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No-deal Brexit: brace for impact

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The UK is currently set to leave the EU on 29 March 2019. This "Brexit" will have far-reaching consequences for companies in a wide range of areas. The exact form these consequences will take depends on the type of Brexit that emerges. This is still uncertain.

On Tuesday, 15 January 2019, the House of Commons is scheduled to vote on the Brexit deal that the UK government and the EU agreed to in December 2018. The deal consists of two documents: a legally binding withdrawal agreement that sets out the terms of the UK's exit from the EU on 29 March 2019, including a transition period, and a non-legally binding political statement (the latter of which gives a rough blueprint for a future, long-term relationship). The general consensus among political commentators is that the Brexit deal with the EU is unlikely to pass. If it does not go through, a number of potential scenarios arise, such as: no deal, renegotiation and extension of the 29 March deadline, a general election, a second referendum, revocation of art. 50, or any given combination. At this stage, anything is possible.

What is certain, however, is that the far from theoretical "no-deal" scenario (where the UK crashes out of the EU on 29 March 2019 without a transition period and without any blueprint for a future relationship), will have a huge impact, affecting many areas including the trade in goods, citizens' rights, financial services, tax, competition law, export controls and trade sanctions, dispute resolution, restructuring and cross-border insolvencies, IP, data protection, and energy/environment. We refer to our earlier Brexit: Deal or No Deal? publication for more details on how several scenarios would impact each area. For this crystal ball gazing issue, we focus on a no-deal Brexit.

Trade

If no deal is reached, the UK will on 30 March 2018 become a third country from the EU's perspective, falling outside the EU's internal market and customs union and trading with the EU under WTO rules. The UK will also no longer be able to trade with non-EU countries on the basis of EU trade agreements, although the UK aims to negotiate a roll-over of the EU trade arrangements with third countries. As the UK is officially not allowed to negotiate any trade agreements until the EU gives its consent, it is unlikely that these will be in place before 30 March 2019.

Trade between the UK and the EU will become subject to tariffs, quotas, customs duties, import/export declarations, export licences for certain regulated goods, different VAT procedures, and border inspections. Both the UK and the European Commission have been putting in place unilateral damage limitation plans, but these do not cover all areas and do not counter all expected problems. To minimise disruption, the UK government has committed to maintaining the EU's Common Customs Tariff as much as possible and to temporarily allow regulated goods that have been cleared in the EU. The European Commission has called on EU member states to use existing options in the Union Customs Code to facilitate trade. In any case, the reintroduction of border controls and the additional import/export paperwork are likely to cause significant delays at border crossings such as Dover, and disrupt JIT (*just-in-time*) delivery and supply chains more generally. For example, the Port of Dover expects 17-mile queues, and some research commissioned by the UK government estimates that a 70-second vehicle check at Dover would lead to six-day long queues. Delays can also be expected at ports on the EU side of the border.

If they have not done so already, companies should assess the impact of no deal on their supply chains and trading operations, and get on top of the required paperwork (either in-house or via third parties such as customs brokers, freight forwarders or logistics providers).

Exchange rate exposure

Since the referendum in 2016, pound sterling has lost significant ground to the euro and dollar. The continuing uncertainty about the occurrence and effects of no deal will likely lead to further fluctuations, stressing the need for companies to reassess their foreign exchange risk management.

Employees

Free movement of people will end if the UK leaves the EU in a no-deal scenario. EU employees in the UK and UK employees in the EU will no longer be protected by this overarching principle, but will become dependent on, and will have to comply with, separate immigration rules in each country. The UK has indicated that it intends to respect existing EU citizens' rights, unilaterally implementing the provisions of the withdrawal agreement. A number of EU countries have already communicated their intentions regarding transitional immigration rules for UK citizens in a no-deal scenario. The Dutch government, for example, has announced that UK citizens who have the right to live in the Netherlands on 29 March 2019 will, in the case of a no-deal Brexit, be allowed to continue living, working and studying there during a 15-month transition period, during which they can apply for a residence permit.

To the extent not already done so, companies should assess the effects of potential immigration constraints on their workforce and on that of important suppliers and customers.

Contracts

A no-deal Brexit could significantly impact the enforceability, performance and viability of contracts.

In terms of the enforceability of contracts, UK judgments could become less effective in the EU and vice versa because EU regulations on conflict of laws, jurisdiction and enforcement of judgments will no longer apply. In respect of jurisdiction, the EU and the UK will have to fall back on their general principles of private international law, unless the UK accedes to the Lugano convention in its own right, which it has indicated it aims to do. Concerning choice of law, the UK intends to incorporate the Rome I and II regulations into domestic law. This would mean that clauses specifying the law governing contractual obligations will continue to be recognised by UK courts. Since the choice of law of non-EU jurisdictions is already recognised within the EU, the choice of UK law will likewise be recognised in the EU.

A no-deal Brexit may also affect contract performance, due to certain licence requirements, regulations or tariffs becoming applicable and supply chains being disrupted. The changes may shift contract risks between contracting parties and result in additional costs, breaches of contract, or lead to contracts becoming non-viable. The EU Commission has advised businesses to prepare to renegotiate commercial terms to take into account the changed trading relationship in the event of a no-deal Brexit.

The more general economic effects of no deal can also have consequences for counterparty risk and trigger contractual provisions. In some cases, a no-deal Brexit as an economic event could possibly qualify as a materially adverse effect (MAC) or as an unforeseen event outside the parties' control (force majeure) which may, depending on the language and interpretation of MAC and force majeure provisions, open up grounds for suspension, termination or renegotiation.

To the extent not already done so, companies will need to evaluate the potential impact of no deal on the enforceability, performance and viability of their contracts and assess the consequences of the related economic effects for counterparty risk and MAC/force majeure triggers.

Brace for impact

We now seem to be approaching the endgame, and a no-deal Brexit has become a real possibility. We recommend that companies ramp up their contingency planning efforts for a no-deal scenario if they have not already done so. Much uncertainty is expected in the coming weeks, with no deal remaining a potential outcome.

This high-level overview highlights certain pressing and general effects that a no-deal Brexit may have. It is important to closely monitor any further measures taken by the UK, the European Commission and EU member states to mitigate no-deal consequences. To find out more, see our Brexit: Deal or No Deal? publication, or get in touch with our dedicated team at brexit@debrauw.com or your De Brauw contact.