After Brexit, the basic principle of the parties’ freedom to choose the law governing their contract will most probably continue to apply.

The choice-of-law rules for non-contractual obligations are uncertain.

In pre-referendum contracts, force majeure and hardship clauses may be triggered in the event of Brexit.

In post-referendum contracts, a special clause is needed to define Brexit and its effects on the agreement.

In the current uncertainty, arbitration clauses offer more security than choice-of-forum clauses.

What Brexit means for the interpretation and drafting of financial contracts

Brexit is creating a lot of uncertainty for banking and financial relationships. This article tries to bring some clarity on four issues: the law applicable to contractual and non-contractual obligations, the interpretation and performance of contracts executed before the referendum, the drafting of post-referendum contracts, and the impact of Brexit on dispute resolution clauses.

BREXIT AND CONFLICT OF LAWS

For private parties, it is of the utmost importance which national law applies to their contractual and other private relations. Courts in all member states – except Denmark – rely upon the Rome I and Rome II Regulations to determine the law governing obligations in civil and commercial matters. After the UK’s withdrawal from the EU, these regulations will cease to apply as supranational law in British courts.

However, the Rome Convention on the law applicable to contractual obligations of 1980 could serve as a fallback rule for contractual conflicts of laws. The Convention is the precursor to the Rome I Regulation and a treaty under public international law, thus independent from EU law. Though at the time of its signing the Convention was similar to the Rome II Convention in that it could reapply after Brexit. Although the Act (Miscellaneous Provisions) Act 1995, which accepted formula, frustration occurs when, the contract is governed by English law, the doctrine of frustration may have the effect of discharging parties from obligations arising out of contracts entered into before the referendum. According to a generally accepted formula, frustration occurs when, the doctrine of frustration is however interpreted in a very restrictive manner. It comes into play only when an intervening event either makes performing the contractual duties impossible or deprives the parties of all interest in their performance. Importantly, the doctrine of frustration cannot be relied upon where performance of contractual obligations merely turns out to be

The most promising option would be for the UK to replicate the Rome I and Rome II Regulations into its domestic law and apply them unilaterally. EU member state courts are bound to follow those regulations under the principle of universal application. There is reason to hope that UK and EU member state courts find mutual inspiration in their decisions and a harmonious interpretation. There would then be no need for a continued application of the Rome Convention – including its mandatory interpretation by the ECJ.

IMPACT OF BREXIT ON PRE-EXISTING CONTRACTS

The implications of Brexit on pre-existing contracts depend on the applicable law. If the contract is governed by English law, the doctrine of frustration may have the effect of discharging parties from obligations arising out of contracts entered into before the referendum. According to a generally accepted formula, frustration occurs when, “… a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract”.

The doctrine of frustration is however interpreted in a very restrictive manner. It comes into play only when an intervening event either makes performing the contractual duties impossible or deprives the parties of all interest in their performance. Importantly, the doctrine of frustration cannot be relied upon where performance of contractual obligations merely turns out to be
more difficult. Whether Brexit can give rise to frustration depends on the circumstances, as the following examples demonstrate.

Let us assume that a British bank acts as the underwriter for the issuance of new shares by a company established in the Czech Republic. As a consequence of a “hard Brexit” (ie one leaving the UK without access to the single market), the Bank loses its passport to place securities with clients on the continent. When assessing whether the contract would be frustrated under those circumstances, it must be borne in mind that passporting is not the only way of providing services on the continent. Equivalence may play the same role and is provided for widely. Even if credit institutions do not benefit from equivalence under CRD IV and CRR, the British bank still has the option of opening a subsidiary in an EU member state. This may prove to be costly, but the fact that performance is more onerous does not alleviate the obligation of the debtor. Hence the contract is not frustrated.

Many contracts under English law contain hardship or force majeure clauses. Brexit could trigger the application of these clauses. To illustrate, take the example of an ISDA derivative contract entered into between a British bank and a client in Frankfurt in 2015 which runs until 2019. Performing this contract will not be made more onerous or difficult due to Brexit because payments between the UK and the EU will continue to be permitted. Hence, hardship or force majeure clauses will not be triggered.

The situation is however very different for a consulting contract between a British consulting firm and a continental client that equally runs until 2019. In the case of a “hard Brexit”, the firm will no longer be allowed to provide services in the EU. Assume that the contract contains a force majeure clause with a list of possible events triggering its application. The events included in the list will typically be beyond the control of the parties and prevent a party from complying with any of its contractual obligations, such as an:

“act of God, war, hostilities, rebellion, revolution, insurrection, civil war, contamination by radio-activity from any nuclear fuel, riot”

Whether Brexit would fall under any of these categories and thus trigger the force majeure clause is doubtful. On the one hand, the list of events is typically non-exhaustive, thus leaving open other kinds of events that are not mentioned. Brexit could thus be considered an event of force majeure. On the other hand, according to the principle of ejusdem generis, Brexit needs to be of a similar gravity as the events mentioned in the clause. Whether this is the case is open to question. In any event, attention must be paid to the specific wording of a clause, which might differ from the example.

Hardship clauses are often drafted in a more general way and refer to a wider class of events in determining what constitutes hardship. Under a typical definition of hardship, a party that is bound by a contractual duty must prove that:

“[a] continued performance of its contractual duties has become excessively onerous due to an event beyond its reasonable control which it could not reasonably have been expected to have taken into account at the time of the conclusion of the contract; and that [b] it could not reasonably have avoided or overcome the event or its consequences. The parties are bound, within a reasonable time of the invocation of this Clause, to negotiate alternative contractual terms which reasonably allow for the consequences of the event.”

It seems reasonably clear that Brexit was not foreseeable before the referendum. Depending on the circumstances, it may also be possible to prove that the performance of the contractual duties by one of the parties has become “excessively onerous”. This might for instance be the case where the party would have to set up a subsidiary in an EU member state just to serve a single client.

In summary, it can be concluded that the ability to invoke both force majeure and hardship clauses depends on the wording of the contract and the particularities of the given case.

**CONTRACT DRAFTING POST REFERENDUM**

Brexit would not activate force majeure and hardship clauses in contracts drafted after 23 June 2016. The publication of the referendum’s results mean that the UK’s exit from the EU is not unlikely. Brexit therefore no longer qualifies as an unforeseeable event, which is an indispensable prerequisite for the triggering of force majeure and hardship clauses. Lawyers will thus have to make special provisions to deal with Brexit’s effects on contractual obligations.

The first option would be to allow either party the right to unilaterally terminate the contract upon the UK leaving the EU. Parties need to define in the contract what Brexit actually means, eg the end of the UK’s membership in the EU, the loss of Britain’s access to the Single Market or its exit from the Customs Union. They can also specify for that matter whether it is of any importance that the UK and the EU enter into a transitional deal or reach an agreement on their future relations.

The second option is to shift the entire risk of Brexit to either of the parties. This can be done, for instance, by giving only one party the right to unilaterally terminate the contract. Alternatively, it is also possible to explicitly exclude any effect on the contract by stating that any obligations would have to be performed by the parties regardless of the UK’s departure from the EU. This would place the burden of any additional costs on one side.

Depending on the needs of the client, the opposite can also be done. The contract could explicitly provide that Brexit triggers a force majeure or hardship clause contained in the contract.

A more balanced solution would be a clause that requires the parties to renegotiate the contract after Brexit. However, an agreement to agree in the future is not enforceable under the English common law as it is too uncertain. Parties could nevertheless commit themselves to enter into negotiations within a defined timeframe after Brexit. Such a contractual commitment could be combined with an arbitration clause that is triggered in case they fail to reach an agreement.
Other issues may arise in contract drafting. For instance, in underwriting agreements it is common to find clauses delimiting the geographical scope of the duty of distribution. Where these clauses refer to the EU, it is important to define what “the EU” means for the purposes of the contract, ie whether it refers to “the EU including the UK”, “the EU excluding the UK”, or “the EU as from time to time”. Challenges may also arise in insurance contracts that provide for joint insurance of a certain risk by a continental firm and a British firm. These agreements need to be split up into two independent contracts in order to avoid any problems arising from a loss of passporting rights: The risks arising on the continent should be exclusively insured by the EU firm, while the risks in the UK should be separately insured by the British firm.

Parties also need to be careful when choosing “English” law to govern their contracts. The reference to “English law” introduces an element of uncertainty because English law will be subject to extensive change after Brexit. This is especially true with respect to consumer and labour law, two areas that are heavily influenced by EU Law. It can also apply to financial regulation insofar as it has a direct impact on contractual obligations. Lawyers are therefore well advised to take precautionary measures. One possibility is to use a “stabilisation clause” which freezes the chosen law to a particular point in time. For instance, the contract could provide that it will be governed by English law as in force at the time of the conclusion of the agreement.

DISPUTE RESOLUTION CLAUSES

The Brussels I Regulation (Recast) (Regulation (EU) 1215/2012) grants exclusive jurisdiction to the court chosen by the parties (see Art 25). It also secures the recognition and enforcement of British judgments in the other member states (see Art 36 et seq). However, after Brexit the regulation will cease to apply to relations between the UK and the EU.

Though the Brussels I (Recast) Regulation’s predecessor, ie the Brussels Convention, may be reactivated, this would not completely solve the problem. First, only 14 out of 27 remaining member states have signed the Convention. Second, the Convention still relies on outdated bureaucratic relics such as the “exequatur” requirement, which comes in the way of speedy enforcement. Furthermore, improvements such as the chosen court’s exclusive right to rule on the validity of a choice-of-forum clause\(^{13}\) do not apply under the Convention.\(^{14}\) In addition, the recognition and enforcement of British judgments in Switzerland, Norway and Iceland is also uncertain as they will no longer benefit from the Lugano Convention’s rules.

A solution to these difficulties would be for the UK to join The Hague Convention on Choice of Court Agreements (2005), which secures the recognition and enforcement of judgments that are based on an exclusive choice-of-forum clause. Until then, international commercial arbitration can offer an effective way to guard against uncertainty. Parties when drafting contracts would be well advised to refer their disputes to arbitral tribunals rather than national courts. The New York Convention with its near universal applicability secures the effective recognition and enforcement of arbitral awards around the world.

OUTLOOK

Contract drafting after Brexit may be more challenging than post-referendum. Even if British firms have continued access to the Single Market because UK law is deemed “equivalent” to EU law, regulatory conditions must be followed. British firms will have to inform their customers in EU member states that they are not allowed to provide services other than to eligible counterparties and professional clients and that they are not subject to regulatory supervision in the European Union.\(^{15}\) They will also have to offer to submit any dispute relating to their services or activities to the jurisdiction of a court or an arbitral tribunal in a member state.\(^{16}\) This does not mean, however, that disputes with European customers can no longer be settled in the UK. The provider must merely offer a forum on the continent. If the consumer declines the offer and accepts dispute resolution in the UK, the firm will be fully compliant with EU law.

Further Reading:
- LexisNexis Loan Ranger blog: Brexit – how does it impact LMA facility documentation?

1 Article 24(1) Rome I Regulation.
2 Article 6(4)(d) and (e) Rome I Regulation.
3 Article 7 Rome I Regulation.
4 Article 9(3) Rome I Regulation.
5 See Art 2 Rome I, Art 3 Rome II Regulation.
6 Davis Contractors Ltd v Fareham Urban District Council, [1956] AC 696, per Lord Radcliffe.
7 eg in Art 47 MiFIR, Art 35 AIFMD (once it has become applicable according to the procedure set out in Art 67 AIFMD) and Art 172 of the Solvency II Directive.
8 Ocean Tramp Tanker Corp v V/O Sovfracht (The Eugenia) [1964] 2 QB 226, per Lord Denning.
9 See World Bank, Public-Private-Partnership in Infrastructure Resource Center, 2016.
12 See eg Danny Lions Ltd v Bristol Cars Ltd [2014] EWHC 817 (QB).
13 Article 31(2) Brussels I Regulation (Recast).
15 Article 46(5) MiFIR.
16 Article 46(6) MiFIR.