Banking
London

BAKER & McKENZIE

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For More Information
Rowena Paskell
+44 20 7919 1278
rowena.paskell@bakermckenzie.com

If you have any questions please speak to your usual Baker & McKenzie contact, or:

Nick Tostivin
Partner, Banking
London Office
T: +44 20 7919 1767
E: nick.tostivin@bakermckenzie.com

Bernard Sharp
Partner, Banking
London Office
T: +44 20 7919 1162
E: bernard.sharp@bakermckenzie.com

Brexit - Implications for English Law Governed LMA Facility Agreements

Introduction

Britain's referendum vote to exit the European Union on Thursday 23 June has led to a degree of instability in the financing markets. It remains to be seen how long-term these effects will be.

In this note, we look at potential consequences of Brexit for LMA (Loan Market Association) based facilities agreements, both those already existing and those for new (or amended) transactions. While we are primarily concerned with English law agreements, many of these comments will apply equally to agreements with different governing laws that have some connection to the United Kingdom.

We expect that, in the near future, the LMA will come out with its own recommendations as to how Facilities Agreements should change to take into account the effects of Brexit. However, it is fair to say that the implications of Brexit on the actual documentation are likely to be quite limited.

As well as the documentation issues, of course, the question of legal authorisation to carry on banking activities may arise in some cases. This is considered further below.

Stages of Brexit

There will be three stages of Brexit:

1. **Current stage** - Decision taken in principle, but legally nothing has changed. However, since a decision has been taken in principle, the consequences need to be taken into account in preparing documents.

2. **Article 50 notification** - This is the formal step by the UK to give notice of intention to leave the EU. This triggers a 2 year period for negotiations. During that period, an agreement on future relations can be reached by a "qualified majority" of EU states (other than the UK) with the UK. Unless all member states agree with the UK to extend the period, at the end of the two years, the UK ceases to be a member of the EU.

Ian Jack
Partner, Banking
London Office
T: +44 20 7919 1700
E: ian.jack@bakermckenzie.com

Calvin Walker
Partner, Banking
London Office
T: +44 20 7919 1899
E: calvin.walker@bakermckenzie.com

Paul Hibbert
Partner, Banking
London Office
T: +44 20 7919 1676
E: paul.hibbert@bakermckenzie.com

Sebastien Marcelin-Rice
Partner, Banking
London Office
T: +44 20 7919 1413
E: sebastien.marcelin-rice
@bakermckenzie.com

3. **Brexit** - It is safe to assume that within the period between the Article 50 notification and the expiry of the notice period, the UK Parliament will adopt legislation, dealing with what happens to EU law which currently applies in the UK, as a result of Brexit. Some legislation will perhaps be altered immediately, but given the amount of EU legislation already incorporated into domestic law, we think it is almost certain that Parliament will provide that EU legislation already incorporated into domestic law continues to apply until amended. Given the politically uncontroversial nature of legislation relating to financing documents, it is likely that EU law already incorporated into English law (e.g. the financial assistance regime, and the Financial Collateral Regulations) will continue to apply.

4. **Further negotiations:** To the extent that some matters have not been agreed between the UK and the EU by the time of Brexit, there are likely to be further negotiations following Brexit.

Clauses to be monitored

Whatever model is ultimately chosen to govern EU-UK relations post-Brexit, consideration nevertheless will need to be given to the following clauses in English law governed LMA loan documents (some of which may require certain amendments):

(a) References to EU legislation

Financing documents often contain references to EU legislation (e.g. an undertaking to comply with the Market Abuse Regulation). In some cases, the EU legislation will continue to be relevant directly (either because there is an EU Obligor, or because activities are taking place in the EU). In other cases, the EU legislation may be superseded in due course by UK legislation (in relation to its application in the UK). The interpretation provisions of the LMA documents will need to be updated (the changes are fairly simple) to take this into account, but we are confident that, for existing agreements, the English courts will be quite capable of taking a sensible approach to construction of the documents, so that the right legislation applies.

(b) English law as governing law

There will be no change in the way that EU countries give effect to the choice of English law to govern a contract.

In terms of English law governed documents, since Rome II was adopted, it has been quite common also to provide for English law to govern non-contractual relationships. As noted above, we think it is likely that Parliament will provide for such laws to continue in force. Even if this is not the case in relation to Rome II, the impact on financing documents will not be significant, since it is the contractual relationships that are key in financing.

Lynn Rosell Rowley
Partner, Banking
London Office
T: +44 20 7919 1549
E: lynn.rosellrowley
@bakermckenzie.com

(c) Determination of Jurisdiction

As well as the recognition of English law, it is important that English judgments should continue to be recognised across the EU.

The reciprocal recognition of judgments across the EU and determination as to which national court retains jurisdiction over a particular matter is governed by the recast Brussels Regulation (the Recast Regulation).

We think it is likely that the UK will, prior to Brexit taking effect, seek to accede to the Lugano Convention, which will ensure continued mutual recognition of judgments. This should hopefully be politically uncontroversial, and we think this is likely. There are differences between this and intra-EU law - for example, parallel proceedings in different member states are possible.

Alternatively, the UK could, following Brexit, accede to the Hague Convention of 30 June 2005 on Choice of Court Agreements (to which we are already a party as a member of the EU, but to which it would need to accede to again following Brexit from outside the EU).

Even absent such steps, English judgments may well be enforceable under domestic law of other countries. However, in this case, it will be important that facilities agreements include, for non-English obligors, an agent for service of process provision (which is standard in any event).

(d) Compliance with laws covenants

We do not foresee any major issues arising here.

(e) Events of Default

The act of withdrawal by the UK from the EU should not in itself constitute an Event of Default under LMA style loan agreements, although there may be issues of illegality and material adverse change (covered below).

(f) Material Adverse Effect

Neither a leave vote nor a Brexit will in themselves constitute a Material Adverse Effect under most definitions of that term. It is possible that the indirect effects of the leave vote and Brexit could impact upon the financial standing of the company (e.g. because of a downturn in the economy, or by preventing free access to markets) which may or may not have a material adverse effect upon a company, depending on all circumstances at the relevant time. However, this is a question of fact, like any other potential Material Adverse Effect.

(g) Sanctions

Sanctions wording in loan agreements is typically provided by the lenders (or their lawyers) rather than the LMA, and include requirement to comply with EU, US sanctions and HM Treasury (that is, UK) sanctions. We note that it was already general practice to refer to HM Treasury Sanctions, even before the EU referendum was proposed. Therefore, no changes will be required here.

(h) Illegality Clause

Lenders, particularly those with ongoing lending obligations, will need to ensure that making loans does not violate local law in the place where the loans are made - normally the place where the Borrowers are located. In some cases, local authorisation or passporting rights may be required. Passporting rights may cease to apply for UK authorised financial institutions on Brexit, depending on whether the UK chooses to become a member of the EEA, or some other arrangements are reached. If passporting ceases to be available to UK institutions, the first step will be for those institutions to consider changing their lending office, or transferring the loan commitment to an EU authorised affiliate, so as to ensure that there is no illegality. We anticipate that most UK financial institutions will be setting up (or transferring relevant loans) to EU authorised financial institutions should this become necessary. Only in the unlikely event that this is not done, would the illegality provision need to be called upon.

(i) Choice of Auditors

EU legislation seeks to limit the ability of Lenders in the EU to influence the choice of auditors by Borrowers (EU Directive No 2014/56 (implemented on 17 June 2016) and EU Regulation No 537/2014 (in effect on 17 June 2017). The UK Competition and Markets Authority has supported similar objectives. Current drafting refrains from forcing auditors on EU companies because of this, and we think that the same considerations will continue to apply to UK companies going forward.

(j) VAT

A minor change will be needed to the definition of VAT, to ensure that UK legislation will be included, even if it changes before Brexit.

(k) COMI

The representation clause 24.29 (Centre of Main Interests and Establishments) makes reference to EU Regulation No 1346/2000. Until relevant legislation ceases to be effective the present wording can be retained.

(l) Definitions of Permitted Acquisition and Permitted Joint Venture

Where the definition currently refers to an investment in companies or businesses located in the EU or EEA (along perhaps with other countries), a reference to the UK should be added. No change is needed where there the UK, or the OECD, is already listed.

(m) Bail In

Following Brexit there will be a drafting requirement to include the Article 55 Requirement. Under Article 55 any contract (including any loan agreement) which is governed by the law of a non-EEA country (e.g. the UK post Brexit) which contains liabilities of a defined in-scope entity (e.g. a structurally important financial institution (or "SIFI" for short) in an EEA member state) must include a provision whereby the counterparty (i.e. the lender) acknowledges that such liability (i.e. the loan) may be subject to bail-in by the applicable regulator. As a matter of practice, we would recommend already including the relevant language in new English law governed agreements which may have EEA financial institutions as parties, to avoid the need to do this later.

(n) Security

In terms of security there is unlikely to be a significant effect in relation to assets located in the UK over which English law security is taken. In relation to the financial collateral regime these have been incorporated into UK domestic law and, as noted above, it seems safe to assume that this will continue to apply post-Brexit. The position in relation to EU-registered intellectual property will need to be clarified.

(o) Agency and Security Agency roles

It is possible that in some jurisdictions, there may be issues with UK institutions acting out of London and without local authorisation performing agency and (to a lesser extent) security agency roles in certain other EU countries, if the UK is not given passporting rights (e.g. by being a member of the EEA). These will need to be addressed on an institution-by-institution and country-by-country basis, as in some countries the answers may depend on factors such as the regularity with which business activities are carried on in a particular country and where accounts are held. In addition, practical issues may arise if Euro clearing is no longer possible in London.