ALLEN & OVERY

Brexit – legal consequences for commercial parties

English governing law clauses – should commercial parties change their approach?

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Issue in focus

English law and the English courts have long been a popular choice for commercial parties doing business internationally. There are many reasons why this is the case. English law is widely considered to be comparatively certain, stable and predictable and the English courts have a deserved reputation for independence and expertise, for the commerciality and reliability of their decisions and for the willingness of judges to give effect to the contractual bargain struck between commercial parties.

In this article we assess whether a vote in favour of Brexit, or Brexit itself, would make a choice of English law less attractive to commercial parties. In Specialist paper No 2 we consider the same question in relation to a choice of the English courts as the forum for resolving commercial disputes.

One observation we would make at the outset is that the harmonisation of the rules applied by Member State courts to determine governing law in civil and commercial matters has been one of the success stories of the European project, at least where commercial parties are concerned. Member State courts (other than Denmark) now apply a uniform set of rules to determine what law they should apply to most commercial disputes. These rules provide that party autonomy is, for the most part, to be respected. As such, commercial parties can feel comfortable that a choice of English law (or any other law, including that of a non-Member State) will be upheld by Member State courts in the vast majority of cases. This certainty, combined with the similar degree of certainty arising from the harmonisation of rules on jurisdiction and the enforcement of judgments (see Specialist paper No 2), enables parties to assess litigation risk and price deals more accurately when negotiating commercial transactions and reduces the risk of having to litigate under an unfamiliar or unintended law when disputes arise.

Most of the reasons why parties choose English law to govern their relationships are entirely unconnected with the UK's membership of the EU and would be unaffected by any departure. Further, it is highly unlikely that Brexit would have any substantive impact on the enforceability of English governing law clauses, whether in the English courts or elsewhere. In our view, therefore, the possibility of Brexit should not lead parties to make changes to their current approach to governing law clauses. A choice of English law to govern both contractual and non-contractual obligations (ie principally torts) is a sound one and will remain so whatever the outcome of the Brexit referendum and even following Brexit itself. We discuss the reasons why below.

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Analysis

Popularity (and enforceability) of a choice of English law – what is the current position?

English law is currently a popular, if not the most popular, choice of law for parties to cross-border commercial contracts worldwide (see, for example, the Singapore Academy of Law's January 2016 survey of 500 lawyers working on cross-border transactions, in which English law was, by a significant margin, the most popular choice of governing law, with 48% of respondents identifying it as their preferred choice). There are many reasons for this:

- English law is comparatively certain, stable and predictable and is commercially oriented, with a strong body of case law in relation to complex commercial transactions that can be relied upon by parties to assist them in assessing how particular contractual terms or concepts are likely to be interpreted and applied.
- English law generally gives effect to the contractual bargain agreed between commercial parties. There is limited scope for terms to be implied or for public policy or other principles to overwrite what has been agreed.
- English law is flexible – the common law system allows the law to develop and grow to deal with economic and societal changes and new and innovative deal structures.
- English law is or has become familiar to many parties, even those with no connection with the UK, because it is an acceptable or even market-standard choice in a wide range of sectors and markets, so the need for parties to conduct a detailed investigation into the law at the time of contracting is reduced.
- English law is a sensible choice for parties wishing to resolve their disputes in the English courts (there is no need for costly expert evidence on the law and less risk that the courts will get the law wrong) and for those wishing to arbitrate their disputes (given the wide pool of English qualified arbitrators).
- A choice of English law facilitates contracting in the English language and allows parties to access a mature legal services market, with specialist lawyers available to advise on complex transactions.

The other point worth noting here is that, as indicated above, Member State courts currently apply the same set of rules to determine the governing law of both contractual and non-contractual obligations in most commercial contexts, namely the Rome I and Rome II Regulations. Both of these Regulations require Member State courts to respect party autonomy on choice of law, meaning that they uphold English governing law clauses subject only to certain limited exceptions. And importantly in this context, that requirement applies regardless of whether a party is located in the EU or whether the chosen law is the law of a Member State.

What might change following Brexit?

The reasons for choosing English law discussed above are for the most part unconnected with, and would be unaffected by, the question of whether the UK remains within the EU or opts to leave. Further, even in those areas where the UK's position vis-à-vis the EU could have an effect, that effect is in our view likely to be limited in practice.

The principal reason for this in relation to contractual governing law is that, to date, substantive English contract law has largely been unaffected by the proliferation of EU law, at least in the context of general commercial contracts (the position is more complex in other spheres, for example in relation to consumer contracts and agency contracts). Instead, the law on almost all key contractual issues including offer, acceptance, consideration, the implication of terms, exclusion clauses, interpretation, the bases on which contracts can be avoided, breach, frustration and damages derives principally from English common law.

The same is broadly true in relation to English tort law, save perhaps in relation to certain statutory torts that have a European law basis. So, whilst there is likely to be significant uncertainty as to some legal obligations that apply to commercial parties while the precise terms of a UK exit from the EU are negotiated and any necessary domestic legislation is passed (for example in relation to financial services regulation, prospectus rules and consumer protection, among many other areas), English law as it applies in relation to commercial contracts between parties conducting business internationally will largely be unaffected by that uncertainty and will therefore continue to be certain, stable, predictable, commercially oriented and familiar.

Similarly, there is no reason to think that English law will be any less flexible post-Brexit. And Brexit would not alter the efficiencies achieved by choosing English law in circumstances where the parties wish to litigate their disputes in the English courts or the ability for parties to contract in English and have access to specialist commercial lawyers.

Further, although Rome I and II may no longer be applied by the English courts following Brexit, it is almost inconceivable that they would change their general approach to respecting a choice of English law post-Brexit. The English courts have long respected party autonomy over choice of law including, of course, a choice of English law to govern contractual obligations, and there is no reason why this should change. Further, the widely recognised benefits in terms of legal certainty that have stemmed from the widespread adoption of non-contractual governing law clauses post-Rome II mean that it is highly unlikely that the UK would take a different approach to upholding a choice of English non-contractual governing law following Brexit. And so far as other Member State courts are concerned, the rules in Rome I and II would be applied in essentially the same way to a choice of English law whether the UK is a Member State or not.

Finally, one further consequence of Brexit in the contract sphere would be that the UK would presumably no longer be part of the continuing debate about the introduction of a pan-European sales law (whether in the online sphere or otherwise). However, this controversial debate may of course still be relevant for parties selling into the EU.

What does this mean for you?

In light of the above, parties to commercial contracts should be able to continue to take the same approach to negotiating governing law clauses post-Brexit as they do today. English law will remain a sensible choice for commercial parties in relation to both contractual and non-contractual obligations. Brexit should not have any significant impact either on the enforceability of a choice of English law to govern contractual or non-contractual obligations or on the substantive rights and obligations of parties that arise from such a choice.

That does not mean, however, that parties who continue to choose English law to govern their contracts and related non-contractual obligations should necessarily continue to contract in precisely the same form post-Brexit as they do today. Commercial contracts may refer to European legislation or use European legal concepts as a reference point (for example representations and warranties on matters such as environmental or data protection compliance, employment policy or compliance with economic sanctions). Others may refer to the territory of the European Union, for example when defining the territorial scope of a distribution agreement or non-compete clause. And there may of course be some transactions where parties would want to consider catering expressly for Brexit itself, for example by including material adverse change clauses that will trigger on Brexit (or a vote in favour of Brexit). Parties may therefore need to revisit their standard contractual documentation to check these points and update the drafting where necessary (and possible). Whether any amendment is necessary in practice will depend in part on the language used and in part on the views taken by the parties as to the likely consequences of Brexit and the terms of the post-Brexit legislative regime.

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