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Brex​it and its Potential Impact on Commercial Contracts

In this article, Shaun looks at the possible impact Brex​it may have on businesses engaged in transactions between Ireland and the UK and the potential impact on commercial contracts.

Introduction

It is impossible to predict with any degree of certainty the impact of Brex​it. However, it is safe to say it has the potential to directly or indirectly affect most transactions between Irish and UK businesses or Irish businesses doing business in the UK. Suppliers will need to consider not just events which may directly impact them but also anything which may affect their supply chain. Customers will need to consider not only possible impacts on their own ability to use goods or services purchased under an agreement (and whether the price they are paying will remain competitive) but also how the market for their own products may be affected. In this article we look at some of the potential effects of Brex​it on commercial contracts.

Brex​it as a cause for termination of contract

It is unlikely that Brex​it will directly give rise to a lawful termination of a contract. Some have queried whether Brex​it would constitute a *material adverse change* (MAC) or could give rise to an *event of default*. Depending on the circumstances of the transaction in question and the exact wording of the MAC, Brex​it may not be sufficient to trigger a MAC clause, in particular because it is a foreseeable event. Neither should Brex​it in itself lead directly to an event of default, however it could impact on ability to pay and thus give rise to an event of default.

Force majeure clauses are often found in commercial contracts, but whether a force majeure clause may be successfully triggered by Brex​it will depend on the exact words that the parties have used, particularly the non-exhaustive list of events that the clause is stated to cover.

Absent a suitable express reference to Brex​it, force majeure clauses are unlikely to assist on Brex​it.

Frustration arises where something occurs after the date of the contract, without the fault of either party that either transforms the obligations into something radically different, or makes it physically or commercially impossible to fulfil the contract. Based on the principles of frustration enunciated by the courts, it is unlikely that contracts will be frustrated by Brex​it save in very rare instances.

Express Brex​it clauses

A "*Brex​it clause*" is a contract clause that triggers some change in the parties' rights and obligations as a result of a defined Brex​it-related event occurring. Given that Brex​it could affect almost every aspect of doing business but its actual impact is still uncertain, the most a Brex​it clause may offer is a binding requirement that the parties will attempt to renegotiate relevant aspects of the contract. It may be possible to specify consequences of certain events, but the risk here is that events occur for which the parties have not made provision.

The parties will need to consider:

- **Definition of Brex​it:** Will the clause specifically refer to Brex​it and, if so, how should Brex​it be defined? Should there be reference to possible outcomes of the negotiations between the UK and the EU?
- **Adverse consequences which trigger re-negotiation:** These may be as broad as an increase in costs, or as narrow as a material change in the requirement for a specified licence. Should there be a specified time period after the triggering event in which the clause must be invoked?

- **Specific events and specified consequences:** Are there any specific events for which the parties feel confident about providing specified consequences, for example on an interest rates rise or certain currency fluctuation, the price of contracts goods will be adjusted by a specific amount or percentage.
- **Renegotiation:** Is it in a party's interest to have a clause allowing for renegotiation and, if that fails, termination, on the occurrence of certain triggers? If so include specific provisions around the negotiations including negotiation in good faith, a specific procedure for conducting negotiations, information rights and a time frame.
- **Termination rights:** If a contract's termination clause already gives a party a right to terminate on relatively short notice, then a Brexit clause may not be necessary; the prospect of termination can be raised as a means of encouraging negotiation.

Audit of existing contracts & negotiation of new contracts

Businesses should carry out an audit of contracts, in particular where there is a UK element to them (direct or through the supply chain), and assess the effect that Brexit may have on them. Similar points arise when negotiating new commercial contracts and the following should be considered:

- **New tariffs, customs checks, non-tariff barriers or other increases in costs:** A supplier should consider including clauses that seek to share the burden of increased costs in providing the goods or services. Agreements could include a number of Brexit-related assumptions on which the charges, or the price, are based e.g. the current tariffs that are in place, applicable corporation tax or VAT rates, the level of complexity of current customs checks, or paperwork. Where those assumptions change, a mechanism could be included for how the agreement will be impacted.
- **Movement of persons:** The freedom of UK nationals to work in the EU and for EU nationals to work in the UK seems likely to be curtailed. This should be of particular importance to businesses operating in the services industry.
- **Freedom to provide services:** New restrictions may apply to the provision of services from the UK or into the UK. Costs may be involved in complying with these restrictions, where compliance is possible.
- **Monitoring currency fluctuations:** Parties may wish to consider how to allocate the risk of future changes in the value of sterling/euro. An agreement may not set out a fixed price, but can include provisions to cater for where there has been an exchange rate shift between the order date and the payment date which exceeds an agreed "exchange rate tolerance".
- **Territorial scope of your agreements:** Does the agreement have the EU as its territorial scope? Depending on the nature of the UK's new relationship with the EU, the question of whether the UK is carved in or out of such territory may now need to be carefully considered and then specifically catered for in the drafting.
- **Parallel regulatory regimes:** If existing or planned commercial agreements govern the introduction of new goods or services onto both the UK and EU markets, note that parallel regulatory regimes – under both UK and EU law – may emerge and contracting businesses will likely need to agree who should be responsible for achieving compliance.
- **Change in law:** Suppliers and customers who are contemplating entering into or are already subject to long-term commercial agreements (particularly service agreements) will need to be mindful of the contractual impact of changes in law arising out of Brexit. Agreements frequently expressly address what will happen if the law changes and who bears the resulting costs, for example by specifying that charges cannot be increased and requiring the supplier to consult with the customer before making any changes to the services.
- **References to the EU:** Some commercial contracts make reference to specific EU legislation, usually by way of an obligation on one party to comply with that legislation. Agreements may also contain references to EU regulatory bodies, or EU standards. Post-Brexit such references may no longer be relevant to the agreement, or may impose an unnecessary level of regulation.

Measures to take

As a practical measure, organisations should:

- **Conduct a business audit:** Consider how Brexit could affect their business generally and their commercial arrangements with third parties.
- **Contract assessment:** Identify the key contracts governing those arrangements and assess if they provide sufficient protection against Brexit, or are at least clear about the implications of Brexit.
- **Contract renegotiation or termination:** Consider whether to try to renegotiate or amend those contracts to deal more clearly with the implications of Brexit.