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Contract Disputes Likely to Result from Brexit

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European Disputes

Introduction

Whether or not a deal is reached with the EU prior to the end of the Brexit transition period on 31 December 2020, the period leading up to 2021 and for some time afterwards is likely to be an uncertain time for many businesses in the UK and beyond. In particular, the commercial effects of Brexit may cause a previously favourable contract to become a bad bargain, or potentially impossible or illegal to perform. Businesses are also likely grappling with elements of contracts that had been carefully calibrated to EU law, which governed trade between the UK and EU for decades, but which may no longer be applicable or appropriate.

In this article, we look into our crystal ball to try to anticipate likely disputes arising under English law contracts, such as in relation to price, distribution of goods, the impact of force majeure events and changes in foreign law, and how those might be expected to play out. For more information on how Brexit might impact governing law, jurisdiction and procedural aspects of litigation, see our recent client alert on these topics.

Disputes Arising from the Impact of Brexit on Contracts

Disputes may arise where Brexit has an adverse impact on a contract from one party's perspective, and that party seeks to extricate itself from the contract. Other issues likely to be litigated include how to understand references to EU laws and references to "the EU" (as a territory, for instance). We explore the five most anticipated issues below.

Scenario One: My contract is now a bad bargain

Brexit is likely to have a commercial impact on many English law contracts with a cross-border element, particularly if the UK leaves on 31 December 2020 without a deal in place with the EU. Depending on the outcome of negotiations with the EU, Brexit may cause contracts that were previously favourable - negotiated as they were in a different economic and political context - to become bad bargains, though still technically possible to perform.

Parties to such a contract may well ask themselves what options they have to limit the subsequent economic damage, by walking away from the contract, based on contractual terms such as Material Adverse Change (MAC) clauses, or force majeure provisions, or on the doctrine of frustration. This might arise, for instance, where foreign exchange rates make the contract too expensive; where tariffs have to be paid on goods crossing borders that were

previously not subject to tariffs; or where a party has to seek a new licence to be able to perform its contractual obligations. Faced with these or similar difficulties, a business might consider terminating the contract, which could well lead to disputes over whether that party was so entitled.

This will turn on the wording of the contract and the specific impact that Brexit has had but, in general terms, English courts have been fairly strict in holding parties to a contract even if it has become financially burdensome or uncommercial. By way of example, in past cases, the English courts have found that a change in foreign exchange rates which rendered a contract less favourable (30% more expensive to perform) was not, in itself, a reason to find that the contract was frustrated; and increased cost of imports due to government intervention (price of imports increased by 20-30%) did not give rise to a right to terminate a contract based on the force majeure clause.

Scenario Two: My contract may now become illegal to perform either in the UK or in an EU Member State

Depending on the terms of the exit, Brexit could in some cases render a contract illegal to perform due to events beyond the parties' control. For instance, as a result of the decoupling of English and EU regulation, it might become illegal to sell a product that is the subject of the contract into an EU Member State.

In this case, if performance under a contract would be unlawful under English law, an English court is very unlikely to find that the party is obliged to perform. However, when it comes to illegality under foreign law (such as that in an EU Member State), the general rule is that a contract governed by English law will not be frustrated or terminable if a change in foreign law renders that contract unlawful as a matter of foreign law. While several exceptions may be applicable, including if the obligation in question is specifically required to be performed in an EU Member State in which that performance would be illegal, the question of the impact of illegality is more complex and nuanced than is often assumed and requires careful consideration before any action is taken.

Scenario Three: Brexit has made my contract impossible to perform

If Brexit renders a contract impossible to perform, it may trigger a force majeure clause or cause the contract to be frustrated, potentially enabling a party to terminate the contract, or at least delay performance. English law sets a high bar in both regards and the English court will examine carefully whether the contract has really been rendered impossible or whether it is just inconvenient, more difficult or more costly to perform, and also the proximate cause of the impossibility.

This was clear in a recent Brexit-related decision from the High Court, *Canary Wharf v European Medicines Agency*, where the European Medicines Agency ("**EMA**") sought to cut short its office lease in Canary Wharf on the basis that Brexit had frustrated the contract. The judge found that Brexit did not render the EMA's occupation of its office premises impossible; it did not prevent the EMA from paying rent to its landlord; and Brexit was also not a supervening illegality that rendered the contract frustrated (see our 2019 article on this case for a more detailed analysis). This case is likely to be a key source of guidance for Brexit-related disputes in the coming years, relied on in particular by those arguing that Brexit does not frustrate a contract.

Scenario Four: My contract refers to an EU law

As a rule, English courts have taken a fairly strict approach to contractual interpretation by looking at the express wording of the contract. This means that if a disputed contract refers to an EU law, an English Court may well apply that EU law, rather than reading it as a reference to an equivalent English law, for example. That said, the circumstances of the case, the purpose of the clause or other provisions of the contract may indicate that that the parties intended something different, and assist the court's interpretation.

Contracting parties may be able to take some limited comfort from the fact that for now, at least, the UK's approach is to keep existing domestic legislation that derives from EU rules in place. In particular, the European Union (Withdrawal Agreement) Act 2020 has the effect of transposing current EU legislation into domestic legislation. However, issues will arise as updates and amendments to EU law take place which are unlikely to be transposed into English law, and English law diverges from EU law.

Scenario Five: My contract refers to the territory as "the EU" - does this include the UK?

If a company distributes goods within the EU including the UK today under a contract that provides that it has the right to distribute "within the EU", post-Brexit, does that party lose the right to distribute goods in the UK? The Court in a dispute will consider the contract as a whole and will construe its meaning, including whether the provisions refer to the EU as at the time the contract was signed (i.e. including the UK) or as formed from time to time (i.e. not including the UK, after Brexit) but this may not be immediately obvious from the face of the contract. Much may depend on context. A contract signed on the cusp of Brexit might be assumed to have taken into account that the EU would not include the UK for much longer, whereas a long-standing contract entered into before Brexit was even a portmanteau, are more likely to include the UK for all purposes.

Conclusions

Brexit will impact different commercial contracts in different ways, and the outcome will depend in part on what - if any - deal the UK strikes with the EU prior to the end of the withdrawal period on 31 December 2020 and the commercial bargaining power of the parties but also, and more importantly from an English law perspective, the specific terms of the contract.

There are a number of practical steps that businesses can take now to prepare themselves for Brexit notwithstanding the uncertainty. They may wish to review existing contracts to highlight any issues that might make a contract difficult, impossible or illegal to perform after Brexit, and to consider commercial strategies to mitigate those risks. Should a Brexit-related dispute arise, however, businesses should be ready to review their potential avenues to a swift resolution.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our EU Dispute Resolution practice:

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