future ability of UK companies to sell goods or services into the EU may have a negative effect; conversely opportunities may arise in terms of pricing, including as a result of currency movements, or where companies decide to establish a base of further operations inside a revised EU. The effect of the result is also likely to vary significantly between both individual companies and industry sectors.

Legal

No laws have changed as a result of the referendum result and there is no certainty that any laws will change. Even following a Brexit, the laws governing M&A transactions in the UK are unlikely to change significantly in the short-term, because M&A is subject to limited amounts of EU derived law and regulation. However, we think it is possible, even at this early stage, to identify certain immediate issues:

1. Signed deals that have not yet completed: has a MAC occurred?

   Parties to deals which signed before the referendum result but which have not yet completed may, if the terms of the deal include a termination right in the event of a material adverse change ("MAC"), wish to consider the extent to which a MAC has now occurred. This will depend entirely on the drafting of particular clauses, and many acquisition agreements will specifically have been drafted taking the referendum into account. However, where a company's business model is subject to particular negative effects as a result of the current outcome (perhaps, for example, where an acquisition target has had to issue a profit warning as a consequence of the referendum result), there may be reasonable grounds for asserting that a MAC has occurred. This position should be considered on a deal-by-deal basis.

2. Future deals: Brexit conditionality

   In addition to standard MAC clauses, it is likely that acquirers will wish in future to negotiate bespoke MAC and conditionality clauses in acquisition agreements to provide themselves with increased flexibility, given the various potential outcomes of the UK's exit negotiations. For example, depending on the industry sector concerned, conditions relating to future passporting rights, specific changes in law or regulation, or potential post-Brexit tariffs may start to appear.

3. Merger control: a potential for greater political interference in UK-related deals?

   Currently, the EU merger control framework acts as a constraint upon political interference in merger control decisions. The European Commission reviews transactions solely on a competition-based test (whether or not the transaction will "significantly impede effective competition" in the EU) and there are limited exceptions where EU Member States can intervene to protect specified "legitimate interests". With the loss of this system following a Brexit, it is possible that UK merger control could become more politicised or locally-focused. This could impact on deal clearance certainty and necessitate the use of political avenues to secure clearances.

   And at a practical level, certain transactions will also no longer benefit within the EU from a "one-stop-shop" merger control review by the European Commission, and will instead require review by both the European Commission and the UK's Competition and Markets Authority. This may increase execution risk and extend deal timetables and costs.

4. Public M&A: the Code will continue

   While it is correct from a technical perspective that the UK Takeover Code implements the EU Takeovers Directive, the Code existed in substantially its present form before the implementation of the Directive and has governed UK public takeovers for over 40 years. While small amendments may therefore be made to reflect a Brexit, it seems likely that the Code will continue in place in substantially the same form and will continue to be developed to ensure that the UK remains at the forefront of takeover regulation worldwide.

5. Private M&A: could cross-border mergers involving companies incorporated in the UK cease?

   Private M&A is significantly less regulated in the UK than M&A relating to public companies. Accordingly, the potential for a Brexit to affect legal aspects of UK private M&A activity is even more limited. One potential impact of a Brexit, however, would be on the ability of UK-incorporated companies to make use of the EU cross-border merger regulations, which enable companies to merge with or into companies incorporated in other EEA states. Although the UK may be happy to continue to apply relevant legislation after a Brexit, it remains to be seen whether EEA states would agree to reciprocate. That said, cross-border mergers have remained only an occasional tool in the UK, so any decision by EEA states not to do so may have limited impact.

6. Due diligence and warranty packages

   The range of potential outcomes from the UK's exit negotiations will also need to be considered by buyers during due diligence and in the context of the warranty and indemnity protections and undertakings built into acquisition agreements. The scope of Brexit-specific due diligence will develop as more information is known about how the referendum result might be implemented, but we expect that increasingly a target's readiness for a Brexit (of any type) in key business areas (e.g. geographic structure, staffing (profile and locations), contractual structure, IP arrangements and payment flows), together with its internal Brexit-planning, will be an area of interest. In particular, a Brexit of any type could affect a target's key contracts. Likely areas of contractual due diligence focus in a Brexit context will include change of control provisions, territorial scope and the potential effects of regulatory change.

7. Intellectual Property Rights

   Following a Brexit, and absent any intervention by the UK government, all pan-EU intellectual property rights would cease to apply in the UK, although national IP rights would likely remain unaffected, at least in the short term. The UK government may choose to deal with this either by allowing all such EU IP rights granted up to the date of Brexit to continue to apply in the UK, or by instituting a form of conversion so that they could be converted into national rights. An alternative may be that businesses would have to re-apply for protection for their key IP as national rights. Buyers and sellers will need to take these potential outcomes into account as they structure deals to ensure that warranties and representations are not inadvertently breached or any necessary actions are taken to ensure IP rights are protected.

8. Business sales and employees: might TUPE requirements be relaxed?

   At present, under the TUPE regulations, following an acquisition of assets constituting a business (as opposed to the shares in a particular company), acquirers have to employ existing staff of the transferor on their current terms and conditions. Even if the UK decides to retain the "automatic transfer" principle after a Brexit, it is likely that it would become easier to change terms and conditions of employment after a transfer. TUPE was reformed in 2006 and again in 2014 and it was recognised on both occasions in the UK that it would be helpful to allow more flexibility around post-transfer harmonisation of terms and conditions, but that this was very difficult to achieve in light of existing European case law. This barrier to future reform could well be removed after a Brexit.

9. Restrictive Covenants

   As more about what the outcome of the referendum result will be is known, it will be prudent to consider existing and proposed restrictive covenants in acquisition agreements and ensure that their drafting is still appropriate in the context of a Brexit. Drafting by reference, for instance, to the "European Union" or "European Economic Area" may not continue to produce the same outcomes following a Brexit.

10. Dispute provisions: will UK jurisdiction clauses and judgments be recognised and enforced?

The risk that a Brexit might lead to jurisdiction clauses in favour of a jurisdiction in the UK not being respected by courts in the remaining EU Member States, or that English judgments will not be easily enforced across the EU following a Brexit, is limited. This is because the EU is subject to the global jurisdiction and enforcement set out in the 2005 Hague Convention on Choice of Court Agreements. Like every EU Member State, except Denmark, the UK is currently subject to the 2005 Convention by virtue of its membership of the EU, but if and when the UK leaves the EU, it will very likely accede to the 2005 Convention as an independent contracting state. It can do that even without the cooperation of the EU. The 2005 Convention guarantees that exclusive jurisdiction clauses in favour, for example, of English courts will continue to be respected in the EU in most civil or commercial disputes of an international nature, and that English judgments can be enforced there with relative ease, whatever the outcome of the negotiations with the EU.

A Brexit will also not affect the enforcement of London-seated arbitration awards, which will continue to be subject to the enforcement regime under the New York Convention, to which all EU Member States are a party.

If you have any questions on the issues raised in this note, please contact your usual Hogan Lovells contact or email brexit@hoganlovells.com.

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