

# Brexit

## Legal implications for businesses

Following the announcement of the UK referendum decision to leave the European Union, there are many uncertainties as to what the future will bring to large areas of the UK's laws and the impact on businesses. Much depends on the terms of the exit deal and future trade deals which the UK manages to negotiate. This note summarises some of the short term legal implications for businesses which may arise from the Brexit decision, and considers the longer term outlook in some key areas.

### Short term

The UK's exit from the EU will likely not occur for at least two years, and potentially longer than that (although there is pressure on both sides of the table to conclude a swift separation). Until then, the legal landscape in the UK will remain largely unchanged. However, the Brexit decision has many short term implications for businesses.

### Finance documents

Market conditions following the Brexit announcement may impact on existing debt financing documents in a number of ways:

- **Interest rate** – The immediate impact on interest rates in the light of market volatility remains to be seen. Apart from the actual cost of funding, borrowers should consider any impact on financial covenant compliance if there were to be rate rises.
- **FX rate** – Exchange rate volatility has a number of potential impacts on facilities agreements, outside of any impact on trading:
  - If any element of the facilities are periodically rebased to a base currency, for example outstanding letters of credit and some revolving facilities, the rate on a particular day could have implications for a business's cash requirements.
  - Facilities agreements contain many different formulations for exchange rates to be used in calculating financial covenant compliance. Borrowers should review the mechanics in their specific agreements to determine both the degree of exposure and any possible flexibility.
- **Material Adverse Effect (MAE)** – The majority of MAE definitions should not be impacted in the short term, as uncertainty about the impact on businesses would likely prevent banks being able to invoke the clause. The risk of any MAE definition being triggered by the referendum result may be greater if the definition follows more closely the Loan Market Association (LMA) formulation; i.e. includes a look-forward link to financial covenant compliance or, more so, a link to the "prospects" of the borrower. Clearly the more directly linked the business of the borrower is to EU trading, the greater risk of a MAE provision being triggered.
- **Certain funds** – Given the nature of the representations, undertakings and defaults found in most "certain funds" provisions, it seems unlikely that the referendum result will enable any bank to cancel funding.
- **Market disruption** – There currently does not seem to be a liquidity crunch of the nature that occurred in 2008. Given the limited exercise of "market disruption" provisions in 2008, it seems unlikely that such a provision will be exercised now.
- **Bank ratings** – If there is pressure on the credit ratings of any banks following the referendum result, borrowers should review any implications for their agreements; for example, whether that bank remains an "Acceptable Bank" for the purposes of cash deposits counting towards any net leverage tests, or whether there are any implications for transfer provisions.
- **Derivatives** – Exchange rate and/or interest rate changes may require margin call payments under derivative agreements.

### Capital markets transactions

The volatility and uncertainty following the referendum result will clearly have an impact on the volume of both equity and debt capital markets transactions in the immediate future, particularly new issues. For transactions which do make it to the market, underwriting agreements often include "market MAC" clauses. Typical provisions are unlikely to be triggered by the Brexit decision itself or the market impact which immediately followed the decision, but should be monitored.

## Key contracts

Consider whether termination rights (including illegality and material adverse change clauses) in existing key contracts are likely to apply. However, such provisions are very unlikely to be triggered without specific reference to Brexit.

## Tax

There is no immediate cause for concern, as structures and arrangements will continue to work in accordance with existing tax law. The UK remains an extremely competitive jurisdiction taking into account its low corporation tax rate of 17% (from 2020).

## Free movement of workers

EU nationals will continue to have free movement within the EU until exit negotiations are concluded. Until then, those EU nationals who qualify are likely to accelerate applications for indefinite leave to remain in the UK.

## Pensions

The Brexit announcement and its effect on financial markets may have a number of consequences in relation to defined benefit pension plans:

- **Asset and liability values** – Depending upon timing of plan valuations, increased deficits will likely lead to higher cash funding demands from trustees. Plan sponsors should monitor the impact of market movements on funding levels and consider ensuring more regular updates on funding issues. Plan trustees may seek to move to a more cautious investment strategy which could further impact any funding deficit.
- **Strength of employer covenant** – Trustees may be concerned by the impact or potential impact of Brexit on the financial strength and prospects of the sponsoring employers, and may seek to put in place additional security arrangements (such as guarantees and/or contingent security) if there are concerns about a weakening of the covenant. Trustees will likely increase requests for information on financial metrics of plan sponsors. Where possible, plan sponsors should consider reassuring trustees as to how they anticipate dealing with the challenges to their business and keep open communication with the trustees to show that they are aware of the pension implications and that they anticipate continuing to work together on funding and covenant issues.
- **Contingent security already in place** – Consideration should be given to whether there are any reporting or funding requirements triggered on existing contingent

security arrangements if Brexit has a detrimental impact on plan sponsors.

## M&A transactions

Market uncertainty may impact on the willingness of buyers to enter into M&A transactions and affect the availability and terms of financing. For transactions which are being negotiated, or which have signed but not closed, the following may need to be considered:

- **Debt financing** – Terms of live or proposed financing for transactions should be checked to ensure that the Brexit decision and its market impact does not affect the ability to draw down funds, although standard debt terms should not cause concern.
- **Closing adjustments and financial limitations** – Exchange rate fluctuations may significantly impact closing adjustments for cross-border businesses. Careful consideration should be given to the currency of any adjustments; for example, where a net debt adjustment is proposed for a business which has debt in sterling and US dollars, it may be appropriate to have separate adjustments, in the relevant currency, for each debt. Similar considerations apply to financial limitations on liability.
- **Material adverse change (MAC) clauses/repetition of warranties** – MAC clauses and conditions relating to the accuracy of warranties at closing may be tested by buyers. The Brexit decision itself and the market impact to date are unlikely to trigger typical MAC provisions, but these need to be looked at on a case-by-case basis. For UK public M&A transactions, the Takeover Panel is extremely unlikely to allow a bidder to invoke a MAC provision as a result of Brexit.
- **Financial regulatory clearances** – It is very unlikely that the UK financial regulators will change their approach to making change of control decisions or suitability of purchasers, at least in the short term. They are likely, however, to insist that financial information provided to them as part of the process is refreshed more frequently than normal and will be more interested in a buyer's plans around governance and stress/scenario testing.

## Medium/longer term

The medium and longer term implications of Brexit are very hard to predict, given their dependence on the terms of the exit deal and future trade deals that will be agreed between the UK and the EU. These are our thoughts on some of the key legal issues and uncertainties relating to an exit.

## Financing

Regulated institutions (such as banks, insurance companies and funds) may see a significant and prolonged impact due to uncertainties around the future regulatory environment, including prudential and capital regulation, conduct of business regulation, passporting, bail-in and recovery and resolution rules, all of which will impact institutions' ability to attract investment and borrow, and which will therefore impact their ability to operate their businesses (including, for banks, lending to and supporting borrowers). Areas that both lenders and borrowers should monitor include:

- Any representations about, or events of default related to, validity of any finance documents, where the validity of any provision relies on any European law; for example, recognition of governing law clauses, or the effectiveness of security relying on the Financial Collateral Directive.
- Any representation relating to the (lack of) need for a lender to be authorised to lend in a relevant jurisdiction.
- Any changes to accounting principles which move away from EU-adopted IFRS.
- Any regulatory changes which may make it illegal for any particular lender to lend.
- Any implications under the Increased Costs clause as a result of any changed bank regulations.
- Any changes to withholding regimes and double tax treaties.

## Free movement of workers

In the longer term, much will depend on the arrangements the UK agrees with the EU; absent any such agreement, Brexit will end free movement of workers between the EU and the UK, and EU citizens will be subject to immigration control in the UK. There are very likely to be "grandfathering" provisions allowing EU nationals who are currently working in the UK to remain, but that is not yet certain. Alternative arrangements could retain free movement with either the EU as a whole or with particular EU countries. Businesses should conduct an audit to identify those of its workers who work in the UK but are EU nationals and those who work in the EU but are UK nationals.

## UK employment law

Until exit negotiations are concluded there is unlikely to be any change to UK employment laws. Our view is that, at least in the short term, following Brexit it is likely that the UK will retain a considerable part of EU-derived employment law with minimal amendment. Any substantive changes to key areas (such as family-friendly rights and anti-discrimination

legislation) are likely to be unpopular and would be strongly resisted by trade unions, whilst amendments to the working time regulations, the TUPE Regulations (concerning the rights of employees on business transfers) and the agency workers regulations may be more likely. However, as part of trade negotiations, the EU may insist on a certain threshold of employment rights being maintained, such as collective redundancy rights, the protection of workers' rights on a business transfer and the rights of agency workers.

## Tax exit charges

If any UK business is considering migrating out of the UK, the migration could trigger corporation tax exit charges which will need to be factored into the economics of whether to migrate or not.

## Withholding taxes

When the UK eventually leaves the EU, it may lose the benefit of certain EU laws which prohibit withholding tax on cross-border payments of dividends, interest and royalties. However, the UK has one of the world's largest double tax treaty networks which will help mitigate any impact of this. Businesses which conduct transactions or arrangements which involve such payments between the UK and the EU (for example, interest under a loan facility) may wish to review the payment flows to determine whether a double tax treaty would be available to relieve any withholding, and which party bears the withholding tax risk.

## Indirect taxes

We anticipate that the biggest changes (some of which may be welcomed by businesses) will be to indirect taxes (VAT, insurance taxes, customs duty, and excise duty), but it is currently impossible to determine what those changes will be, as they will fundamentally depend upon the exit deal and future deals negotiated by the UK government.

## Competition law – M&A transactions

Following UK withdrawal from the EU, a number of transactions that are big enough to be notifiable under the EU Merger Regulation (which automatically pre-empts filings with EU Member States) will also be susceptible to pre-merger review in the UK. That potentially means two merger reviews in Europe (rather than the current "one-stop" review in Brussels), increasing the costs/burdens of the pre-merger process, with inconsistent timetables (UK reviews are lengthier than EU reviews) and possibly inconsistent outcomes. As a substantive matter, however, the UK is likely to reach decisions in most cases that are similar to the European Commission decisions, since the UK Competition & Markets Authority and the EC apply similar, economically-

oriented rules of assessment that emphasise the importance of free markets and unfettered competition (rather than the “public interest” and protectionist values that typify some other countries’ reviews). What happens after Brexit in the EU (not the UK) is less predictable. Without the UK playing its traditionally leading role (with Germany) in development/application of the EC’s competition rules and processes, those may, over time, become more interventionist/protectionist than has been the case so far.

### **Competition law – behaviour**

Outside the transactions area, rules of competitive conduct in the UK will continue largely unchanged. The UK was a leader in the development of the EU’s rules, and the two bodies of law are therefore largely the same.

### **Financial services**

A Brexit is unlikely to have a significant impact on the regulation of purely domestic financial services businesses. However, for international businesses with their EU base in the UK, particularly banks, the consequences will likely be significant. A financial services institution regulated in an EEA state may “passport” its authorisation to carry on its regulated activities into any other EEA state. If this passport becomes unavailable following Brexit, UK-based regulated businesses may need to set up a separate entity in an EEA state to enable them to continue their activities throughout the EEA. That will be a substantial cost to those businesses in terms of capital adequacy and additional compliance requirements. Similar issues will arise for non-UK based EU firms (such as Deutsche Bank) which are authorised outside, but operate in, the UK.

### **Capital markets**

At present, there is a common set of rules for drawing up a prospectus across the EEA, and an ability to “passport” a prospectus into other members states. Following a Brexit, the UK may no longer be subject to, or have the benefit of, these rules and will need to implement its own rules (which are likely to be similar to the existing rules). This will most likely impact transactions which involve a public offer of securities in both a continuing EEA state and the UK, or where there is a public offer of securities in an EEA state and a listing in the UK (and vice versa), or a dual listing in more than one country. However, cross-border listings of this nature are relatively rare and so, in practice, the impact on capital markets transactions requiring a prospectus is likely to be limited.

### **Private funds**

The private fund management industry will be affected in a

number of ways by Brexit:

- **Authorisation of fund management activities** – There appear to be three possible outcomes for UK private fund managers in relation to the management of their funds, which depend on the approach taken by the UK to the Alternative Investment Fund Managers Directive (AIFMD):
  - Retain the AIFMD regime in full. This would likely result in no change for UK managers from their current regulatory position with respect to their fund management obligations.
  - Reverts to the UK’s pre-AIFMD regime (or some other non-AIFMD, less onerous) regime. The likely result would be a lessening of regulation for UK managers with respect to their fund management obligations (but see below re: marketing to EEA investors).
  - Adopt a dual regime; i.e. mandatory pre-AIFMD (or other non-AIFMD, less onerous) regime with an opt-in additional regime which mirrors AIFMD. The object of opting in would be to qualify for the third country passport – this is similar to the route that some other territories, for example Guernsey, have already taken. This would likely result in a lessening of regulation for UK managers with respect to their fund management obligations unless they want to opt-in.
- **Marketing by UK managers to EEA investors** – It currently seems likely (although it is not yet definite) that the UK will become a “third country” under the AIFMD regime. If so, UK managers should be able to market their funds under the current existing private placement regimes (subject to compliance with certain requirements). In due course, the UK may be eligible for the third country passport (this would only really work under the first and third options above regarding the UK manager authorisation regime and would involve full compliance with AIFMD and registration in an EEA member state of reference). Any future loss of access to the AIFMD marketing passport will be detrimental to UK managers, and future marketing will involve work to comply with the new regime (but potentially more flexibility for managers targeting only certain jurisdictions).
- **Marketing by non-UK managers to UK investors** – The UK is likely either to keep the AIFMD registration regime (no change for non-EEA managers and a minor change for EEA managers) or revert to the pre-AIFMD financial promotions regime (which would reduce the requirements for non-UK managers marketing to UK investors). In

practice, therefore, this is not expected to result in any serious difficulties for non-UK managers marketing their funds into the UK.

## Restructuring and insolvency

The legal framework for consensual restructurings is unlikely to be significantly affected in the short term following Brexit. Similarly, the substantive insolvency laws of relevance to non-consensual restructurings, and which also form a reference point for achieving consensual restructurings, are unlikely to be significantly affected, given that the UK's insolvency laws are largely domestic. However:

- Jurisdictional questions affecting recognition and application of UK insolvency laws in the EU (and vice versa) may be affected. This means that cross-border restructurings could be impacted, and greater attention will need to be taken when considering distressed investments within the EU, if the intention is to restructure within the UK or vice versa.
- EU proposals on the harmonisation of substantive insolvency laws and pre-insolvency measures – for example, the proposed moratorium and debtor-in-possession funding – may not now be implemented in the longer term in the UK (although the UK has started its own consultation in this area).

## Dispute resolution

There are many uncertainties around the resolution of disputes with an EU element following Brexit, including:

- **Continuing role of the European Court of Justice (ECJ)** – It is not clear how any UK-related claims under pre-Brexit EU law will be dealt with post-Brexit; for example, will the ECJ continue to be the ultimate arbiter of such claims, or will that jurisdiction move to, for example, the UK Supreme Court? (This may be particularly problematic in relation to EU law claims with a cross-border element).
- **Human rights** – Leaving the EU will not automatically mean that the UK ceases to be a signatory to the European Convention on Human Rights, and therefore it is not clear whether the European Court of Human Rights will continue to have any jurisdiction in relation to UK matters.
- **Exclusive jurisdiction and arbitration** – At present, a series of international European conventions govern the appropriate forum for the resolution of disputes and limit the ability of parties to bring claims in multiple jurisdictions. Currently parties are not able to obtain injunctive relief preventing commencement of court

proceedings in Europe in breach of an arbitration agreement; post-Brexit, it is likely that parties will be able to get such injunctive relief. However, it remains to be seen how the terms of the UK's exit from the EU will affect these matters. As the situation becomes clearer, it may be necessary to revisit jurisdiction clauses in agreements.

- **Cross-border enforcement of judgments** – It is currently relatively straightforward to enforce UK judgments in other EU countries. Again, it is not clear whether that will continue to be the case following Brexit.

## Intellectual property rights

EU trade marks may not offer protection in the UK following Brexit, so national registrations and European conversions should be considered (nationally registered IP rights will be unaffected by Brexit). Copyright is not registrable in the UK or Europe, so protection in the UK will be largely the same.

## Data privacy

The Data Protection Act 1998 will continue to apply in the UK for the time being. The forthcoming General Data Protection Regulation, which provides radical reforms to EU data privacy laws, is due to come into force on 25 May 2018 (before it is expected that a Brexit will have occurred), and the Data Protection Act is likely to be repealed at that time. However, following a Brexit, the General Data Protection Regulation and the Cyber Security Directive may not automatically apply in the UK and may therefore need to be replaced (either by a new law or a revived Data Protection Act). Existing lawful data transfer arrangements will continue to apply, but the complex inter-relationships between the UK, EU and US regarding data transfers will need to be monitored. Given the uncertainty, organisations should consider reviewing their privacy policies to determine whether obtaining consent to the cross-border transfer of personal data is a viable option.

## Environment

Many of the environmental laws in the UK derive from the EU, principally in relation to climate change (including energy consumption and recycling). While these laws have often been a source of irritation for the UK public and the anti-EU press, in reality it is unlikely that there will be a wholesale change of approach following Brexit. Technical changes to a number of laws will be needed, and they might ultimately be modified as part of a new future environmental policy. However, it is almost certain that continuing access to the single market will require continuing compliance with EU environmental policies.



## Pensions

It is unlikely there will be any immediate change to UK pensions law or the bodies regulating UK pension plans as a result of Brexit. It is probable that there would be resistance to changing pensions legislation which protects members' benefits, even where the legislation originated from the EU. There has been suggestion that, in due course, there could potentially be legislative changes to reduce funding pressures on plan sponsors. However, in light of recent high profile corporate failures, there may be significant resistance to this.

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