15 October 2024

PRESS SUMMARY

Standard Chartered PLC v (1) Guaranty Nominees Limited (2) D E Shaw Galvanic Portfolios LLC (3) Olifant Fund Ltd (4) FFI Fund Ltd (5) FYI Ltd [2024] EWHC 2605 (Comm)

Financial List Divisional Court: Sir Julian Flaux (Chancellor of the High Court), Mr Justice Foxton

BACKGROUND

This case concerns the abolition of the London Interbank Offered Rate ("**LIBOR**") and its effect on certain financial instruments referring to that rate. The case was determined under the Financial Markets Test Case Scheme established by CPR Practice Direction 63AA for cases which raise issues of general importance to the financial markets. The case has been heard, and judgment has been given, on an expedited basis.

In 2006, Standard Chartered PLC ("**SC**") issued certain preference shares (the "**Preference Shares**"). The sole registered shareholder of the Preference Shares is the First Defendant (**"GNL"**) as nominee for JPMorgan Chase Bank NA which issued American Depository Shares ("**ADSs**"), holding the economic value of the Preference Shares. The Second to Fifth Defendants (the "**Funds**") hold an undisclosed number of ADSs but are said to represent c. 10% of holders.

The terms of the Preference Shares and ADSs provide, amongst other things, that they are perpetual, being redeemable only at SC's option (in whole or in part) every 10 years, and pay dividends semi-annually at a fixed rate for the first 10-years and at a floating rate of "*1.51% plus Three Month LIBOR*" (the "**dividend rate**") thereafter.

For well publicised reasons, regulators and market stakeholders around the world have taken steps to establish a replacement for LIBOR, which it was clear would cease to operate. In the United States, the regulatory authorities and market bodies created a replacement reference rate, known as the Secured Overnight Funds Rate ("**SOFR**").

For a period, the Financial Conduct Authority of the United Kingdom required the publication of synthetic USD LIBOR, which ceased at the end of September 2024. The effect of that cessation was that it would no longer be possible for SC to calculate the applicable dividend rate using a USD LIBOR rate. SC sought to amend the dividend rate to three month compound SOFR with a Spread Adjustment through a shareholders' special resolution. However, it failed to achieve the 75% majority required.

SC commenced proceedings seeking a declaration concerning the applicable dividend rate to be used for dividend payments on or after 30 October 2024. SC's primary case was that the phrase "*three month US dollar LIBOR in effect*" (as used in the definition of "*Three Month LIBOR*" in the terms governing the Preference Shares) should be interpreted as a rate that effectively replicates or replaces three month USD LIBOR. SC's alternative case was that the Preference Shares' terms contain an implied term that allows SC to use a reasonable alternative rate to three month USD LIBOR. In either case, SC submitted that the rate should be based on

SOFR with a Spread Adjustment which had been recommended by the International Swap Dealers' Association and endorsed by a number of regulators and market participants (together the "**Proposed Rate**"). The Funds disagreed with SC's case and argued that the Preference Shares' terms contain an implied term that required SC to redeem the Preference Shares in the event that LIBOR was discontinued.

JUDGMENT

The Court concluded that the contract contains an implied term that the reasonable alternative to three month USD LIBOR is to be used where the definition of Three Month LIBOR is no longer operative. At present, that reasonable alternative rate is the Proposed Rate.

REASONS FOR JUDGMENT

The terms governing the Preference Shares are subject to English law rules of contractual interpretation **[8(vii)]**. These rules require a contract to be interpreted objectively, and as a whole, by asking what a reasonable person, with all the background knowledge which would reasonably have been available to the parties when they entered the contract, would have understood the language of the contract to mean **[41]**. See *Sara & Hossein Asset Holdings Ltd v Blacks Outdoor Retail Ltd* [2023] UKSC 2, [2023] 1 WLR 575 at [29].

So far as the argument by reference to express terms is concerned, SC's interpretation is not the natural reading of the relevant provision. The more natural reading of "*in effect*" in its context is that it refers to the LIBOR rate operating at a specific point in time rather than being a synonym for "*effectively*"; this is supported by the wider structure of the definition of Three Month LIBOR, as well as the way in which the phrase is used by the parties elsewhere in the Offering Circular [**55**].

However, English law adopts a flexible interpretation of long-term contracts in a manner which is consistent with the parties' common intention for the contract to survive and continue to operate even as circumstances change **[51]-[52]**. Ensuring that long-term contracts survive (non-frustrating) unforeseen changes in circumstances is an important policy of English contract law. This approach to interpretation applies equally to ascertaining implied terms **[63]**. A term may be implied into a contract where it is either necessary to give business efficacy to the contract or so obvious that it goes without saying; the term must be capable of clear expression, not inconsistent with the contract's express terms, and be reasonable and equitable **[42]**. See *Marks & Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742.

In this case, the Preference Shares are long-term (potentially perpetual) instruments, and their terms should be interpreted flexibly [**63**]. Furthermore, the wider structure of the definition of Three Month LIBOR supports the implication of a term into the contract. First, the reference to LIBOR was a mechanism for measuring the costs of unsecured bank borrowing over time. LIBOR was a means to that end and not the end in itself [**58**]. Second, the use of various "fall-back" mechanisms in the definition of Three Month LIBOR evidences a common intention that the contract should continue to operate even if LIBOR is not published **[60]**. Third, the definition also indicates that the parties' envisioned a floating rate which would be updated and calculated in real time as the dividends came to be paid **[61]**.

As such, it is necessary to give business efficacy to the Preference Shares to imply a term that if the express definition of Three Month LIBOR ceases to be capable of operation, dividends should be calculated using the reasonable alternative rate to three month USD LIBOR at the date the dividend falls to be calculated **[66]**. The term is also so obvious that it goes without saying, given the common intention of the parties to index the calculation of the dividend to prevailing market conditions once the fixed period is over **[68]**. That tern is capable of clear expression **[69]**.

By contrast, the Funds' implied term is not necessary to give business efficacy to the contract. The common intention of the parties is to provide for the long-term provision of capital in return for the regular payment of indexed dividends, whereas the Funds' implied term would do the opposite **[81]**. The Funds' proposed term is not so obvious that it goes without saying **[82]**, it is inconsistent with the express terms of the contract (which places the ability to redeem firmly within SC's election) **[83]**, and is not capable of clear expression **[84]**.

As regards the applicable rate, the Proposed Rate is the reasonable alternative to USD 3-month LIBOR and is widely used or endorsed as an alternative to LIBOR **[88]-[94]**.

Debt instruments

The arguments in favour of the implied term found in this case are likely to be similarly persuasive when considering the effect of the cessation of LIBOR on debt instruments which use LIBOR as a reference rate but do not expressly provide for what is to happen if publication of LIBOR ceases. In those contracts, the specific reference to LIBOR is likely to be a non-essential term, and the inoperability of the mechanism should not defeat the continuation of the contract **[86]-[87]**.

References in square brackets are to paragraphs in the judgment.