SLAUGHTER AND MAY/

OCTOBER 2024

FIRST ENGLISH JUDGMENT ON LIBOR TRANSITION

STANDARD CHARTERED PLC v GUARANTY NOMINEES LTD & ORS

On 15 October 2024, the High Court handed down its judgment in *Standard Chartered PLC v Guaranty Nominees Ltd & others*, a case under the Financial Markets Test Case Scheme relating to the transition from LIBOR to alternative benchmark rates.

We understand that it is only the second case to proceed under the Financial Markets Test Case Scheme (the first one having related to business interruption insurance) and that this is the first time that effects of the cessation of the publication of LIBOR have been litigated in England and Wales. Slaughter and May successfully acted for Standard Chartered.

Executive summary

The test case concerned a series of preference shares issued in 2006 by Standard Chartered PLC, on which dividends were calculated at a rate linked to three-month USD LIBOR. The High Court was asked to consider the consequences for the preference shares of the cessation of publication of USD LIBOR.

Standard Chartered successfully argued that there is an implied term that dividends on the preference shares may be calculated using a reasonable alternative rate to three month USD LIBOR. The Court has confirmed that, as matters stand, three-month CME Term SOFR plus a credit adjustment spread of 0.26161% per annum is the reasonable alternative rate, which was the rate identified by Standard Chartered's expert in the proceedings.

The judgment in this case is likely to have wider implications for the LIBOR transition in relation to so-called "tough legacy" contracts.

Background

The proceedings relate to certain perpetual preference shares issued by Standard Chartered in December 2006 (which were in turn issued to investors in the form of American Depositary Shares ("**ADSs**")). Dividends on the preference shares were calculated by reference to a fixed rate of 6.409% until 30 January 2017, at which point they reverted to a floating rate of 1.51% per annum plus three-month USD LIBOR. USD LIBOR was, at that time, the prevailing floating rate in the market.

However, following the 2008 financial crisis, the status and credibility of LIBOR was called into question as evidence of manipulation of the rate led to criminal and regulatory investigations and the volume of transactions on which LIBOR was based declined, leading to concerns about the sensitivity of LIBOR to liquidity conditions.

On 5 March 2021, the Financial Conduct Authority (the "**FCA**") announced that all LIBOR settings would either cease to be provided by any administrator, or would no longer be representative of the underlying market, from certain specified dates – 30 June 2023 in the case of three-month USD LIBOR. In its announcement, the FCA stated that "*the lack of an active market makes LIBOR unsustainable, and unsuitable for the widespread reliance that has been placed upon it*" and urged market participants to take active steps to implement the transition from LIBOR to alternative benchmark rates.

A transitional period was provided by the publication of one-, three- and six-month USD LIBOR settings for a limited period from 30 June 2023 using a "synthetic" methodology (as announced by the FCA on 3 April 2023). Three month "synthetic" USD LIBOR was three-month Term SOFR plus a credit adjustment spread of 0.26161% per annum. It was described by the FCA as a "*fair and reasonable approximation of what LIBOR might have been had it continued to exist*". However, the publication of three-month "synthetic" USD LIBOR ceased on 30 September 2024.

Standard Chartered sought declarations from the Court on the use of an alternative benchmark rate to calculate the dividends payable on the preference shares after this date. The claim was opposed by certain ADS holders who intervened in the proceedings and argued that there was an implied term which, subject to applicable laws and regulations and regulator's consent, required Standard Chartered to redeem the preference shares.

The proceedings and the High Court's judgment

The expedited trial was held between 27 September and 2 October 2024. The High Court had determined that the case should be heard within the Financial Markets Test Case Scheme in the Financial List (designed to consider claims giving rise to issues of general importance to financial markets) before a court of two judges, Mr Justice Foxton and the Chancellor of the High Court, Sir Julian Flaux.

The judgment was handed down on 15 October 2024, and the Court agreed with Standard Chartered that there is an implied term that, if the relevant express term ceases to be capable of operation, dividends on the preference shares should be calculated using a reasonable alternative rate to three-month USD LIBOR. It concluded that, as matters stand, three month CME Term SOFR plus a credit adjustment spread of 0.26161% per annum is the reasonable alternative rate, which was the rate proposed by Standard Chartered in the proceedings.

Implied terms

The Court noted that the preference shares were long-term instruments which were intended to revert to a floating rate and, having conducted a detailed review of the relevant case law, it concluded that a flexible approach to the construction of the agreement was required to best match the reasonable expectations of the parties.

In so doing the Court found that the reference to USD LIBOR was simply a mechanism for determining the floating rate and that the parties did not intend for any issues with the publication of USD LIBOR to prevent the continued performance of their agreement.

The Court described the implied term proposed by the intervening ADS holders as "*wholly untenable*", including because it would bring the provision of capital and the payment of dividends to an end (when the preference shares were intended to be long-term instruments) and because it was inconsistent with the express terms of the contract, under which the right of redemption was intended to be exercisable only at Standard Chartered's option. In addition, the Court did not consider their proposed implied term to be sufficiently clear, particularly given the risk of the regulator imposing conditions on redemption and the question as to the rate of dividends payable in the interim period prior to redemption.

Alternative benchmark rates

Having concluded that the terms of the preference shares contained an implied term that dividends should be calculated using a reasonable alternative rate to three month USD LIBOR, the Court turned to the question of what that reasonable alternative rate should be.

The Court concluded that the answer to this question was "*straightforward*", and followed both parties' experts and regulatory precedent here in the UK and in the US, in deciding that, of all the rates available, three-month CME Term SOFR plus a credit adjustment spread of 0.26161% per annum is, as matters stand, the best alternative rate to three-month USD LIBOR.

Wider implications

The judgment in this case is likely to have implications for the LIBOR transition in respect of what have become known as "tough legacy" contracts. The Court noted that its conclusions in relation to Standard Chartered's preferences shares are likely to be "*similarly persuasive*" in relation to debt instruments which use LIBOR as a reference rate but do not expressly provide for what is to happen if the publication of LIBOR ceases. For these "tough legacy" contracts, the judgment may permit the implication of a term regarding the use of a reasonable alternative rate. While the process for identifying the reasonable alternative rate is fact specific, the judgment provides a strong basis for an assessment that a Term SOFR-based rate and a spread adjustment (specifically that recommended by ISDA) is, at least at present, likely to be a reasonable alternative rate for USD LIBOR.

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