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Brexit clauses

What is a Brexit clause?

A “Brexit clause” is a contractual provision which triggers some change in rights/obligations as a result of a defined Brexit-related event. The clause therefore sets out two basic things: (a) the specific Brexit related event triggering the clause; and (b) the contractual consequences of that event.

Are Brexit clauses fundamentally different from other “change” clauses (including Material Adverse Change (“MAC”) clauses)?

No.

Many agreements include provisions addressing the potential impacts of future change, ranging from broadly based MAC clauses to very specific provisions for the impact of change in a particular law or regulation or in the price of a particular commodity. Brexit clauses are just a variation on this familiar theme.

Why use a Brexit clause?

A Brexit clause can provide protection against adverse circumstances arising in connection with Brexit. However, as with any “change” clause, there are challenges. Can the parties define and agree a trigger event which is sufficiently specific to be contractually enforceable? Is it realistic to predetermine the consequences of a future event? What should the consequences be if the event occurs? By their very nature, change clauses can be vulnerable to the parties interpreting them in different ways.

Is “Brexit” an appropriate trigger for change?

Technically, “Brexit” would occur when the UK formally stops being a member of the EU. However, it is currently very unclear what the post-Brexit trading landscape will look like and how Brexit would, in practice, take effect, which makes it more difficult to anticipate precisely what effect Brexit will have on business agreements.

At its most extreme, Brexit could result in all UK laws which have derived from the EU being repealed and barriers to trade and movement of goods, services, people and intangibles being erected between the UK and EU. Equally, it is possible that the UK eventually decides not to trigger Article 50, and remains in the EU, but secures agreement to significant changes. However, both these outcomes currently appear unlikely.

Even if the UK eventually formally stops being a member of the EU, it is probable that many of the UK's laws and many aspects of the trading position between the UK and EU will remain unchanged, e.g. because UK law needs to remain aligned with EU law to facilitate trade or because the UK law in question is not derived from EU law. It is also likely that Brexit changes will take effect over a period of time rather than on a single day.

Given these uncertainties, it will be difficult for parties to a contract to agree an effective clause which triggers change just by using the simple phrase "if Brexit occurs" as "Brexit" may, in practice, mean different things. It is more likely to be appropriate, and more likely to create an effective clause, to define a specific trigger(s) which is relevant to the contract.

Could Brexit trigger a MAC, change or force majeure clause?

It is unlikely that, in most cases, the result of the referendum would itself trigger an existing, broadly drafted, clause that is triggered on a "material change" or similar language. However, it is possible that the consequences of the referendum (for example, changes in exchange rates or deterioration in the economic prospects of a business) could satisfy the thresholds or fall within the scope of some existing clauses with specifically defined MAC triggers (some of which may have been developed with Brexit in mind, e.g. in finance documentation) but this will only be the case in specific circumstances.

It is more likely that some specific aspect of the Brexit process, such as regulatory change or imposition of tariffs could trigger a generic clause. For example, if a UK entity is no longer capable of

being authorised to provide certain services within the EU this could constitute a "material adverse change" or even "force majeure".

It will be important to review existing significant agreements to assess the potential impact of various Brexit related events on MAC, change and force majeure clauses and to have Brexit in mind when negotiating future clauses.

What types of trigger might a Brexit clause include?

When assessing the nature of a Brexit clause it is important to consider the specific context of the agreement. For example, both the appropriate trigger and the consequences of a clause are likely to differ between an agreement with a relatively short horizon (e.g. a share purchase agreement or capital markets underwriting agreement) and a long term agreement (e.g. a joint venture or strategic commercial supply contract).

The following are some categories of potential triggers for a Brexit clause:

- A specific change in the law or the imposition by government of specific costs (Example: "*A change in the laws applicable to [relevant activity] such that [Party A] is no longer entitled by law to sell [product or service] in the member states of the European Union.*")
- A divergence between the rules applicable in the UK and those applicable in the EU (Example: "*The laws applicable to [relevant activity] in the United Kingdom ceasing to be [substantially similar] to those applicable to [that activity] in the European Union*")
- A loss of "passporting" benefits currently available under EU rules (Example: "*A change in the laws applicable to [relevant industry] such that [Party A] is no longer entitled by law to sell [product or service] in the member states of the European Union.*")
- Tariffs or other specific costs being imposed (Example: "*Tariffs being imposed upon the sale, licensing or other transfer of [specified goods or services] from the United Kingdom to a member state of the European Union.*").

In specific contexts it may also be appropriate to consider clauses linked to political events (such as the service of a notice under Article 50 or calling of a UK General Election) or market events (such as exchange rate movements through particular thresholds).

A simple clause providing a trigger “when the UK ceases to be a member of the European Union” may itself create uncertainty and is unlikely to be desirable in most cases. If, for example, as part of agreed transitional arrangements some elements of EU structure and laws continue to apply to the UK for a transitional period after “exit”, such a clause may not operate as originally intended.

What potential consequences might a Brexit clause provide for?

The following are some categories of consequences which might be provided for in a Brexit clause:

- A right for one, or either, party to terminate the contract. In this case it will be important to be clear whether the associated consequences of termination and/or termination mechanisms treat this as a “fault” or “no-fault” termination
- A process of negotiations between the parties with a view to agreeing the consequences of the relevant trigger. In this case it will be important to be clear as to the consequences if no agreement is reached and the timeline/end-stop date for such negotiations

- A specific change in the effect of the contract (*Example: “If the United Kingdom ceases to be a member of the European Union, then with effect from the date of such event [the United Kingdom will not be part of the Territory][the Territory is amended to include the United Kingdom and the European Union]”*)
- Allocation of responsibility for addressing a particular consequence (*Example: “If there is any change in the law applicable to [relevant activity] in the United Kingdom, [Party A] will be responsible for ensuring compliance with such revised law”*)
- Allocation of responsibility for particular costs (*Example: “If tariffs are imposed upon the sale, licensing or other transfer of [specified goods or services] from the United Kingdom to a member state of the European Union, those tariffs will be paid by [Party A]”*)
- Some combination of factors (*Example: “If [Brexit related event] occurs, [Party B] will be responsible for [specific Brexit related action] PROVIDED THAT [Party A] will reimburse and pay to [Party B] all costs and expenses reasonably incurred in connection with such [specific Brexit related action] up to a maximum aggregate amount of £[]”*).



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