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The impact of Brexit on the use of English law in international transactions

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This presentation looks at the likely impact of Brexit on the use of English law in international transactions generally, and on the provisions of finance documents governed by English law in particular.

It's not known exactly what proportion of cross-border transactions are governed by English law, but it's widely agreed to be more than any other legal system. A recent survey carried out by the Singapore Academy of Law revealed that 48% of in-house lawyers across the globe specified English law as their preferred choice of law in cross-border transactions. English law is used far more outside the UK than it is in domestic transactions; 80% of cases before the Commercial Court in London involve a foreign party.

As a result, legal services are a substantial and lucrative part of the UK economy; the total value of the legal services industry is GBP25.7 billion. To put that in context, the entire motor vehicle industry is only worth GBP 18 billion. There are around 370,000 people employed in legal services and the sector consistently outperforms the rest of the UK economy, growing on average 3.3% per annum over the last ten years, compared with 1.2% in the rest of the economy.

Is that all about to change in the light of Brexit?

The strength of the UK legal services industry is due in part to the way English lawyers have used the access to the single market provided by EU membership to leverage off the widespread use of English law outside the UK. English law firms have taken advantage of successive EU Directives first to offer legal services across national borders, then to establish offices in nearly every Member State of the EU and most recently to re-qualify easily and practise local law. Whilst these rights are available to lawyers in all Member States, I think it's fair to say that English law firms have benefitted from them far more than lawyers in any other jurisdiction.

If the UK leaves the EU but remains in the single market, English law firms will continue to enjoy these benefits. However, at the Conservative Party Conference last week the Prime Minister, Theresa May, stated that her priority in proceeding with Brexit is to regain control over immigration, while

EU leaders have indicated that access to the single market is conditional on continued free movement of people. These antithetical positions suggest that it is more likely than not that the UK will cease to be a member of the single market, and that some, if not all, of these advantages will be lost.

One unexpected consequence of Brexit is the possible resurrection of the Common European Sales Law (CESL), which was a proposal to introduce a coherent set of rules for the marketing of digital products and services across the EU. The proposals were approved by a substantial majority in the European Parliament in February 2014, and abandoned by the European Commission the next year, in the face of strong opposition from the Law Society of England and Wales and the UK Government, largely on the basis, I suspect, that the EU already has a coherent set of rules for the marketing of digital products and services across the EU, namely English law.

English practitioners are taking matters into their own hands; according to the Financial Times, the Law Society of Ireland has been receiving 30 applications a day from English solicitors wishing to re-qualify in Ireland. That report appeared in August, and the recent developments regarding the UK's stance on the single market will only have served to increase interest in requalification.

On the brighter side for the English legal profession, a recent article in the Wall Street Journal ("Post Brexit, London's Financial Center has English law on its side") ran the argument that the extent of the use of English law and the English courts in international finance "provides London's financial district with a gravitational pull for finance companies", and makes it more likely than not that London will retain its position as the leading financial centre post-Brexit.

Despite this optimism, Brexit provides both a challenge for the English legal services industry and an opportunity for other jurisdictions. A few years ago the German Ministry of Justice issued a publication entitled "Law - Made in Germany: global, effective, cost-efficient" and in 2011 it partnered with the National Council of French Bar Associations to revise and extend it into a publication entitled "Continental Law: global, predictable, flexible, cost effective". These selling points are remarkably similar to those identified by the Law Society of England and Wales as the compelling reasons to choose English law in their publication "England and Wales: Jurisdiction of Choice": namely, that English law is transparent and predictable, more flexible and supports the needs of modern commerce.

The Law Society of England and Wales is, of course, well aware of these challenges. At a recent round table of European law firms with offices in London, the President of the Law Society, Robert Bourns, indicated that the Law Society is lobbying the Government to confirm as quickly as possible that it will keep in force arrangements equivalent to the three Directives that enable the cross border practice of law, and the Brussels Regulation on the recognition and enforcement of foreign judgements, and to obtain reciprocal confirmation from the EU.

In terms of the impact of Brexit on the substantive content of English law, we do now have some clarity on how the delinking of English law from EU law is to be effected. On 2 October, at the Conservative Party Conference, the Prime Minister announced that there will be a "Great Repeal Bill" which will repeal the European Communities Act of 1972, the legislation which took the UK into the EU. The name of the legislation is meant to evoke the Great Reform Act, the name commonly given to the Representation of the People Act of 1832, which began the process of democratisation of Parliament which eventually achieved universal franchise. The Great Repeal Act will not come into force until the moment the UK actually leaves the EU, when it will indeed repeal the ECA, but it will also import into English law all the provisions of EU which are binding on the UK at that point in time. The UK will then start the process of repealing those parts of EU which it does not wish to be bound by, whilst keeping the rest.

In fact, EU law has had relatively little effect on English contract law, the law that is primarily used in cross-border transactions. Its influence is more to be found in environmental law, procurement rules, and, of course, competition law. For that reason we can expect to see lenders including in loan documentation with English borrowers provisions expressly requiring them to adhere to EU environmental and procurement standards, rather than relying on the general covenant to abide by the law.

The areas of contract law that have attracted most queries since the Brexit decision are choice of law and enforcement of judgements, material adverse change clauses and illegality and change of law clauses, bail in provisions and the possibility of "flexit" clauses.

Under the Rome 1 Regulation, the law chosen by contracting EU parties is respected, even if they have no physical connection with that jurisdiction. This was the case under English common law anyway so it will continue to be the case even if we derogate from the Regulation. The Regulation applies where a non EU law is chosen, so parties outside the UK will still be able to choose English law without fear of it being set aside. Enforcement of judgements is more complicated. Brexit will have no effect on the enforcement by remaining EU parties of judgments on UK parties or over assets located in the UK, and the Great Repeal Act will operate to oblige the UK courts to recognise the judgements of EU courts. But the Great Repeal Act has no effect outside the UK and in the absence of any other agreement being reached, English judgements will not automatically be enforceable in EU judgements. Whether they are enforceable will fall to be determined by the rules in each member state in relation to the enforceability of non EU judgements.

The Brexit decision came as a shock to the financial community, so much so that there was a great deal of discussion around whether the result alone could be enough to trigger material adverse change (MAC) clauses. However, it became apparent in the following days and weeks that the vote had not brought about any change of itself, adverse or otherwise, and a consensus emerged that the referendum result did not amount to grounds to trigger the typical MAC clause. If in the longer term Brexit gives rise to serious enough economic repercussions, it may be possible to declare a MAC, but parties should bear in mind that it is notoriously difficult to trigger MAC clauses. Take, for example, the famous Yukos case, where the company had been downgraded multiple times, $3billion worth of assets had been frozen, the CEO had been arrested and the company was expected to lose its key licences. There was still enough doubt that this scenario amounted to a material adverse change for the case to go to court. Furthermore, it is particularly difficult to trigger a MAC clause on the basis of circumstances of which the parties were aware at the time the contract was entered into. Arguably the possibility of Brexit has existed since the Conservatives won the 2015 election, since the referendum was part of their manifesto.

It's worth looking at change of law clauses in the light of Brexit because the drafting is often not wide enough to cover repeals or disapplication of laws, and they are not always bilateral. It's important that any change which affects both the lender's ability to exercise its rights as well as the borrower's ability to perform its obligations is covered.

Parties who are restricted, whether constitutionally or by the terms of their investment mandates, to dealing with other EU entities need to be sure that the illegality provisions operate to relieve them of any obligation to lend, for example, to UK entities after Brexit becomes effective.

The UK was an enthusiastic supporter of the European Bank Recovery and Resolution Directive (BRRD) and it is enshrined in UK domestic law, both in the Banking Act and the rulebooks of the Financial Conduct Authority and the Prudential Regulation Authority. Article 55 requires EU entities contracting with non EEA entities to include bail-in clauses. At this point it seems perfectly possible that the UK will not become a member of the EEA, so other EU entities need to consider including bail in wording in contracts with UK entities from now on.

Finally, the prospect of "flexit" clauses becoming common in loan documentation for UK borrowers seems to have receded. A "flexit" clause would allow lenders to increase the margin on a loan after the completion of Brexit. However there was never any very good justification for such a measure, and the idea does not seem to have gained traction. ■