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REAL ESTATE FINANCE news and views

The Changes Continue

February 25, 2021 | Issue No. 21

Brexit Update – Changes to Loan Documentation

Following the expiry of the transition period which ended on 31 December 2020 at 11pm GMT (known as "IP Completion Day"), the UK is no longer a member of the EU. During the transition period (between 31 January 2020 when the UK has formally withdrawn from the European Union) to the IP Completion Day, the UK has implemented certain key pieces of legislation to ensure that following its exit from the European Union, the majority of the EU laws which apply in financing transactions in their current form continue to apply, albeit with some changes to the scope and application. In this article, we discuss some of the key changes from a documentary perspective for financing transactions.

Choice of law

The use of English law for finance documentation is largely unaffected post-UK's withdrawal from the European Union. English law remains the dominant and preferred choice of law (subject to local law requirements, especially with respect to taking security) in the market due to the English law's commercial orientation and its transparency. English contract law is largely unaffected by EU law and, therefore, the UK's withdrawal from the European Union does not result in any material changes.

The choice of law will continue to be recognised by the courts of EU member states. Prior to Brexit, Rome I Regulation provides that all EU member states give effect to the parties' choice of law. This includes the law of an EU member or non-EU member (*e.g.*, New York law). Whilst the UK is now no longer a member of the EU and therefore not a member to Rome I Regulation, the UK has legislated to incorporate Rome I and Rome II into English law, under the ***Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019***. This means that English courts will give effect to the parties' choice of law, whether this is English law, EU law or law of a non-EU member state. The EU courts will continue to apply Rome I and Rome II, and therefore give effect to the choice of any law (including English law as a law of a non-EU member state). Therefore, the choice of law and recognition of choice of law is largely unaffected by Brexit.

Choice of jurisdiction

It has been common practice in loan documentation for lenders to nominate the use of "one-sided exclusive jurisdiction" clauses. These clauses provide that the borrower must take proceedings in the courts of England only, whereas the lenders may take proceedings in any court of competent jurisdiction. This has been the favoured approach for lenders for many reasons. It enhances their flexibility in choice of forum yet provides certainty that the borrower can only take the matters to English courts to adjudicate on matters relating to English law and, therefore, exposure is only limited to the one jurisdiction.

This one-sided exclusive jurisdiction clause was possible by virtue of the Brussels I Regulation, which provides that any one court in the EU has jurisdiction and that such court's judgment is enforceable across the EU. Post-Brexit, however, the UK is no longer part of this convention and so the reciprocity no longer applies. This means that, unless the UK signs up to any other convention with the EU**[1]** or implements other similar legislation, enforcement of foreign judgments fall back to the 2005 Hague Convention, to which the UK is a party.

Under the Hague Convention, all EU member states will be required to respect the parties' choice of court and enforce English judgments on a contract containing a "two-way exclusive jurisdiction clause." Unlike the one-way exclusive jurisdiction clause, the two-way exclusive jurisdiction clause is where both parties nominate the same court to which proceedings may be initiated.

EU member state courts will generally respect two-way exclusive English jurisdiction clauses and enforce the resulting judgments under the Hague Convention, and the English courts will likewise do the same with respect to the two-way exclusive jurisdiction clause of an EU member state court.

The question, then, for lenders is to consider whether, under the current circumstances, a two-way exclusive jurisdiction clause should be used in place of a one-sided exclusive jurisdiction clause given the recognition of exclusive jurisdiction provisions under the Hague Convention. On the one hand, adopting the two-way exclusive jurisdiction clause will assure the judgment to be recognised and enforced in any EU member state. On the other hand, if the judgment doesn't qualify for the Hague Convention, enforcement will depend on the national rules of the relevant EU member state, which may or may not be as straightforward. Therefore, appropriate local law advice would be required to form an assessment of the potential enforceability or otherwise of a Non-Hague Judgment pursuant to the national rules of any EU member state.

Application of European law

Pursuant to the European Union (Withdrawal) Act 2018, as amended by the European Union (Withdrawal Agreement) Act 2020 (the "EUWAA")) (the "EUWA"), existing EU law which applied in the UK before the expiry of the transition period will continue to apply as retained EU law.

In particular, section 2 preserves UK law that implements EU law and section 3 onshores directly applicable EU law into UK law. Furthermore, section 8 of the EUWA provides that retained EU law can be amended by statutory instrument going forward.

It follows that legislative references will have to change to the relevant statutory instrument as and when they are implemented. The Loan Market Association ("LMA") is in the process of updating these references in their published finance documentation.

Article 55

The UK will become a third country for the purposes of Article 55 of the Bank Recovery and Resolution Directive ("BRRD"). What this means is a bail-in clause will be required in the relevant English law-governed document. Article 55 of the BRRD is also a retained EU law and, therefore, a bail-in provision of the UK bail-in legislation will be required in any EEA law-governed contract.

Inclusion of the bail-in clause has been recommended by LMA prior to the IP Completion Day, and market participants have been including the bail-in clause in English law contracts for some time. The practice will remain the same post-IP Completion Day.

[1] There are currently discussions around the UK signing up to the 2007 Lugano Convention (which applies between EU member states and Iceland, Norway and Switzerland), in which case jurisdiction and enforcement as between the countries to this convention remains largely the same compared to the pre-Brexit position.