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Brexit: Potential Impact on Mergers & Acquisitions

This note addresses the potential impact of Brexit on transactions related to mergers and acquisitions (M&A). It is one of a series of *GTM Alerts* designed to assist businesses in identifying the legal issues to consider and address in response to the UK's referendum vote of 23 June 2016 to withdraw from the EU.

Timing of Brexit

The UK has not left the EU. It will remain a member of the EU, and EU law will continue to apply in its territory, for some time.

Before exiting, the UK needs to go through the exit procedure set out in Article 50 of the Treaty on European Union, starting with notification to the European Council of its decision to leave the EU. The new UK Prime Minister, Theresa May, appointed on 13 July 2016, has clearly stated that, while "Brexit means Brexit," there should be no rush to serve the Article 50 notification. She and David Davis, the Secretary of State for the new government department in charge of managing Brexit, have supported the view that notification should not take place before the end of the year. While the situation remains fluid – with the EU institutions and the remaining 27 EU Member States increasing the pressure for formal negotiations to commence swiftly – notification may be delayed for some time to allow consideration of the UK's preferred exit terms and model for its future relationship with the EU. When the notification is made, it will trigger a two-year, extendible period of negotiation with the EU on the UK's terms of exit only. To read more about the timeline for Brexit, please see our previous GTM Alerts, "Brexit: The Timeline" and "Brexit: Progress Report One Month In."

At this time, it is not clear if negotiation of new arrangements with the EU will be conducted in parallel, or at a later stage. It is, however, clear that the UK intends to start negotiating trade terms with non-EU countries as soon as possible.

Potential Impact on M&A Activity

While the ultimate shape of the UK's relationship with the EU remains unclear, businesses involved in M&A transactions should take account of the preparations for Brexit, and any proposed UK policy changes, in their deal planning, negotiation and execution.

Set out below are a number of areas worthy of consideration:

Brexit Conditionality

It is clear that significant changes to the legal landscape are coming. What is less clear is when and in what form. As a result, businesses should consider whether it is necessary to cater for the implications of Brexit in their deal documentation to avoid being caught out by an unexpected change of circumstance or, in the case of longer term obligations, to address the "known unknown" of Brexit.

For instance, such clauses may:

- in the case of signed transactions expected to close prior to Brexit occurring, enable one or both parties to terminate or reconsider the transaction if Brexit occurs prior to closing – this may mean that the UK ceases to have access to the Single Market because either no agreement has yet been reached between the UK and the EU on their future relationship, or because the relationship concluded by the UK and the EU does not include access to the Single Market, resulting in, for example, tariffs being imposed on specified products, or transfer of employees across borders becoming more difficult; or

- provide that specified post-closing obligations shall only apply up until the UK actually withdraws from the EU or provide for modified arrangements after the UK leaves the EU – for instance, a licensing agreement could be specified to cover the entire EU including the UK until Brexit, and be limited to the EU excluding the UK post-Brexit.

Brexit Due Diligence

Consideration needs to be given by acquirers and sellers alike to the possibility that the nature and value of certain types of assets to be acquired as part of a transaction may change once the UK exits the EU, impacting valuation. In addition, acquirers should assess the likely impact of withdrawal from the EU on the operations and profitability of the target business and the readiness of that business for the changes likely to be brought about by Brexit.

By way of example:

- the geographic scope of key commercial contracts such as agency, distribution, supply, and licensing agreements may change as result of the UK no longer forming part of the EU;

- the UK's exit from the EU may trigger material adverse change provisions or regulatory change provisions in key contracts allowing for the counterparty to terminate or vary the contract;

- pan-EU intellectual property right protections could cease to apply in the UK following Brexit;

- Brexit may result in new challenges for the target business such as tariffs being imposed on goods exported to, or imported from, the EU, difficulties in moving EU staff into the UK (or vice versa) and needing to comply with differing standards of data protection legislation; and

- EU loans that may extend beyond the UK's withdrawal from the EU could be withdrawn.

Warranty and indemnity provisions contained in the sale and purchase documentation for pre-Brexit transactions will need to be tailored to take account of the UK's impending exit from the EU. Brexit due diligence may also inform deal valuation, deal-specific tax considerations, corporate restructuring and overall transaction structure.

Definitional Issues

Currently any references to the "laws of England" will include any EU legislation directly applicable in England. Following the UK's withdrawal from the EU, this will no longer be the case. To the extent it is desired to refer to any EU legislation, express references to any such legislation will need to be carefully considered.

Similarly, any contractual definitions using or relying on the current geographic scope of the EU may be impacted by Brexit – depending on whether they refer to a state of affairs at a specified point in time or from time to time. A basic example would be the application of a non-compete provision to the "European Union" entered into before Brexit. Following Brexit, the provision may or may not apply to the UK, depending on whether the contractual definition of "European Union" was at a specified (pre-Brexit) point in time.

Takeover Rules

The role played by EU legislation in the private M&A context in the UK is relatively limited so withdrawal of the UK from the EU is unlikely to have a significant direct impact on the legal framework for such transactions.

With regard to public takeovers, the UK Takeover Code implements the EU Takeovers Directive. That said, withdrawal from the EU is unlikely to have a significant effect on the substance of the rules applying to public takeovers in the UK because the EU Directive implemented by the UK Code was heavily modelled on the UK Code in the first place.

It should also be noted that unless the UK remains in the EEA, UK companies engaging in cross-border takeovers involving listed companies in the EEA and EEA companies engaging in cross-border takeovers involving listed companies in the UK may encounter additional regulatory burdens. For instance, where share consideration is involved in an M&A transaction, UK companies may be required to issue separate EU-compliant prospectuses in order to satisfy competent EU regulators. Conversely, EEA companies may be required to issue separate UK-compliant prospectuses in order to satisfy future UK requirements.

Merger Control

Brexit will have a significant impact on the regulatory framework for the review of M&A transactions involving parties with operations in the UK. Currently, many large-scale M&A transactions are notified exclusively to the European Commission under the one-stop-shop principle of the EU merger control regime. Following the UK's withdrawal from the EU, many such transactions will also require separate assessment under the UK merger control regime.

While the UK regime is voluntary in nature (at least until a transaction is "called in" for review), it can be expected that many transactions notified in Brussels will result in parallel notifications to the UK's Competition and Markets Authority – thereby increasing the cost, regulatory burden and uncertainty inherent in M&A activity.

In this context, recent comments by the Prime Minister also suggest an appetite for using the UK's merger control regime for more general industrial policy reasons, potentially including an ability to intervene in M&A transactions involving industries considered strategically important. This could involve the use of a broader set of public interest criteria than currently available under the existing EU and UK merger control regimes.

Restrictive Covenants

EU law currently has supremacy in the UK, as in all EU Member States. Consequently, the assessment of restrictive covenants (such as non-compete and non-solicitation provisions) in sale and purchase documentation under UK and EU law is aligned. After Brexit, UK competition law alone will apply and it is possible that eventually the two legal regimes will start to diverge.

Governing Law Clauses

Choice of law provisions are currently governed by the so-called Rome I Regulation (for contractual obligations) and the Rome II Regulation (for non-contractual obligations). These regulations enshrine the principle of party autonomy in relation to choice of law and are of universal application, meaning that an express choice of law will be upheld whether or not it is the law of an EU Member State.

In the courts of the EU Member States, therefore, the enforceability of choice of English law clauses will not be affected by Brexit. In the UK, however, Rome I and II will no longer apply post-Brexit, and absent a replacement treaty solution, English courts will revert to the Private International Law legislation that was in force in the UK prior to the introduction of Rome I and II. This may have different implications for contractual obligations and non-contractual obligations:

- for contractual obligations, English courts are likely to continue to uphold parties' choice of law, as Rome I is substantially similar to the Rome Convention, implemented in the UK Contracts (Applicable Law) Act 1990, and common law principles;

- the position is more uncertain for non-contractual obligations, as the relevant UK legislation (*i.e.,* the Private International Law (Miscellaneous Provisions) Act 1995) does not permit the parties to contractually specify the law governing their non-contractual obligations.

It is important to bear these factors in mind, but generally speaking – while it is conceivable that a divergence in approach will emerge between UK and EU courts over time – it is unlikely that English courts will contradict a clear expression of the parties' intention and risk diminishing the attractiveness of the jurisdiction as a forum for dispute resolution.

Jurisdiction Clauses and Enforcement of Judgments

As an EU Member State, the UK is currently subject to the so-called Brussels Regulations, which regulate the recognition and enforcement of judgments in civil and commercial matters handed down by courts of other EU Member States. Once the UK leaves the EU, these regulations will cease to apply to the UK, which creates uncertainty whether the national courts of the remaining 27 EU Member States will recognize clauses providing for UK jurisdiction as well as the enforcement of English judgments in those Member States. The UK would also no longer be a member of the Lugano

Convention, which provides for similar rules vis-à-vis Iceland, Norway and Switzerland. Similarly, Brexit would cast doubt on the UK enforcement of jurisdiction clauses and judgments originating in the remaining 27 EU Member States.

Arrangements comparable to the Brussels Regulations and the Lugano Convention could be negotiated by the UK in the EU exit terms or as part of the post-exit arrangements, but there has been little discussion of such details in the recent debates on Brexit.

Further, although the Hague Convention on Choice of Court Agreements of 2005 currently applies in the UK because the EU is a signatory of the convention, upon leaving the EU, this will no longer be the case. It would, however, be open for the UK to join this convention in its own right, although this may take time. In most international civil or commercial disputes, doing so should ensure that the Convention's provisions on the recognition of choice of law clauses and the enforcement of judgments apply in the remaining 27 EU Member States. In practice, however, enforcement will depend on how national courts in the EU approach the interrelationship between the Hague Convention, the EU and the national jurisdiction rules. The Hague Convention is untested in this respect.

Given that all EU Member States are each individually parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the position regarding the enforcement of arbitration awards by London-based tribunals in the EU and EU-based tribunals in the UK should not be affected by the UK's exit from the EU.

Conclusion

The full implications of the UK's withdrawal from the EU are still being worked through and they will depend to a great extent on the model chosen by the UK for its future relationship with the EU and the EU exit arrangements. Those choices will be heavily influenced by the new UK Prime Minister, but also heavily negotiated by the EU. Until there is greater clarity and certainty, businesses should continue to monitor developments, identify those areas where their businesses are likely to be affected by new or amended legislation and regulation – and, importantly, those areas that are unlikely to be affected – and determine how to mitigate risks in affected areas.

Further information on issues related to Brexit can be found here.

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