This is the seventh in our series of contract disputes practical guides, designed to provide clients with practical guidance on some key issues that feature in disputes relating to commercial contracts under English law.

**CONTRACT DISPUTES PRACTICAL GUIDES**

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**ENGLISH LAW CONTRACTS POST-BREXIT:**

**WHAT CHANGES SHOULD COMMERCIAL PARTIES EXPECT?**

The core principles of English contract law, such as interpretation of contracts and remedies for breach, will not be affected by Brexit and the key attractions of English law will remain.

Brexit may, however, have implications for particular aspects of parties’ contractual relationships, including how certain terms may be interpreted and whether any termination rights may be triggered, and on questions relating to jurisdiction and enforcement of judgments.

Anna Pertoldi, Neil Blake and Alex Kay consider what might change post-Brexit, and provide some practical steps that contracting parties can take to protect their position.
**BREXIT – TOP TIPS FOR ENGLISH LAW CONTRACTS:**

- **DO** review existing contracts for any terms that may be affected by Brexit
- **DO** consider whether there may be advantages in seeking to agree amendments to avoid any difficulties in interpretation before a dispute arises
- **DO** consider whether there may be a basis to terminate onerous contracts in light of Brexit-related events
- **DON’T** be hasty in terminating – if you get it wrong, you may be liable for significant damages
- **DO** consider addressing Brexit expressly in new contracts, eg to allow for termination on Brexit or to make it clear there is no such right, or to make appropriate amendments to reflect Brexit
- **DO** consider dispute resolution options carefully, particularly if it is important to be able to enforce judgments in the EU or avoid proceedings being brought in the EU

1. **INTRODUCTION**

   English law has long been a popular choice for international parties entering into commercial contracts. It is viewed as stable and predictable, while also being flexible enough to adapt to new developments in commercial practice. It respects “freedom of contract”, generally giving effect to the parties’ contractual bargain with only limited scope for implied terms or the influence of public policy.

   These key attractions will not be diminished as a result of Brexit. The core principles of English contract law come from the common law (ie judge-made case law) and as such are unaffected by Brexit; only in specific spheres, such as consumer contracts, has English contract law been significantly affected by EU law.

   Nor will Brexit have any impact on the effectiveness of a choice of English law to govern commercial contracts. EU rules require Member States to respect a choice of law, regardless of whether any contracting party is EU-domiciled or whether the chosen law is that of a Member State.

   Although Brexit will not affect the principles governing interpretation of contracts, it may lead to questions as to how particular terms should be interpreted (see section 2 below) or whether one party is entitled to terminate in light of changes resulting from Brexit (see section 3). It also has implications for issues relating to jurisdiction and enforcement of judgments (see section 4).

   “Brexit should not have any impact on the willingness of commercial parties to choose English law to govern their contracts. Its key attractions are based on common law principles which are unaffected by Brexit.”
2. INTERPRETATION

It is not possible to list every contract term that might conceivably give rise to issues of interpretation following Brexit. However, obvious candidates include references to the European Union, or the EU, and references to legislation which originates from the EU.

Under English law, the court’s aim in interpreting a contract term is to determine the meaning it would convey to a reasonable person with all the background knowledge available to the parties at the time the contract was made. As well as the words used and the relevant background, the court will take into account how the clause fits within the contract as a whole and considerations of commercial common sense - though recently the trend has been for the courts to place greater emphasis on the language used and downplay considerations of commercial common sense, unless there is some ambiguity or lack of clarity.

The court may also imply a term that the parties have not expressly included in their contract, but the bar for doing so is set high. In general, the term either must be so obvious as to go without saying or must be necessary to give business efficacy to the contract. These are not easy hurdles to meet.

For more detail on the court’s approach to contractual interpretation and implied terms, see issue 2 of this series of contract disputes practical guides, “What does your contract mean? How the courts interpret contracts”, and our blog post on a subsequent Supreme Court decision on implied terms, “Supreme Court clarifies test for implying terms into a contract”.

“Brexit may give rise to questions as to how specific contract terms should be interpreted in circumstances which may not have been foreseen when the contract was entered into.”

References to legislation: Where a contract refers to directly applicable EU legislation which no longer applies to the UK following Brexit (ie treaty provisions or EU Regulations), questions may arise as to whether this means the relevant legislation as it existed at the time, or any legislation enacted to replace it. The question may be resolved by an express interpretation clause.

Where there is no such clause, section 17(2) of the Interpretation Act 1978 provides that a reference to legislation that has been repealed and re-enacted is construed as a reference to the re-enacted version (unless the new statute makes a contrary provision). But section 17(2) may not be relevant where EU legislation ceases to apply as a result of Brexit, rather than being expressly repealed. Given the uncertainty, it is better to include an express interpretation clause in contracts.

Where a contract refers to UK legislation which implements non-directly applicable EU legislation (ie an implemented EU Directive), and which is amended post-Brexit, ordinary principles of contractual interpretation will apply to determine which version is meant. (Section 20(2) of the Interpretation Act 1978 deals with references to amended legislation but, unlike section 17(2), it applies only to references in legislation, not in contracts.) Again, therefore, it is better to have an express clause.

There may also be questions as to how the UK legislation itself will be interpreted post-Brexit. Currently, English courts endeavour to interpret UK legislation in such a way that it complies with EU law. There will be no obligation to do so post-Brexit. However, EU law may continue to be persuasive, particularly where the relevant UK legislation was intended to implement EU legislation.
References to the EU: A contract may refer to the EU in a variety of contexts. For example, a distribution contract may define the distributor’s territory as the whole of the EU. Or a business sale agreement may prohibit the seller becoming involved in a competing business throughout the EU.

Once the UK leaves the EU, questions may arise as to whether such references should be interpreted to mean the territory of the EU at the time the contract was entered into, so that the UK is included, or the territory of the EU from time to time, so that the UK is excluded.

Since the exercise of interpretation depends on the commercial context and the background knowledge available to the parties, the answer may well be different in different contracts. English courts are likely to take a sensible view and to favour commercial interpretations.

So for example in the context of an ongoing distribution agreement, if the UK forms an important part of the distributor’s operation, a court might readily conclude that the territory was not intended to change in the event of the UK’s exit from the EU. All will depend on the facts and circumstances of the contract.

For new contracts, if referring to the EU, it would obviously be better to cover the point expressly.
3. TERMINATION

Recent events have inevitably prompted many commercial parties to reassess their contractual arrangements. In some cases, parties may wish to exit certain arrangements or may wish to make changes, eg to exclude the UK from an EU-wide agreement so that separate arrangements may be made.

Some parties may already have put in place express rights to terminate or amend their agreements if and when the UK leaves the EU as part of an attempt to “Brexit-proof” the arrangements. Other contracts may contain a right for one or both parties to terminate on notice and without cause. In such cases, the position should be relatively straightforward.

Where a contract contains no such provisions, there are three main routes a party wishing to end its contractual obligations might seek to rely on:

a. **Frustration**: Excuses the parties from performance where something has happened to make performance impossible or to render the obligation radically different from what was contracted for.

b. **Force majeure clause**: A contract term which excuses one or both parties from performing the contract if prevented by circumstances outside the party’s control.

c. **Material adverse change (or “MAC”) clause**: A term found in some agreements which allows a party (for example a buyer or lender) to refuse to proceed if certain events occur after the contract date.

“It is better to include an express right to terminate in the event of a Brexit rather than relying on more general clauses or on frustration.”

**Frustration**

The effect of frustration is to bring the contract to an end automatically. This common law doctrine will only apply, however, where an event occurs after the contract has been entered into, which is not due to the fault of either party, and which renders further performance impossible or illegal, or makes the relevant obligations radically different from those contemplated by the parties at the time of contracting.

The courts have tended to apply the doctrine of frustration narrowly, emphasising that it is not lightly to be invoked to allow a contracting party to escape from what has turned out to be a bad bargain. In determining whether the doctrine applies, the court will consider multiple factors including the parties’ knowledge and expectations at the time of contracting, as objectively ascertained. Events which make performance more onerous or more expensive will not necessarily be sufficient to frustrate the contract.

The fact that an event is foreseeable, or even that it is the subject of express contractual provision, will not necessarily preclude a finding of frustration, eg if an event such as a strike lasts so long as to render performance radically different from that contracted for. However, the less an event is foreseeable, the more likely it is to lead to frustration.

The scope for the doctrine of frustration to apply as a result of Brexit-related events seems likely to be limited, particularly where contracts were entered into in the run-up to (or since) the referendum so that Brexit was foreseeable or expected. An argument based on frustration may, however, be available in some limited circumstances; all will depend on the facts.
**Force majeure**

Whether Brexit-related events might constitute force majeure will depend on how the particular clause is drafted. In most clauses, force majeure is defined by reference to a non-exhaustive list of events, together with a general “wrap-up” provision to include other events which are not within a party’s reasonable control. The clause may also exclude specific categories of event which the parties agree will not constitute force majeure.

In the run-up to the referendum, parties may have expressly included (or excluded) Brexit-related events in defining force majeure. Absent an express term, categories of event which are commonly included in the definition and which might occur in connection with Brexit include: acts of governments; restriction, suspension or withdrawal of any licenses etc; and changes in law or regulation.

However, it is not enough to have an event falling within the definition of force majeure. The clause will generally be triggered only if the event prevents, hinders or delays a party performing its obligations. Typically, in that event, the obligations are suspended without liability while the impact of the force majeure event continues (subject to obligations to notify the counterparty of the force majeure event and to seek to mitigate its effects). Most force majeure clauses will also give a right to terminate the contract if the force majeure event continues for a specified period of time.

A change in economic or market circumstances which makes the contract less profitable or performance more onerous is not generally regarded as sufficient to trigger a force majeure clause. Parties wishing to rely on Brexit-related events as force majeure are therefore likely to have to point to something beyond mere economic hardship. For new contracts, the best route is to include an express termination right.

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**Edwinton Commercial v Tsavliris Russ [2007] EWCA Civ 547** concerned whether a 20 day time charter had been frustrated by a delay of 108 days in redelivery of the vessel due to its detention by port authorities. The Court of Appeal held that it had not. The critical question was whether, at the relevant point, the existing and prospective delay would have led the parties to have reasonably concluded that the charter was frustrated.

Applying the doctrine of frustration required a “multi-factorial approach”, taking into account for instance the terms of the contract, its context, the parties’ (objectively determined) assumptions in particular as to risk, the nature of the supervening event, and the parties’ “reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances”.

Here the court based its conclusion on a number of factors, including that the delay came at the very end of the charter, rather than interrupting “the heart of the adventure”, and that the contractual risk of such delay was, in the court’s view, firmly on the charterers. It was also relevant that the risk of detention was foreseeable, in general terms, even if the actual circumstances of the detention were unusual.

This conclusion was consistent with the dictates of justice, which provided a “reality check” as to the court’s assessment of the issue of frustration.

“Brexit-related events may result in frustration of a contract if they render further performance impossible or illegal, or make it radically different from what was contracted for – but this will be rare.”
Material adverse change (MAC)

The drafting of MAC clauses varies greatly. They may be drafted widely, subject to specific carve-outs of events that will not qualify, or they may be drafted more narrowly to specify particular events that will qualify as a MAC.

As with any contract term, the interpretation of a MAC clause will depend on the language used in the context of the contract as a whole, the background facts and commercial context.

The party seeking to terminate the contract under a MAC clause has the burden of proving that a MAC has occurred. In general, a court will not be easily persuaded that a party should be released from its obligations under a concluded contract, and so there is a heavy evidential burden on the party seeking to rely on the clause.

A MAC clause cannot be triggered on the basis of circumstances known to the relevant party on entering into the agreement, although it may be possible to invoke the clause where conditions worsen in a way that makes them materially different in nature. The change relied on must also be material, in the sense that it must be sufficiently significant or substantial, and it must not be merely a temporary blip.

Whether Brexit-related events may amount to a MAC will depend on the terms of the clause and the specific circumstances. In general, however, it may not be straightforward to argue that a MAC clause is triggered by Brexit unless events have taken an unexpected turn after the contract is entered into which has a dramatic impact in the particular circumstances of the transaction.

Again, for new contracts, the best route is to include an express termination right.

In *Thames Valley Power v Total Gas & Power* [2005] EWHC 2208 (Comm) the High Court found that a force majeure clause in a gas supply contract was not triggered by a sharp rise in the market price of gas, making it uneconomic for the seller to supply the gas.

The court agreed with the buyer that the increased cost of gas did not mean the seller was unable to carry out its obligations under the agreement; it merely made the contract less profitable. This was not sufficient. The fact that a contract has become expensive to perform, or even dramatically more expensive, is not a ground to relieve a party from performance on the grounds of force majeure (or indeed frustration).

Similarly, in *Tandrin Aviation Holdings v Aero Toy Store* [2010] EWHC 40 (Comm), the High Court found there was no triable argument that a force majeure clause in an aircraft sale agreement was triggered by the “unanticipated, unforeseeable and cataclysmic downward spiral of the world’s financial markets”.

The court referred to the well-established position under English law that a change in economic or market circumstances which affects the profitability of a contract or the ease with which the parties’ obligations can be performed is not regarded as being a force majeure event.

“Whether Brexit-related events might constitute force majeure will depend on the terms and circumstances of the particular contract. Absent express provision, however, it is likely to be a difficult argument to run in most cases.”
4. JURISDICTION AND ENFORCEMENT OF JUDGMENTS

It is highly likely that, after Brexit, Member State courts will continue to respect an English jurisdiction clause and enforce English judgments. Whether there are any changes to the current position, however, depends on the arrangements put in place. The main options are set out to the right.

Brexit will not have any impact on arbitration clauses or enforcement of arbitral awards. The regime for the recognition of an agreement to arbitrate and enforcement of an arbitral award is the 1958 New York Convention, an international treaty to which 156 states worldwide are party, including the UK and all other EU Member States.

If a party would have chosen an English court jurisdiction clause absent any considerations relating to Brexit, then whether it may want to consider the matter further will depend on two principal questions:

(a) Is it important that any judgment can be enforced in an EU Member State? If the possibility of having to take steps to enforce is remote, or if the counterparty has sufficient assets within the UK (or some other country known to enforce English judgments), and assuming that is unlikely to change, there may be no need to consider this aspect further.

(b) Is there a risk of the counterparty bringing proceedings in an EU Member State court that needs to be avoided? If neither the parties nor the contract have any connection with another Member State which would allow the courts of that Member State to accept jurisdiction over the claim (either under the Brussels regime or its own domestic rules), there may be no need to consider this aspect further.

(1) An agreement with the EU on similar lines to the recast Brussels Regulation: In this case little if anything would change, depending on precisely what was agreed.

(2) An agreement to join the 2007 Lugano Convention: In this case the position would be as it was before the recast Brussels Regulation took effect in January 2015. The most significant difference is that certain improvements under the recast Brussels Regulation, to prevent parties delaying proceedings in the chosen court by launching so-called “torpedo actions”, would not apply.

(3) Joining the 2005 Hague Convention on Choice of Court Agreements: In this case there would probably be relatively little change where an exclusive English jurisdiction clause has been agreed. The Convention does not apply, however, where there is a one-way or non-exclusive jurisdiction clause. For such cases, the position would be the same as if no agreement were put in place (see below).

(4) No agreement or convention with the EU on jurisdiction and enforcement of judgments (though this is highly unlikely): It is likely that the question of whether an EU Member State court would respect an English jurisdiction clause or enforce English judgments would largely depend on its own domestic law. Local law advice would therefore be needed, but the domestic law in many Member States does provide for the recognition of jurisdiction agreements and enforcement of foreign judgments.
If a party considers it important to be able to enforce any judgment against assets in an EU Member State, or to prevent the risk of proceedings being brought in an EU Member State court, it may wish to take local law advice in the relevant Member State(s) as to what would happen if, following Brexit, there were to be no applicable agreement or convention with the UK (though this is highly unlikely).

If there is uncertainty as to the relevant Member State’s approach to an English jurisdiction clause or English judgment in such an event, then that would be a factor to consider. However, the party would have to weigh up the advantages and risks of a choice of English jurisdiction as against the available alternatives.

These include English-seated arbitration, either as the sole dispute resolution mechanism or as an optional clause. For example, with an optional clause, the English court might have exclusive jurisdiction save that one or more parties would have an option to refer disputes to arbitration in particular circumstances, such as if the UK has left the EU.

Commonly recognised attractions of English court jurisdiction include the quality of the judiciary, the possibility of appeal and the ready availability of summary procedures. Conversely, arbitration may be favoured for various reasons including ease of enforcement, ability to choose the tribunal, party autonomy in determining the process, and relative confidentiality.

**COURT VS ARBITRATION: SOME FACTORS**

- Quality/choice of tribunal
- Neutrality
- Party autonomy
- Speed/cost
- Ease of enforcement
- Potential for appeal
- Summary procedures
- Privacy/confidentiality
CONTACTS

Anna Pertoldi
T +44 20 7466 2399
anna.pertoldi@hsf.com

Anna is a general commercial litigator by background and the partner responsible for litigation know-how in London.

Anna lectures and writes regularly on litigation topics, in particular on privilege and jurisdiction law issues and developments. She is an editor of the firm’s ‘Litigation notes’ blog (www.hsfnotes.com/litigation) and litigation e-bulletin. She is a member of Practical Law’s Consultation Board and also contributes to Blackstone’s Civil Practice publication.

Neil Blake
T +44 20 7466 2755
neil.blake@hsf.com

Neil is a partner in the disputes division in London. He has extensive experience of commercial disputes of varying kinds, and of all forms of dispute resolution, including High Court litigation, arbitration, adjudication and mediation.

Neil’s expertise includes complex commercial contract disputes, professional negligence claims, M&A-related litigation, claims for breach of directors’ duties and litigation arising from sovereign debt obligations.

Neil also has particular experience of media law matters and also advises clients in the sports sector on legal and regulatory matters.

Alex Kay
T +44 20 7466 2447
alex.kay@hsf.com

Alex is a corporate partner in London. He advises on a wide range of corporate finance, public and private M&A transactions and on governance issues, specialising in advising corporates and financial institutions on cross border takeovers, M&A and restructurings.

Alex leads our financial institutions practice and also has particular experience of the real estate, technology, media and telecommunications sectors.


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