



Introduction

Implications of Brexit for debt contracts generally

What next?

# Brexit - What does it mean for debt contracts generally?

## Introduction

A UK vote to leave the EU has far-reaching political implications. Many commentators also foresee economic consequences, and such volatility would have commercial ramifications for participants in the debt markets.

In this briefing we focus on the possible legal and documentary impact of a vote to leave the EU and an actual withdrawal from the EU by the UK following such a vote (a *Brexit*). This briefing considers the impact on debt contracts generally; the commercial effects of a Brexit are beyond the scope of this note. For a discussion of key issues for business generally, please see our briefing “[If Britain votes to leave](#)”.

## Implications of Brexit for debt contracts generally

Brexit will pose implications for contracts generally, including debt documentation.

### Choice of governing law

Two EU Regulations set out the rules that the English courts currently apply to determine which law applies to obligations between parties. The Rome I Regulation covers contractual obligations and the Rome II Regulation covers non-contractual obligations. Under these Regulations, in most situations involving commercial parties which tend to involve a written contract with a governing law clause, the obligations are normally governed by the law chosen by the parties.

On a Brexit, the Rome I and II Regulations may cease to apply in the UK. In these circumstances, a choice of English law to govern contractual obligations should still be recognised by courts in the UK, and will still be recognised by EU member states. A choice of English law to govern non-contractual obligations would continue to be upheld by the courts of EU member states. However, the position under English law in relation to non-contractual obligations would be less clear as, before the Rome II Regulation regime came into effect, parties did not have an express right to choose which law applied to non-contractual obligations arising between them.

### Choice of jurisdiction and enforcement of judgments

The Brussels Regulation governs which EU member state courts should have jurisdiction in a dispute, and the recognition and enforcement of civil and commercial court judgments between EU member states. In general, the Brussels Regulation respects the parties' agreement that the courts of another EU member state should have jurisdiction. Under the Brussels Regulation, parallel proceedings in the courts of more than one EU member state are prohibited where those proceedings involve the same issues, and may be prohibited if the issues are related. The Brussels Regulation also provides for mutual recognition and enforcement of judgments between EU member state courts, subject to limited exceptions.

On a Brexit, English courts would still be likely to respect provisions in contracts that confer jurisdiction by agreement on the English courts. However, in the absence of any supranational arrangement with the EU, the recognition of English jurisdiction clauses and enforcement of English court judgments by the courts of EU member states is likely to be significantly more complex than at present. It would be open to the UK to seek to sign up to the Lugano Convention and/or the Hague Convention in order to decrease uncertainty in this area (the Lugano Convention is very similar to the current EU regime to which the UK is a party).

In relation to arbitration, the New York Convention governs the recognition and enforcement of arbitral awards between contracting states. As the UK and other EU member states are signatories to the Convention, it is unlikely that a Brexit would have an impact on the reciprocal recognition of arbitral awards where the parties have agreed on arbitration as the only dispute resolution method under a contract.

#### **Contractual recognition of bail-in and contractual recognition of resolution stays**

The EU Bank Recovery and Resolution Directive (*BRRD*) requires a European Economic Area (*EEA*) financial institution to include a specific clause (a "contractual recognition of bail-in clause") in almost all of its contracts that are governed by a non-EEA law and under which it has certain liabilities. Under the clause, the counterparty to the contract acknowledges that the EEA financial institution's liabilities under the contract are subject to the exercise of bail-in powers under *BRRD* by an EEA regulator. If the UK leaves the EU *and ceases to be a member of the EEA*, an English law-governed contract under which an EEA financial institution has any relevant liabilities for the purposes of *BRRD* will be governed by a non-EEA law. Consequently, that financial institution will need to ensure that all such contracts to which it is a party contain a contractual recognition of bail-in clause. This may involve amending pre-existing contracts to incorporate the clause.

Similarly, under a framework created by the Financial Stability Board, certain EU member state regulators have introduced rules that require an in-scope financial institution in their respective jurisdictions to include a "contractual recognition of resolution stays clause" in its financial contracts. Under the clause, the counterparty to the contract agrees to suspend its rights to terminate the contract in the event that the financial institution enters into resolution proceedings. As the framework does not arise out of EU legislation, the adoption of these rules differs between EU member states (although *BRRD* does include provisions to ensure that a stay enforced by a resolution authority in an EU member state will automatically be recognised and given effect throughout the EU). If the rules in the relevant EU member state require a contractual recognition of resolution stays clause to be included in all relevant non-EEA law-governed contracts, and the UK leaves the EU *and ceases to be a member of the EEA*, such a contractual recognition of resolution stays clause will need to be included in all relevant English law-governed contracts to which the financial institution is a party. Again, this may involve amending pre-existing contracts to incorporate the clause.

#### **Status of EU law elements of UK law**

A large proportion of the body of law currently applicable in the UK consists of law derived from the EU. This includes EU Regulations (directly applicable in the UK), EU Directives (implemented by UK primary or secondary legislation), judgments of the Court of Justice of the European Union (which may be implemented by secondary legislation) and EU institutional acts. Following a Brexit, the UK government would need to perform the enormous task of deciding what UK law should look like outside the EU. In the long-term, the European Communities Act, which implements EU law into UK law, would need to be repealed or substantially amended so that UK law ceases to recognise any EU Regulations as being directly applicable in the UK, and to prevent the use of secondary legislation to implement EU Directives in the UK. The UK government would be expected to look at all UK primary legislation that implements EU law to determine if it needs to be repealed or amended. Judgments of the Court of Justice of the European Union and EU institutional acts would cease to be binding in the UK.

Although it is unclear to what extent the UK government would decide to retain EU-derived law as part of UK law following a Brexit, it is likely that the UK government would, as part of preparations leading up to a Brexit, enact legislation to maintain the effect of EU-derived law, subject to some selected repeals or modifications, at least for a transitional period following the exit. The UK government could also decide to "grandfather" pre-existing contractual arrangements, so that those arrangements are unaffected by any repeal of or modification to the relevant legislation. Both of these mechanisms would decrease the scope for uncertainty in this area.

#### **Provisions referring to EU law**

Contractual provisions may refer to pieces of UK legislation that implement EU law or to pieces of EU law itself. As discussed above, following a Brexit, EU-derived law is likely to cease to have effect in the UK or may be subject to certain modifications.

Where the contract in question provides for a reference to a provision of law to be interpreted as a reference to that provision as amended or re-enacted, the contract should be construed as referring to the modified legislation or to any legislation that replaces the repealed legislation. Although this would provide contractual continuity, uncertainty would arise in relation to the effect of the modified or replacement legislation on the contract. In addition, such a provision would not assist with references to any EU-derived law that is repealed, but not replaced, following a Brexit. The absence of such a provision in a contract is likely to be problematic. Any transitional arrangements to provide continuity of EU-derived law following a Brexit and the "grandfathering" of contractual arrangements (both discussed above) may assist in mitigating this uncertainty.

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## What next - documenting for Brexit?

Given the uncertainty that will ensue following a vote to leave, together with the expected time period between the vote and the UK's exit from the EU, it is difficult to anticipate what, if any, particular contractual or structural features may be introduced into the debt markets or into finance transactions in the immediate term.

That said, following a vote to leave, industry bodies such as the LMA, ICMA and ISDA may well begin reviewing their standard documentation for technical changes which could help to mitigate uncertainty, for example, amending references to EU legislation or enabling future amendments to address change in law and regulation.

A distinction should be drawn between such technical changes, and any business-driven changes market participants may seek to include in debt documentation in the coming months or longer to protect themselves against the scenarios to which a Brexit could give rise. For the moment, it is likely to be too soon to start including specific clauses to deal with Brexit. The consequences for debt products in the medium- and longer-term will be shaped by the macro context of Brexit for legislators and market participants alike, and should be closely monitored as the legal and regulatory landscape becomes more certain.

*For further information on the issues posed by Brexit, please see our [Britain and the EU](#) website. Your usual Freshfields contacts will be very happy to discuss any of the points raised in this briefing, and to assist you in any contingency planning as you assess the impact of a vote to leave for your business.*

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