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Brexit: what might change
Corporate/M&A

Introduction
On 23 June 2016 the UK population voted for the UK's exit from the European Union (EU). The applicable exit procedure and certain possible legal consequences of Brexit for Corporate/M&A will be discussed below.

In the short term, we do not identify material changes for the legal practice. The European law and regulations will remain in force until the negotiations between the EU and the UK have been completed and the withdrawal procedure has come to an end. To which extent European law and regulations will also apply following the UK's exit from the EU, will largely depend on the outcome of the negotiations. One of the fundamentals of the EU is the internal market, allowing for the free movement of goods, services, workers and capital (Internal Market). In this context we note that in January 2017, Prime Minister May announced that the UK will opt for a "hard Brexit", meaning that the UK will no longer maintain membership of the Internal Market, nor accede to any associated status. Instead, the UK will seek a free-trade deal with the EU outside the Internal Market.

Brexit – background
Since 2007 (Treaty of Lisbon), the EU Treaty offers a Member State an explicit legal basis to leave the EU (Article 50 TEU). Pursuant to Article 50(2) TEU, the UK can start the exit procedure by giving notice to the European Council. The exit agreement will be concluded on behalf of the EU by the Council[1], acting upon a qualified majority[2] and after having obtained the consent of the European Parliament. The agreement must set out the arrangements for the UK's exit and take account of the framework for the UK's future relationship with the EU. The UK cannot participate in the relevant discussions or decisions of the European Council or Council.

The EU Treaties cease to apply to the UK from the date of entry into force of the exit agreement or, if there is no such agreement, 2 years after the date of notice under Article 50 TEU, unless the European Council, in agreement with the UK, unanimously decides to extend this period. The exit procedure has never been called for and the way forward is full of uncertainties. Apart from Article 50 TEU, no further provisions or guidelines apply.

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1 The Council consists of a representative of each Member State at ministerial level, who may bind the government of the Member State in question and cast its vote (Article 16 TEU).

2 The qualified majority shall be defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States (Article 238(3)(b) TFEU).

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General framework: EU-derived standards and legislation. Potential impact of Brexit.

Over the years, harmonisation initiatives have been taken in several areas of company law.

Some Directives dictate a minimum legal framework in specific areas, for example, the incorporation of companies and publicity requirements, the Prokura principle, capital requirements in limited liability companies, creditors' protection, single-member private limited-liability companies, branch disclosure, (cross-border) restructuring, intragroup taxation, accounting and consolidation requirements, financial reporting and audit standards, protection of shareholders' rights in listed companies, public takeovers, etc. These are all regulated by the Directives.

In addition, EU Regulations stipulate the forms under which European companies are organised: the European Company (SE), the European Economic Interest Grouping (EEIG) and the European Cooperative Company (SCE). Another Regulation deals with the application of international accounting standards in listed companies.

Certain types of transactions or corporate "events" are based on EU case law and established practice. These are mainly cross-border conversions and cross-border relocations.

Some matters are covered by EU "Recommendations", but have not been the subject of a legislative initiative, such as corporate governance in listed companies, remuneration policies, transparency and corporate governance reporting.

All the above-mentioned standards and practices are generally applicable to companies throughout the EU. The assessment of the actual impact of Brexit in the area of corporate law depends, however, on various factors:

(i) the way in which each matter is implemented or applied in the UK (direct effect of EU Regulations vs (maximum/minimum) transposition of Directives into national laws, procedures based on case law, etc.);
(ii) whether the aim of such standards is to regulate cross-border transactions or merely domestic matters; and
(iii) the actual Brexit scenario that will be negotiated between the EU and the UK, the one having least impact being the UK joining the EEA, in which case most matters relating to company law would remain unchanged.

Depending on the Brexit scenario that is adopted, the UK may nevertheless be able to amend thoroughly or abolish entirely EU-derived corporate law. In such a scenario, eagerness actually to do so will be tempered by (i) the way in which European standards and regulations are initially (and currently) received/implemented/opposed by the UK, and (ii) the need for a balanced legal framework enabling the UK to be an attractive and trustworthy jurisdiction for third countries, without jeopardising its position towards the EU and its Member States.

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Areas likely to be affected by Brexit

General company law

Matters with an EU dimension

(a) European corporate entities: SE, SCE and EEIG
Since these company forms are based on EU Regulations, SEs, SCEs or EEIGs with registered offices in the UK may lose their legal basis in the UK and may have to be converted into a type of UK company. Likewise, UK companies may no longer be able to change into a European corporate entity. European entities involving a UK company may no longer be possible.

(b) Cross-border mergers
Cross-border mergers – based on the EU Merger Directive – between UK companies and companies in EU Member States may become impossible, depending on the national legislation in each relevant country. The latter will need to provide for bilateral/mutual mechanisms allowing cross-border mergers with non-EU companies, otherwise the transaction would not be possible. More precisely, under current Belgian and Luxembourg legislation (but not under Dutch legislation), a cross-border merger with a non-EU country is possible, provided that it is also permitted by the legislation of that non-EU country.

(c) Cross-border conversion and relocation
The cross-border conversion based on ECJ case law of a company of an EU Member State into a UK entity, and vice versa, may become impossible if the relevant jurisdictions do not provide for bilateral/mutual mechanisms for cross-border conversions.

Cross-border relocation of the effective place of management between certain EU Member States and the UK (adhering to the “incorporation theory”) may remain possible to the extent it is permitted on the basis of compatible provisions of international private law in each relevant jurisdiction, as is already the case in Luxembourg and Belgium. However, such mechanisms may no longer benefit from, or be based on the EU principles of the freedom of establishment and freedom of movement.

This may have an impact, for example, on the use of a UK “Limited” company throughout the EU if it is used merely because of the flexibility of its legal framework, but operates in another EU Member State.

(d) Branches of UK companies
A UK-based company with a branch located in an EU Member State may become subject to the (more burdensome) disclosure requirements applicable to branches of non-EU companies. Conversely, it may become more difficult for an EU company to open a branch in the UK.

Matters with a domestic dimension
It is uncertain whether EU-derived UK legislation on matters with a mere “national” dimension will remain in force following Brexit. Matters without any direct cross-border aspect, such as the Prokura principle, requirements for limited-liability companies, third-party protection, capital-protection rules, domestic (de)mergers, standards relating to accounting and reporting, publicity, etc., which have been transposed into UK law on the basis of EU Directives or Recommendations may, however, be amended, removed or made more flexible by the UK government.

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Amending these standards may involve risk and a loss of "credibility" for the UK, although on the other hand, the UK may as well take advantage of the flexibility it has regained.

Public companies

Capital markets – prospectus – passporting

The potentially huge impact of Brexit in this area (including listing/prospectus, passporting, etc.) is discussed in more detail in our Banking and Finance note.

Cross-border exercise and protection of shareholders' rights

The minimum rights for (foreign) shareholders in listed companies, including prompt access to relevant information on general meetings and proxy voting and correspondence voting that has been made easier, may no longer apply in an EU-UK context.

Corporate governance – remunerations

The EU Recommendations on corporate governance, remuneration policies and corporate-governance reporting, for example, although non-binding, may cease to be guiding principles in the UK.

Public reporting obligations

Companies should consider whether the potential impact of Brexit on their business and financial situation is to be reported when publishing periodic information, or even by means of a separate statement.

M&A

General M&A climate

Cautious "wait and see" approach: current market uncertainty and currency volatility are obviously causing a slowdown in transactional activity, which will continue until new business opportunities are found in the aftermath of Brexit.

Although the potential impact of Brexit on the legal framework itself of (private) M&A transactions does not seem insurmountable, Brexit does have an immediate impact from a commercial and financial point of view, and thus affects M&A activity in general. The devaluation of the pound and unknown potential future costs prevent parties from making accurate valuations and EBITDA projections, which may cause them to call off negotiations concerning transactions or to invoke an MAC clause (cf. below).

When performing due diligence, M&A practitioners need to be well aware of the potential impact of Brexit on all the different areas of law and must consider the short and long-term consequences of the different Brexit scenarios for the transaction.[3]

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3 A few examples of this are: data protection may no longer apply to UK companies, IP rights may be affected, EU funding or grants may be cancelled, UK state aid may become possible in certain situations, product standards and production processes may be amended in the UK, free movement of labour may be abolished, (in)direct tax benefits may be lost, the regulatory framework may be amended, etc.

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It is certainly a challenge to provide for sufficient "safety nets" in the documentation on transactions in order to cover such financial, commercial and operational uncertainty.

Public M&A: Takeovers Directive

The EU minimum standards for takeover bids (or changes in control) involving the securities of EU companies, which aim to protect minority shareholders, employees and other interested parties, may become irrelevant. However, the UK Takeover Code, although giving effect to the Directive, was initially used as a basis for the Directive. It is thus possible that the UK Takeover Code remains in force after Brexit.

MAC clauses

Depending on the definitions used in the documentation on transactions, Brexit may qualify as an event triggering the application of MAC clauses or force-majeure clauses if the target's future (legal) context is too uncertain as a result of Brexit.

Other noteworthy issues

The territorial scope and time restriction for non-compete clauses (as generally accepted under EU law) may no longer apply to UK parties. Other contractual clauses containing territorial restrictions relating to the EU would also have to be amended.

The "transfer of undertakings" principle for the automatic transfer of employees in asset transactions may no longer be applicable in the case of a UK target.

Choice of law and jurisdiction: although private M&A transactions in Europe are often based on UK law and inspired by UK market practices, it may no longer be sensible, in transactions with no UK connection, to submit them to UK law and to opt for the jurisdiction of the UK courts. Indeed, UK courts may no longer be bound by the case law of the Court of Justice. In addition, mutual enforcement and recognition of judicial decisions between the UK and EU may become uncertain.

What next?

Once the UK invokes Article 50 TEU, the UK and the EU will negotiate the terms of Brexit. It will be a highly political process and the outcome is as yet unclear. Therefore it is of the utmost importance to monitor the developments and the potential impact on your company's position closely. We will keep you informed about further developments.

Please contact your trusted adviser at Loyens & Loeff or send an e-mail to Brexit@loyensloeff.com if you have any queries.

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