# Brexit – a legal analysis

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# Introduction

The most important referendum of our generation is now fast approaching on 23 June.

Since its inception, the European Union has sought to legislate heavily in some areas, for instance employment rights, data protection, financial services, VAT and anti-trust. But in other areas, such as the bulk of tax law, real estate and commercial contracts, our English common law remains relatively untouched.

One of the key unknowns about staying in the EU is the extent to which the European Commission and Parliament would in the future seek to legislate in these and other areas so as to achieve ever greater legal harmonisation across the EU. Although the UK has an opt-out from ever closer union, the reality is that there is no upper ceiling on the areas in which new EU legislation could be passed in the future.

With that in mind, this article seeks to analyse what would happen in some key areas of legal practice if the UK votes for Brexit.

If you would like to discuss any aspect of this article, please contact the relevant persons listed, or your usual contact at RPC.

# M&A and takeovers

In broad terms, M&A transactions and public offers, together with the related documentation, are unlikely to be affected by Brexit due to their reliance on English law and the exclusive jurisdiction of the English courts. One area, however, where Brexit could have an impact is where such documentation includes a material adverse change clause (MAC clause). Such clauses are a common feature of public offer and private M&A documents. A MAC clause in a standard public offer document seeks to allow the bidder to withdraw its bid if there is a material adverse change in the business, assets or profits of the target company between the bidder announcing its offer and the offer becoming unconditional. In a share or asset purchase agreement for an M&A transaction, a MAC clause is a provision which aims to give the buyer the right to withdraw from a transaction before completion if a material adverse change occurs in relation to the target company's business, assets or profits between exchange and completion of the transaction.

For a MAC clause to be invoked, the transaction would need to announce or exchange prior to the EU Referendum with the offer becoming unconditional or completion of the transaction occurring after the result of the EU Referendum being announced. The issue would then be whether the result of the EU Referendum had caused a material adverse change to the target company. Whether this is the case will turn on the nature and scope of the MAC clause in question. A MAC clause will be interpreted in accordance with general principles of contract under English law. Accordingly, the courts will consider the intention of the parties in relation to the terms of the agreement as a whole. Whether or not a material adverse change has occurred will generally be a matter of factual determination, with specific conditions being easier to enforce than general conditions.

Based on the above, if the relevant MAC clause is general in nature – ie it covers any matters or events that may occur following the announcement or exchange which materially and adversely the target company's business, assets or profits – then it is unlikely that Brexit would enable the bidder/buyer to invoke the MAC clause. This is because general or macro economic, industry or political conditions or events will not be deemed specific enough in the context of the relevant transaction. In fact, such general events are often carved out from a general MAC clause on the basis that general market risks should be borne by the bidder/buyer. If, however, the MAC clause has been tailored to the specific target business – eg it is a business which imports or exports a lot of goods to or from the EU – or it specifically makes reference to the impact of Brexit on the target company, it is much more likely that the MAC clause could be invoked. This is because the courts would be more likely to view it as being within the relevant parties' intention due to the inclusion of such specific, objective tests as to what constitutes a material adverse change.

# Facility agreements, security arrangements and derivatives

While more straight-forward finance documents (for example short form or intra-group loan agreements) are unlikely to be affected by Brexit, longer form facility agreements entered into by clearing banks and other large lenders (particularly those agreements drafted on Loan Market Association standard terms) may contain provisions which could be impacted by Brexit. For example, many such agreements will include a material adverse change event of default, and, as discussed above, such a clause may be triggered by Brexit or related changes in law/regulation. Where Brexit does have a material adverse effect on the borrower's prospects/ability to repay or the validity or enforceability of any transaction security, it could entitle a lender to call an event of default.

Any changes in law or regulation brought about by Brexit which impact on a borrower's ability to perform its obligations under longer form finance documents (for example, Loan Market Association facilities agreements or ISDA master agreements) may be considered events of default/termination events. This would particularly be the case where the borrower's performance of its obligations would be unlawful following the change in law/regulation, but might also apply if any finance document ceases to be in full force and effect, or if any transaction security ceases to be legal, valid, binding enforceable or effective. Similarly, changes in law or regulation which make any lender's performance of any obligations under finance documents unlawful in any jurisdiction could give such lenders a right to cancel their commitments and request repayment. In the case of syndicated facilities, it may be the case that affected lenders would be able to drop out of the syndicate (and request repayment of all amounts owing to them) while the unaffected lenders remain in place.

Although we would not anticipate a flood of lenders rushing to call defaults under existing loans in the wake of Brexit, it may be the case that post-Brexit changes to laws and regulations could give lenders an ability to point to a technical default, which could be used to their advantage if looking to move an unwanted loan relationship from their book.

# Investment funds

The consequences of Brexit for the UK investment funds industry remain unclear. The marketing of investment funds in the EU is particularly closely tied to Brexit as much of the applicable regulation is derived from EU legislation. The Alternative Investment Fund Managers Directive (AIFMD) regulates EU fund managers who manage alternative investment funds and all EU Member States were required to implement the directive into national law on or prior to 22 July 2013. The UK has met this implementation time frame. Amongst other things the AIFMD regulates the marketing of alternative investment funds in the EU with the intention of introducing a harmonised regulatory framework for monitoring and supervising fund managers in the EU and the marketing of investment funds in the EU. A key aspect of the regulation is the marketing "passport" which permits EU fund managers (who are authorised in their home Member State) to market alternative investment funds to professional investors across the European Economic Area (EEA) without the need to comply with the national private placement regimes of each separate Member State. Accordingly the passporting regime is extremely important for UK fund managers looking to raise capital from professional investors throughout the EEA.

As the AIFMD has "EEA relevance" the provisions of the AIFMD relating to the marketing of investment funds to European investors apply equally to members of the EEA (not just the EU) and EEA members are required to implement the AIFMD into national law. Should the UK leave the EU but remain a member of the EEA the UK will remain obliged to comply with the AIFMD and will be able to benefit from the marketing passport.

If the UK leaves both the EU and the EEA and becomes a member of the European Free Trade Association (EFTA) there will be no obligation on the UK to comply with the AIFMD. However, as the UK already incorporates the AIFMD into its existing legislation, it is highly likely that the UK would apply, along with other non-EEA jurisdictions such as Jersey and Guernsey (who have been approved to use the passport by the European Securities and Markets Authority (ESMA)), the USA and Hong Kong (both of which have not yet been approved to use the passport by ESMA), to be entitled to use the marketing passport as the burden of complying with national private placement regimes would be extremely prohibitive to raising funds in the UK. Whether the passport would be granted to the UK in such circumstances would be for ESMA to determine.

# Insurance

Purchasers of insurance policies from UK-based insurance companies may have understandable concerns regarding a policy's legal status post-Brexit. However, in our experience, Britain's membership of the EU has very little bearing on the interpretation and administration of insurance policies. In the UK market, insureds and insurers are free to negotiate the governing law and jurisdiction of any given insurance policy. This freedom applies to insured and insurers irrespective of whether they are based inside or outside of the EU – it is an area that is rarely affected by supranational EU law. Post-Brexit, EU-based insureds should not notice any change. Insureds will still be able to purchase, administer and notify claims under policies governed by English law and subject to the exclusive jurisdiction of the English courts.

In contrast, UK-based insurance companies will undoubtedly notice some regulatory change post-Brexit. The scale of this change is currently uncertain and will depend on what access the UK can gain to the EU's "single market" after the post-Brexit negotiations have been concluded. Currently, under the EU's Solvency II regime, UK-based insurance companies can take advantage of the "passport system" across all of the 28 Member States. This means that the regulation of UK-based insurance companies by the PRA and FCA is automatically recognised by other Member States and, as a result, insurance companies are free to trade, underwrite insurance policies and participate in other investment activities across the EU without needing to be separately regulated and/or have a branch office located in any other EU state. This analysis also applies to any third-country investors who have set up an insurance company or syndicate at Lloyd's of London so as to use the UK as a platform for its pan-EU business.

In the event of Brexit, could there be a work-around for UK-based insurance companies? If, post-Brexit, access to the EU's single market becomes restricted or prohibited, the UK could seek to agree a bilateral trade agreement with a friendlier EU state (for example, the Republic of Ireland). A UK-based insurance company might then establish an Irish subsidiary which could then avail itself of the pass porting regime under Solvency II.

# Intellectual property rights

IP rights in the UK are all influenced and moulded to a greater or lesser degree by European law. The different rights exist on a spectrum, from those that are unitary pan-European rights (such as Community Trade Marks and Registered Designs), to those that are heavily harmonised (for example national trade mark rights under the Trade Marks Directive) to those that have common features, but also national differences (such as copyright and patents).

The task of unpicking the implications for those different rights in the event of a Brexit would not be simple, but presumably the current legislation would remain exactly as it is for a considerable period. One immediate problem would be to assess whether pan European rights (Community Trade Marks and Registered Designs) would continue to offer protection in the UK post-Brexit. Presumably they would not, but to avoid huge disruptions to business it can only be assumed the UK's Intellectual Property Office would have to offer a system of "grandfathering" over the "UK element" of those European rights into separate analogous UK rights. Brexit would also almost certainly mean the end of the UK's eligibility to take part in the proposed new unitary EU patent and its planned role as a host of one of the central divisions of the proposed Unified Patent Court.

The limits of IP rights in the UK have also for many years been defined by the interplay with EU competition law. So, for example, trade mark licences to distributors could not prohibit those distributors from engaging in passive sales outside of their territory but within the EU and the act of placing IP-protected products on the market in one member state is deemed to "exhaust" the proprietor's right to object the subsequent free circulation of those goods within the EU. If UK IP law and EU competition law is to converge, then UK rights holders may be able to control more tightly the circulation of their products on the wider market.

# Commercial contracts

Most contracts contain an obligation for parties to comply with "Applicable Laws". This is likely to include compliance with EU derived legislation. If Brexit occurs, customers and suppliers will need to review their contracts to determine whether any amendments to the contract are required to be made, who is liable for any related compliance and who will bear the cost. The impact and costs of change could be particularly substantial in regulated sectors.

There is a possibility that a contracting party could claim a contract is frustrated (ie made impossible or illegal to perform) by Brexit, for example if due to legal change a service provider was no longer lawfully able to deliver certain services. There could also be an argument that a widely drafted "force majeure event" could also be triggered by Brexit.

Gaps may arise in existing contracts as a result of the non-applicability of any EU regulations or derived laws. For example, if no longer relevant, references to EU standards or model clauses may need to be amended to refer to any replacement regime.

# Real estate

The real estate sector is one of the few legal areas to have significantly retained national sovereignty. Differences between national real estate laws within the EU are greater than in most other branches of law. As a result, the repercussions of the British public voting "Leave" on 23 June 2016 are more significant from a commercial than a legal perspective.

Brexit would likely see an end to free movement of people, goods and services which could affect the cost of construction projects and impact the market for real estate developers. What is likely to have the biggest impact on investors and developers, however, is the resolve of the UK economy, and any external perceptions of its strength. As things stand the UK is the number one choice for commercial property investment within the EU, with London clearly on top compared with its European counterpart capital cities. Brexit would almost certainly have a short to medium term negative impact on international investors looking to deploy capital into UK real estate markets.

From a legal perspective, areas that might be affected would include the EU directives concerning energy efficiency and standardised Health and Safety legislation; planning requirements such as environmental impact assessments; and the regulation of real estate investment funds (including AIFMD), for which see the section above on investment funds.

# Litigation

The uncertainty caused by Brexit is likely to lead to increased levels of commercial litigation in the English Courts, particularly in the period following a "yes" vote (during which, over the course of two years or more, the UK would negotiate the terms of its withdrawal with the EU). For example, Brexit may give rise to litigation between parties to commercial contracts in relation to clauses dealing with termination, material adverse change and/or increased cost. Difficulties may also arise where facility agreements or similar documents contain provisions relating, for example, to reference entities, counter-parties, assets, products and/or services domiciled in or originating from an EU member state.

In addition, one would expect the English Courts to remain a popular and effective forum for multi-jurisdictional dispute resolution because of the perceived benefits, such as the comparative stability and certainty of English law, the quality of the judiciary and legal representation available, and the use of the English language. These factors are unconnected to the UK's membership of the EU. Parties will remain bound by properly constituted contractual provisions providing for Court or arbitration processes to determine disputes in the same way they are now, albeit there may be more uncertainty in situations where parties do not contractually agree such matters. For example, English law and jurisdiction clauses remain one of the two default law and jurisdiction options in the ISDA Master Agreement. Enforcement of judgments within other EU member states may prove to be a little less straightforward than it currently is under the Brussels regime, but it is unlikely to a significant issue or concern.

# Employment rights

Much of UK employment law emanates from the EU including laws on discrimination, collective consultation, certain family friendly rights and transfer of undertakings. In theory, in the event of a Brexit, the UK government could repeal such laws. In reality, the Government is unlikely to do so on any wholesale basis. Generally speaking, many of these laws (particularly anti-discrimination) are viewed positively and represent UK social norms. There is unlikely to be an appetite for repealing laws which are obviously to the benefit of UK citizens or business. On occasion, the UK already "gold-plates" EU legislation – in other words, some existing UK laws actually go further than required by the EU. Take, for example, TUPE which is derived from an EU directive. In 2006 the Government extended the scope of TUPE to expressly cover service provision changes such as outsourcings, going over and above the strict requirements of the EU directive. Despite the Government's across the board programme to remove legislative gold-plating, when TUPE was amended again in 2014, the Government made a conscious decision to maintain this service provision change regime which was seen as valuable to business.

There may well be some "tinkering" around the edges with discrete changes to certain areas of law as well as some outright limited legislative repeal. For example, theoretically the threshold for triggering collective consultation for redundancy could be increased and the applicable time frame for consultation could be reduced with a view to decreasing the burden on employers. The Government may also seek to remove provisions in TUPE which prevent businesses from harmonising employment terms after a business transfer or service provision change. The days of the 48-hour maximum working week and the Agency Worker Regulations could also be numbered as the Government would be free to abolish these provisions which have proven unpopular in many quarters of the business community. We could also witness changes to the interpretation and application of retained EU derived legislation if UK courts and tribunals were no longer bound to apply European court reasoning.

One area in which a Brexit causes concern to business is the movement of workers for both large and small organisations. At present, UK businesses have the ability to employ workers from within the EEA without specific permission and the movement of workers between an employer's various EU offices is fairly straightforward. Should we opt out of the EU, this automatic right may no longer exist. That said, the Government may well negotiate free movement of labour provisions to apply following any exit particularly if we wish to continue our strong trade links with the EU. If no free movement provisions were negotiated new arrivals from the EEA would be subject to the same visa rules as non-EEA workers when entering the UK and those moving from the UK would be subject to the equivalent rules of the relevant destination country. In the event of a Brexit, what happens to current workers, as well as workers in the future, is likely to be heavily negotiated in a process which could take many years.

# Anti-trust and merger control

## Competition and anti-trust

The EU antitrust rules apply to both EU and non-EU companies who carry on business in Europe or whose activities affect trade in Europe. The UK competition rules currently mirror the EU antitrust rules and both EU and non-EU companies are therefore subject to a very similar regime where conduct affects the UK only. As such a UK exit from the EU would have limited impact.

While the UK is within the EU the UK competition authorities cannot investigate a case where the EU Commission takes jurisdiction. However a UK exit from the EU would mean that there will be more cases where both the EU and the UK could in parallel open an investigation and impose fines and other remedies for anti-competitive conduct affecting both the EU and the UK. This could potentially add to the risk and costs for affected businesses.

## Merger control

In respect of merger control, the main impact of Brexit is likely to be parallel investigations. Under the EU Merger Regulation (EUMR), a transaction that qualifies under the EUMR is no longer subject to the merger control regime(s) of the relevant Member State(s) (subject to some exceptions).

If the UK leaves the EU, the EUMR and UK merger control regimes would run in parallel. A transaction that qualifies under the EUMR may also be subject to UK merger control (provided the jurisdictional threshold for UK merger control is met). This could add a burden and cost for businesses, in particular in view of the level of the UK merger fee (ranging from £40,000 to £160,000 depending on the UK turnover of the enterprises acquired) and the potentially longer time frames for UK merger control clearance.

## Follow on damages claims

The UK is currently one of the most popular jurisdictions for follow-on damages actions for breach of EU competition law, where the claimant relies on an existing EU Commission infringement decision. Following a Brexit, EU Commission infringement decisions will cease to have a binding effect on UK courts and one expects that claimants will look to other jurisdictions when choosing the forum to bring such claims.

## State aid and public procurement

Following Brexit, the EU State aid rules would cease to apply in the UK (unless the UK joins EFTA). The same outcome applies to the EU public procurement rules.

# Tax and VAT

The most obvious EU influence on UK tax policy is in the field of indirect taxation, and in particular VAT which is an EU wide tax with set minimum rates. In the event of Brexit the UK is highly unlikely to abolish VAT (it currently accounts for nearly 20% of the total UK tax take) but it might well make changes to its VAT law that are not currently permitted, such as to extend some of the lower VAT rates to additional types of goods and services, and to introduce further VAT exemptions. The VAT position for businesses supplying or receiving cross-border EU supplies might become more complicated.

Excise duties are the other main indirect taxes governed by EU rules. Tobacco, alcohol and energy are all subject to excise duties and there are agreed minimum rates for each of these, although Member States are free to set excise duties above the minimum rates. Again Brexit would enable the UK to make changes.

With regards to direct tax, the EU plays a much lesser role and these taxes are principally a matter for each Member State. However, there are a number of relevant EU Directives, which are primarily aimed at removing obstacles for businesses operating within the EU. These include the Merger Directive (which applies reliefs for mergers, divisions, transfers of assets and exchanges of shares which take place between companies in different Member States), the Parent-Subsidiary Directive (concerned with profit distributions between associated companies) and the Interest and Royalties Directive (prevents withholding taxes on royalty and interest payments). Brexit may mean that the UK would no longer be required to give effect to these Directives, which might increase tax costs for UK companies.

Overall Brexit would have no immediate effect on any tax legislation which has been incorporated into UK law, although the government might be able to amend the law as it wished. Whether it would want to do so is a different question and the extent to which it could would depend upon the nature of any post-Brexit UK/EU relationship.

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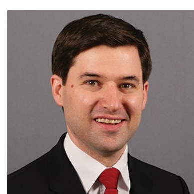

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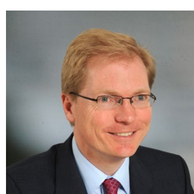

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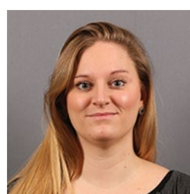

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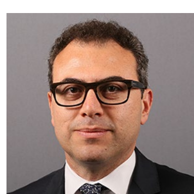

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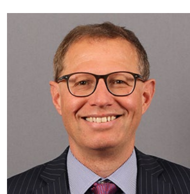

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