Brexit strategy

Need to Brexit a contract? Lucy Pert & Adam Jacobs provide a plan

IN BRIEF

- The unique challenges posed by Brexit may leave parties with little choice but to litigate.
- Since the 2016 referendum it has become increasingly common for parties to insert so-called 'Brexit clauses' into their contracts.

Brexit and particularly a 'no-deal Brexit', whereby the UK withdraws from the EU with no agreements in place regulating their future relationship, will affect many aspects of commercial life in Britain. In some circumstances, parties may well find that Brexit has impacted them in such a way that they are no longer able to perform their contractual obligations or that performance has become unduly onerous.

What can be done?

The legal mechanisms available under English law to parties who wish to discharge contractual rights without breach include material adverse change clauses, force majeure clauses and the doctrine of frustration. Although they operate in different ways, each is concerned with regulating the effects of unfavourable events on contractual performance.

Since the referendum in June 2016, some parties have also included Brexit-specific clauses within their agreements.

Material adverse change (MAC) clauses

MAC clauses are used in transactional documents to allocate the risk of events, unforeseen at the time of contracting, which are detrimental to one of the parties to the contract. Though their effects and usage are varied, the impact of MAC clauses is generally magnified during economic disruptors such as Brexit.

Whether an event is encompassed within a MAC clause depends on the specific drafting of the clause and the factual circumstances at the time of the alleged adverse change. This inherent uncertainty has meant that parties have been reluctant to rely on the courts for interpretation. This notwithstanding, the unique challenges posed by Brexit may leave parties with little choice but to litigate.

The High Court considered a typical MAC clause in the case of *Grupo Hotelo Urvasco SA v Carey Value Added SL & anr* [2013] EWHC 1039 (Comm), [2013] All ER (D) 227 (Apr). There, the dispute turned on the proper interpretation of a representation in a loan agreement that there had been 'no material adverse change in the financial condition of [the borrower]'. Mr Justice Blair set out the following principles:

1. The assessment of the financial condition of the borrower should normally begin with its financial information, although other compelling evidence may be required.
2. The adverse change would only be material if it significantly affected the borrower's ability to repay the loan in question.
3. A lender could not trigger a MAC clause on the basis of circumstances of which it was aware at the time of the agreement.
4. In order to be material, the change could not be temporary.

These criteria are strict and the extent to which they might be fulfilled by Brexit—or its consequences, such as the imposition of tariffs, the loss of passporting rights or exchange rate fluctuations—will depend on the specific contractual wording and the factual circumstances.

Nonetheless, entities can consider MAC clauses where agreements do not cater for Brexit specific occurrences and there are concerns about the ability of their counterparties to perform their obligations.

Force majeure clauses

Force majeure clauses suspend or excuse performance of obligations when contractually-specified incidents beyond the control of the parties occur. So-called 'force majeure events' are usually drafted to be intentionally broad and non-exhaustive.

The extent to which the consequences of Brexit can be categorised as force majeure events is a matter of ordinary contractual interpretation.

Some indication of the Court's possible approach to Brexit-related force-majeure clause arguments can be found in *Tandrin Aviation Holdings Ltd v Aero Toy Store LLC* [2010] EWHC 40 (Comm), [2001] 2 Lloyd's Rep 668, [2010] All ER (D) 111 (Jan). Here, the purchaser of an executive jet aircraft defaulted on its obligation to take delivery. It asserted that the economic collapse of the financial markets had triggered a force majeure clause which excused performance for 'any other cause beyond the Seller's reasonable control'.

Mr Justice Hamblen (as he then was) rejected this submission on the basis that changes in economic or market conditions affecting the profitability of a contract or its ease of performance did not generally trigger force majeure clauses in English law. Economic circumstances had not been specified in the clause as an instance of force majeure and were not capable of being construed as such. Moreover, the natural and ordinary meaning of the relevant contractual wording addressed the position of the seller exclusively rather than the buyer, such that the buyer could not rely on it.

The judgment demonstrates how fact dependent force majeure arguments are. Although it seems that financial inconvenience or disruption caused by Brexit would not, in the ordinary course, be sufficient, a case might succeed if performance of an obligation was rendered physically or legally impossible by Brexit and the clause catered for this. However, any wording specifically referring to Brexit would clearly be helpful.

Brexit clauses

Since the result of the referendum on 23 June 2016, it has become increasingly common for parties to insert so-called 'Brexit clauses' into their contracts. These usually seek to define the specific Brexit related trigger and its consequences. For example, a typical provision might state:

'If at any time after Brexit, a Brexit Trigger Event [as defined] occurs which has (or is likely to have) an Adverse Impact [as defined], the impacted party may:

(a) require the party to renegotiate an amendment to this agreement to alleviate the Adverse Impact; or

(b) if such a renegotiation fails, terminate this agreement.'

Such clauses will provide some comfort to parties who are concerned about the negative impact of Brexit. Nonetheless, the difficulties with defining a Brexit Trigger Event in the above example with sufficient precision are obvious. As such, one can easily anticipate disputes arising over their scope, effect and enforceability.

Frustration

Frustration operates to discharge an agreement where a supervening event renders performance physically or commercially impossible, illegal, or radically transforms the obligations beyond

the original contemplation of the parties. Importantly, the supervening event should not be self-induced.

Traditionally, the courts have been reluctant to intervene in bargains and have carefully limited the doctrine's scope. Nevertheless, the application of the doctrine is well established in certain circumstances including:

- subsequent changes in the law affecting a contract (eg Baily v De Crespigny [1869] LR 4 QB 180, [1861-73] All ER Rep 332). In Baily's case, the court refused to hold a lessor liable for breaching a restrictive covenant that neither he, nor his assigns, would build on neighbouring land, when a railway company, using statutory powers subsequently conferred on it, compulsorily purchased the land and built a station on it;
- supervening illegality. For instance, in *Metropolitan Water Board v Dick, Kerr & Co Ltd* [1915] 3 KB 676, an agreement to build a reservoir within six years from 1914 was frustrated when the contractors were obliged to cease construction in 1916 by order of the Ministry of Munitions; and
- frustration of 'common purpose' (eg *Krell v Henry* [1903] 2 KB 740, [1900-03] All ER Rep 20). This was one of the 'coronation cases' in which the defendant hired the claimant's apartment on specific dates to view Edward VII's coronation processions. Performance of the contract was excused when the processions were postponed.

When these principles are applied to Brexit, arguments may well be viable where, for instance, the agreement was predicated on the UK's continued membership of the EU or access to the single market.

The recent decision of *Canary Wharf (BP4) T1 Limited and ors v European Medicines Agency* [2019] EWHC 335 (Ch), [2019] All ER (D) 154 (Feb) provides some early guidance on the issue. In that case, Mr Justice Marcus Smith found that the European Medicines Agency (EMA) could not rely on the doctrine of frustration to abandon its lease with Canary Wharf for its headquarters in London, despite the fact that Brexit was not "relevantly foreseeable" when an Agreement to Lease had been entered into. The agency argued it was against EU law for its headquarters to be located in a non-member state. However, the Court disagreed and held that although it was inconvenient for the EMA to remain in the UK after Brexit, it retained the legal capacity to do so.

Further, the judge also found that the EMA needed to show that the illegality complained of was under English rather than EU law. Even if this was wrong, the alleged frustration had been self-induced. Finally, the judge also rejected that there had been frustration of common purpose because the EMA still had the benefit of the lease, was free to assign it and had not bargained (or paid) for a break clause.

Although this reaffirms the difficulty of pleading frustration, the EMA's position, as an EU agency, is relatively unusual. The judgment does not exclude the possibility of a frustration argument succeeding where, post-Brexit, contractual obligations become illegal under English law, or radically different from what the parties originally contemplated.

Comment

Businesses may well turn to the courts to try to alleviate the pain caused by Brexit, and a no-deal Brexit in particular. Although it is always preferable to settle disputes commercially, businesses have legal avenues available to them if they are unable to reach a compromise with their counterparty. **NLJ**

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