BREXIT – IMPLICATIONS FOR LOAN DOCUMENTATION: KEEP CALM AND CARRY ON

Since the Brexit referendum, some parties have been wondering whether any provisions need to change in their English law loan documentation. Although there is considerable uncertainty as to how and when Brexit might occur and therefore how it could impact documentation, in this briefing we consider some of the potential implications and whether any changes to practice should be considered now.

Key issues

- English law remains an appropriate choice of law
- References to the EU in documentation should be checked on a transaction by transaction basis
- It is too early to say whether some clauses such as illegality or increased costs may eventually be triggered

GOVERNING LAW

English law has, historically, been a popular choice for the governing law of international loan documentation. The benefits of English law, such as freedom of contract and emphasising the importance of parties' commercial bargains, will be unaffected by Brexit, if and when it occurs.

As a result of the Rome I Regulation, courts in EU member states will be obliged to continue to give effect to the parties' choice of law, whether that choice is of an EU member state's law or a third country's, and given that English courts upheld the parties' express choice of governing law before Rome I Regulation's predecessor, the Rome Convention, came into force, there is no reason to doubt that they will do so, after Brexit. Of course, that choice might not be English law and parties should continue, as they always have, to choose the law most appropriate for their transaction.

JURISDICTION AND ENFORCEMENT

English courts have long been a popular forum due to their expertise, commerciality and relative speed in resolving financial disputes. None of this should change following Brexit. However, depending on arrangements between the UK and the EU following Brexit and if this is a concern for parties, consideration may need to be given to the enforceability of a judgment from an English court in EU member states (and vice versa). At present, English judgments are enforceable in EU member states under the Brussels I Regulation.

Following Brexit, it may be that this regulation would no longer apply to English judgments but it is entirely possible that arrangements for automatic recognition of judgments may be achieved, for example, in due course the UK could accede to the Hague convention or other arrangements may be agreed. In the worst case, English judgments would be in a similar a position to that of, say, the judgments of New York courts, whose enforceability in EU member states depends on the local law in each of those states.

Therefore, on balance and at present, we think that where parties have chosen English law for their transaction, it would be best to follow usual practice (i.e. opt for the non-exclusive or exclusive jurisdiction of the English courts) although parties should consider this in light of the particular circumstances of a transaction.

SPECIFIC DOCUMENTARY CONSIDERATIONS

LMA – style loan agreements tend to contain references to the "European Union" or similar. They may also contain provisions based on EU legislation. Further, sanctions provisions referring to applicable regimes may have been inserted. In terms of existing documents, we do not see any particular concerns with this on the basis that the courts are likely to take a pragmatic view of contractual interpretation under existing contracts as and when Brexit occurs. For new documents, it may be worth considering the existing references and whether these should be amended or supplemented given the uncertainty as to what future legislation will look like.

One specific example that parties have been considering is the inclusion of an "Article 55" clause. If the UK leaves the EU and does not become a member of the EEA then English law contracts containing in scope liabilities of EU financial institutions may become subject to the Article 55 BRRD requirement. However, it is entirely possible that they will not (for example, through EEA membership or the UK maintaining equivalent legislation). In any event, inclusion of such a clause at this stage is not a legal requirement although parties may wish to consider inclusion depending on the circumstances and particularly in the relatively uncommon situation where a financial institution is a borrower and wishes to classify its borrowing liabilities as MREL/TLAC eligible liabilities.

POTENTIAL IMPLICATIONS FOR LENDERS

One of the biggest uncertainties for lenders following the referendum vote is the regulatory landscape. It is too early to tell what will happen, but this may have implications for lenders under loan documentation. For example, loss of passporting rights may mean that lenders need to look to the illegality provisions if they are unable to fund or maintain participation in certain loans. This could occur where lenders do not have the requisite licences in jurisdictions where these are required for lending. Licence requirements are governed by domestic rather than EU legislation and therefore are not uniform in application (some states have no such requirements – the UK at present regulates deposit taking but not corporate lending). To the extent that they do not already do so, lenders may want to consider inserting provisions in loan agreements allowing them to designate affiliates who meet any relevant regulatory requirements to make loans (without transferring commitment) to preserve a degree of flexibility.

In addition, there may be scenarios where lenders incur increased costs (as a result of changes in the regulatory landscape) and the ability to recoup these under loan documentation may be considered. Again, it is too early to tell whether there will be any additional costs as a result of Brexit and we think that at this stage it is unlikely that any changes will be made to the increased costs clause in loan agreements.

WITHHOLDING TAX

Withholding tax is obviously an important structuring issue for transactions. Unless a borrower's jurisdiction imposes no withholding tax, lenders usually

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ensure that they qualify for exemptions from withholding tax. These exemptions are in practice always a function of domestic law or double tax treaties, and are therefore generally unaffected by Brexit.

There are, however, exceptions where a domestic law exemption cross-refers to the EU. The principal example is Italy, where the principal withholding tax exemption for Italian borrowers under loan agreements applies to EU resident banks. However, although under existing loan agreements this would most likely become a borrower risk on Brexit, parties will be keen to ensure there is as little cash leakage as possible and looking at gross-up baskets may be a potential compromise.

MATERIAL ADVERSE EFFECT

Given the turn of events in the UK since the referendum vote, parties may be wondering about the likelihood of these events causing a "Material Adverse Effect". In short, this depends on the actual terms of the documents and the circumstances or events concerned and will need to be addressed on a case by case basis. An obligor/business Material Adverse Effect is unlikely to have been caused by the actual vote result itself but it is not yet clear what will happen as a result of any actual Brexit.

CONCLUSION

Although there are a number of provisions of loan agreements that should be borne in mind and considered on a transaction by transaction basis, there is no need to consider wholesale changes to loan documentation at this stage. Keep calm and carry on!

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CONTACTS

Mark Campbell
Partner

T +44 20 7006 2015
E mark.campbell
@cliffordchance.com

Charles Cochrane
Partner

T +44 20 7006 2196
E charles.cochrane
@cliffordchance.com

James Butters
Partner

T +44 20 7006 2296
E james.butters
@cliffordchance.com

Emma Folds
Partner

T +44 20 7006 2231
E emma.folds
@cliffordchance.com

Matthew Dunn
Partner

T +44 20 7006 4160
E matthew.dunn
@cliffordchance.com

Katie Hoyle
Professional Support
Lawyer

T +44 20 7006 4528
E katie.hoyle
@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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