BREXIT AND LONG-TERM CONTRACTS — FEBRUARY 2020

Introduction[1]

This note considers what future hold in terms of Brexit – and what the implications are for any parties which have long-term contracts, in particular with government or other public-sector entities.

There is, despite the UK leaving the EU on 31 January 2020, still major uncertainty surrounding the longer-term outcome in trade terms, and what it will mean for businesses, including those operating in the infrastructure and outsourcing sectors.

All businesses, particularly those which rely on importing goods and materials from the EU (or on exporting to the EU) or rely on services being provided from within the EU therefore need to have business continuity plans in place to deal with the potentially very significant disruption, both short-term and long-term, which Brexit may bring – particularly if the UK and the EU fail to sign a free trade agreement ("**FTA**") or the FTA which they do sign is a "low-alignment" one, as both of these outcomes would be likely to result in significant friction at border crossings.[2]

The contingency plans which such business will need to have will include managing the risk that the cost of importing goods or materials required to perform a contract become more expensive (i.e. will they or their contractual counterparties be responsible for bearing any increased costs in such circumstances?), the risk of liquidated damages ("**LDs**") becoming payable under the contract on account of delays at entry ports, risks around reliance on services and/or staff coming from within the EU and, ultimately, whether it becomes impossible to perform the contract at all, on account of e.g., no longer being able to source the required goods/materials necessary to perform the contract.

This article describes the types of issues which need to be considered when dealing with Brexit-related risks in long-term contracts, both in terms of reviewing existing long-term contracts to establish whether they contain adequate protection from Brexit-related risks, and also in terms of the approach which needs to be adopted by such parties in making future contracts "Brexit-proof".

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[1] For further information on the current position in relation to the negotiation of a Free Trade Agreement between the UK and the EU, refer to our client briefing ***"Brexit: where do we go from here?"*** (February 2020).
[2] Note that the British Chambers of Commerce have produced a useful "Business Brexit Checklist" to assist business planning at both operational and board levels: see www.britishchambers.org.uk/business-brexit-checklist for further details.

There are some complex issues in this note and, by its nature, it is generic. If you require specific advice on your existing contracts or future contracts to be entered into, please do take detailed legal advice as there may also be other considerations to take into account.

Is it still possible to perform the contract post-Brexit?

On pre-existing long-term contracts there is likely to be a sliding scale of outcomes resulting from Brexit (particularly in the event of no trade deal being agreed between the UK and the EU, or only a very "rough and ready" one) – from making a contract more difficult or more expensive to perform, right up to performance of the contract becoming impossible – e.g. because of lengthy delays in importing fresh produce to the UK on account of long delays at Channel ports. Although the government has spent millions of pounds on contingency arrangements to reduce the possibility of this occurring, it is inevitable that at least some short-term disruption will occur, particularly in the event of no trade deal, or a low-alignment one.

If it were to become impossible to perform the contract, the English law doctrine of "frustration" of the contract would need to be considered – this is discussed further below. In addition, the parties would need to analyse the terms of any "force majeure"[3] provision in the contract. In contracts governed by English law the list of events constituting "force majeure" has to be spelled out explicitly within the contract as, unlike in civil law jurisdictions such as France or Spain, under English law there is no judicially-recognised definition of precisely what constitutes a force majeure event.[4]

The issue of whether Brexit constituted a frustrating event under a contract was considered by the High Court last year in relation to a long-term commercial lease of a property in Canary Wharf, London.[5] The facts were as follows: the European Medicines Agency ("**EMA**") relocated from London to Amsterdam on account of the Brexit referendum result. However, the lease of its property at 30 Churchill Place in Canary Wharf ran until June 2039 and did not contain a break clause. The EMA wrote to Canary Wharf Group ("**CW**") stating that it was treating Brexit as a frustration of the lease. CW sought a High Court declaration that the lease would not be frustrated by Brexit. Marcus Smith J in the High Court granted the declaration in favour of CW, finding that the lease was not frustrated by Brexit, either on the grounds of supervening illegality or frustration of a common purpose – the tests set down in previous case law on the subject. The EMA initially lodged an appeal to the Court of Appeal, but withdrew the appeal once it succeeded in signing a sub-lease of the property with WeWork, running until the end of the lease period. The Court of Appeal therefore did not have an opportunity to opine on this issue, although the High Court decision confirmed that the test to prove that a contract had been frustrated was a very high one and that, in this case, Brexit had not frustrated the contract.

In relation to an existing contract, parties will need to rely on concepts such as frustration and/or rely on Force Majeure provisions which are unlikely to have envisaged Brexit. The extent to which they can be relied upon will be based on the facts and extent of the drafting.

For future long-term contracts that may span a number of years during the implementation of Brexit, parties will be advised to consider what could happen and specifically contract to cover off eventualities. See below also in relation to Change in Law provisions.

Brexit-related delays in importing goods and materials

As well as additional costs resulting from the introduction of import taxes/tariffs , particularly in the event of a low-alignment FTA, or no FTA being signed, there is also a high risk of significant delays resulting from additional

[3] I.e. events outside the control of either party which the parties agree render the contract no longer capable of being performed while the event continues in force.
[4] Note that, in civil law jurisdictions, long-term contracts often contain a so-called "hardship clause" which enables a party who has been unduly affected by a change in external circumstances beyond its reasonable control, and where the continued performance of its contractual obligations would be unduly burdensome on that party, to seek to negotiate alternative contractual terms to take into account the consequences of that event.
[5] Canary Wharf Group -v- European Medicines Agency [2019] EWHC 335 (Ch) https://www.bailii.org/ew/cases/EWHC/Ch/2019/335.html

customs requirements (checking paperwork and contents of containers, etc.) which will need to be introduced at ports, airports and bonded warehouses to ensure that the correct level of import taxes/tariffs are being imposed and paid. This could impact, for example, on parts or spares coming to the UK from the continent or in relation to completed goods being imported. They equally could apply to exports.

The lack of certainty around Brexit and borders means that the risk of delays at UK ports and airports as a result of customs checks needing to be introduced remains unquantifiable. Without doubt, however, disruption to cross-Channel traffic is one of the most serious potential repercussions of leaving the EU without a FTA having been signed.

From our experience in advising clients on these issues (including for example in relation to the import of goods, parts and spares for rolling stock), there is as yet no clear-cut market position on how such delays should be dealt with or who should bear the risk. However, it would not be unusual for a similar position to be adopted as often applies in a force majeure scenario, with losses "lying where they fall" – i.e. each party being responsible for its own losses and providing that there is sufficient mitigation of any losses. Consideration should be given to including significant (i.e. in excess of a certain agreed duration) Brexit-related delays as a force majeure event leading to potential termination of the contract.

Certainly, in existing contracts, care should be taken to understand whether some of the existing provisions in the contract could be of help. Could the delay be construed as a force majeure event? Are delays caused by matters outside of the control of the parties dealt with in another way (for example as a relief event, compensation event or as permitted delay)? Is there any other relief from any liquidated damages? And does Change in Law help (see below)?

For new contracts the prospect of delays caused by increased administrative requirements and red tape should be analysed until the position is settled.

Brexit-related costs and disruption: the Change in Law and Variations provisions

As already mentioned, there may be some protection within existing contracts that can be called upon to assist in the event that parties incur costs and/or delays due to Brexit related risks and, for new contracts, provisions need to be carefully drafted to provide protection as required.

Brexit-related cost implications

It goes without saying that the long time-frames and the high value of long term contracts (which can include infrastructure projects as well as goods and services supply contracts), mean that the cost implications of a "Brexit-related change in law" - both in terms of additional taxes via import tariffs[6], and the delays which the introduction of customs frontiers is likely to introduce - are highly significant. A similar issue could apply in relation to the impact of freedom of movement post-Brexit, and with potential problems recruiting appropriate staff (or moving staff around the EU) and the cost of doing so becoming significantly more expensive. As these changes are essentially happening due a "change in law", parties may wish to consider (i) in relation to existing contracts, the extent to which this change in law is envisaged or provides protection in the contract; and (ii) in relation to new contracts, whether specific "Brexit change in law" provisions should be negotiated into the contracts.

"Law" in this context is generally quite broadly defined, to also include industry standards and regulations, usually within an umbrella term such as "Applicable Law and Standards". A change to the application or interpretation of a rule, or the extension of the application of a rule to a person or body to whom it did not previously apply, may also be covered. If there is such a change, it will usually trigger a variation to the contract, and time and cost protection for the supplier. This could be helpful as Brexit itself is in fact brought into effect by a series of changes in such Law.

[6] See separate briefing note ***"Brexit and trade law issues"*** (February 2020) on international trade and tariffs post-Brexit.

However, there are caveats to this. In most cases, "Changes in Law" which were foreseeable on the date on which the contract was signed are generally excluded from change in law protection as are changes which are non-discriminatory to the subject matter of contract. Changes in taxation are often also excluded from the protection.

Foreseeable changes in law

This means that if, on the day the contract is signed, there is information in the public domain relating to possible future changes which could impact the contract (e.g. a law which has been passed although is not yet in force; the existence of a draft bill or statutory instrument; proposals within a government consultation paper, etc.) such "Foreseeable Changes in Law" are unlikely to be given protection.

Although Brexit has been, since the date of the 2016 referendum, if not before, "foreseeable", its potential consequences are many and varied, depending on the form of the FTA (if any) which is negotiated between the UK and the EU, and therefore it is arguable that the impact of Brexit is not currently "foreseeable".

For new contracts, there will need to be a detailed negotiation between the parties as to precisely what types of Brexit-related changes in legislation should be carved out of the definition of "Foreseeable Change in Law" and thereby afforded costs protection and relief from time penalties under any variation procedure.

Discriminatory

Often, only discriminatory changes in law are protected under a contract. Therefore changes in law which apply more generally across the economy or across different sectors will not be afforded protection. It is important to understand the limitations of the clauses and ensure that the specific change being sought to be relied on fits therefore within the definition.

For example, it may not be discriminatory if all imports of goods at a border are dealt within the same way (e.g. increased paperwork is the same); but it may be discriminatory if this only applies to specific goods that are the subject matter of the contract.

Taxation

Prime among considerations for change in law will be which party should bear the cost of any additional tariffs imposed on imported goods post-Brexit. This will very much depend on the drafting of the change in law provisions and whether import duties can be considered a form of tax.

For future contracts, of course, the parties may wish to address specific concerns relating to Brexit Changes in law. This may include: (i) an acknowledgement that the impacts of Brexit are not foreseeable (or limiting the extent of the foreseeability); (ii) as a result of (i) above, that all Brexit changes are considered to be discriminatory (or highlighting which changes are discriminatory); and (iii) import duties would not be considered to taxation – or at least agreeing between the parties who would bear any specific cost risk around import duties.

Wider implications of Brexit

There are of course wider implications of Brexit that are not covered by this note. These include:

- Availability of staff post Brexit (including movement of staff post Brexit) – see our separate note "Brexit and immigration law issues"
- Interest rate fluctuations may also impact on pricing and cost of providing services
- Enforcement of contracts across the EU and jurisdiction issues – see our separate note "Brexit and dispute resolution issues"
- Transfer of employees under TUPE – see our separate note "Brexit and employment law issues"
- Trade and tariff issues – see our separate note "Brexit and trade law issues"
- Competition law and Brexit, particularly in relation to Northern Ireland – see our separate note "Brexit and competition law issues"

- Data protection issues post-Brexit – see our separate note here "Brexit and data protection issues"

Conclusion

In conclusion, parties to long-term contracts in the public or private sector may find that their contracts have become more expensive to perform, more difficult to perform and/or suffer extensive delays to performance of their contracts as a result of Brexit. Whether this is because of increased tariffs, increased administrative burden, delays at ports and/or other changes in laws and standards that apply to them.

It is advisable for such parties to review their existing contractual arrangements in order to establish what protections there may already be for these consequences. Certainly, for new contracts parties should consider the specific circumstances of Brexit, what risks this brings to their contracts and make specific provision to allocate risks and costs accordingly.

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