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LIBOR reform and contractual continuity Issues for the financial markets

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LIBOR reform and contractual continuity – issues for the financial markets

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Overview

LIBOR is used as a benchmark in a vast number of contracts globally. Market participants are questioning what will happen to their contracts if the way in which LIBOR is calculated is changed. Although the outcome will depend on the precise terms of the contract, the circumstances in which it was entered into and what happens to LIBOR, the English courts will be well aware of the wider importance to the financial markets of any decision they make and should strive to ensure as little disruption to the financial markets as possible. They have a number of tools at their disposal to achieve continuity (notably contractual interpretation and implication of terms) and will also rely to the extent possible, on any contractual interest rate fall-back provisions.

Warren Buffet referred to LIBOR as "the base rate for the whole world" reflecting the fact that contracts with an estimated notional value in excess of $300 trillion use LIBOR as their benchmark. But what LIBOR should look like in the future - indeed, whether there should continue to be a LIBOR - is up for debate. If LIBOR does change, what will happen to the contracts that rely on it? Will interest be calculated on the basis of any new LIBOR or will contractual interest rate fall-back provisions apply? At the extreme, will interest be payable at all? In this paper we consider these issues by reference to commonly used financial documents, particularly those published by the LMA and ISDA, in the context of the following four LIBOR scenarios.

1. LIBOR is discontinued and is not replaced with an alternative market standard benchmark. This has already happened in relation to LIBOR for DKK, NZD, AUD, SEK and CAD and for certain tenors of CHF, EUR, GBP, JPY and USD following the Wheatley Review of LIBOR dated September 2012 ("the Wheatley Review").
2. LIBOR is comprehensively reformed in accordance with the ten point plan contained in the Wheatley Review.
3. LIBOR is discontinued and replaced with one or more alternative benchmarks based on actual transactions and using new calculation methodologies and procedures. We assume that any new benchmarks will be available on a screen and will be introduced by UK and/or US regulators or, indeed, by market-led change.
4. LIBOR is discontinued and replaced as set out in paragraph 3 above but the change is backed up with legislation dealing with the question of contractual continuity (similar to the EU legislation in the context of EMU).

Before analysing these scenarios, it is helpful to set the scene by examining the likely approach of the English courts to contractual continuity and LIBOR reform, i.e. whether a contract that relies on LIBOR will continue in force or whether it will fall if LIBOR falls or if LIBOR is changed.

General approach of the English courts

If a question arising from the disappearance of, or a change in, LIBOR were to come before the English courts, judges will be well aware of the wider implications of their decision for the financial markets. As a result, they are likely to try to ensure as little disruption to the financial markets as possible. To achieve continuity, the courts have three principal tools available to them, the appropriateness of any particular tool being driven by the precise wording and function of any particular contract.

Tool One – contractual interpretation

The approach of the English courts to contractual interpretation has been the subject of much judicial consideration in recent years. In summary, the process of construing a contract involves the court in considering the language used in the contract and ascertaining what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense. (See, for example, *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 at [21].)

Interpretation could be relevant to matters such as whether the parties intended their references to LIBOR to mean only LIBOR in its current incarnation or to include any successor, and the circumstances in which any fall-back provisions in the contract apply.

Tool Two – implication of terms

The functions of interpreting the existing wording of a contract and of deciding whether new words should be implied are ultimately the same, namely to identify what a reasonable person would have understood the parties to have intended their contract to mean in light of the surrounding circumstances. However, implying a term into a contract is a more ambitious exercise than interpreting the parties' words because it involves inserting new words in order to fill a gap that the parties have left in their contract. In order to imply a term into a contract, it is generally necessary to identify a gap in the existing contractual terms, for it to be objectively necessary from both parties' perspective for the gap to be filled, to show that the parties would have filled the gap had they thought about it, and for it to be reasonably certain how the parties would have filled the gap. Where the parties have entered into a long and carefully drafted contract but omitted to make provision for a particular matter, it may be difficult to infer with confidence what the parties intended. (See, for example, *Torre Asset Funding Limited v The Royal Bank of Scotland plc* [2013] EWHC 2760 (Ch) at [152].)

Tool Three – subsidiary mechanical process

Although less likely, the third and final principal tool that could be used by the English courts to achieve contractual continuity would be to treat the calculation of LIBOR in the contract as a "subsidiary and non-essential question of how a contractual liability to make payment according to a specified objective standard is to be quantified" (*Didymi Corporation v Atlantic Lines & Navigation Co Ltd Inc* [1988] 2 Lloyd's Rep 108, 115) enabling the court to decide on an alternative mechanism to establish the rate payable where the contractual mechanism has fallen down. This doctrine was espoused in a line of cases, notably Sudbrook *Trading Estate v Eggleton* [1983] AC 444.

Applicability of LIBOR Fall-backs

Although the English courts have the above legal toolkit available to them, they may not need to resort to it to achieve continuity if the contract in question contains LIBOR fall-back provisions that come into play in the particular LIBOR scenario. Both the LMA and ISDA recommended form documentation contain LIBOR fall-back provisions which apply when the rate is not available (in the case of the LMA) or does not appear on the specified screen (in the case of ISDA). If the contract already provides an alternative to LIBOR when LIBOR is unavailable, the court has no need to intervene, absent any argument over whether the particular fall-backs were intended to apply in the particular circumstances. However, if LIBOR continues to be available, the fall-back provisions never come into effect.

No LIBOR fall-backs

If contractual continuity cannot be achieved through reliance on the fall-back

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provisions in the contract or through application of one of the three legal tools discussed above, parties may seek to argue that the rate should be zero or, alternatively, that their contract is frustrated.

A court is unlikely to conclude that no interest is payable when the parties' clear intention is that interest of some kind would be payable. A court is more likely to make use of the *Sudbrook* principle outlined above and substitute its own machinery for the contractual machinery.

It is also unlikely that the court would conclude that the contract had been frustrated unless all other possibilities had been exhausted. Chitty on Contracts (31st Edn) states that:

"a contract may be discharged on the ground of frustration when something occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract or transform the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract". (paragraph 23-001)

The key question is whether the particular LIBOR outcome is equivalent to the destruction or unavailability of the subject matter of the contract in circumstances not covered by the contract. In most financial contracts, and certainly in recommended form documents such as those produced by the LMA and ISDA, the parties try to

make careful provision for all possible outcomes, including what is to happen if there is a breach of the agreement. In addition, the parties may have been making payments by reference to LIBOR under these contracts for some time. It would therefore be counter-intuitive to conclude that the agreement had been frustrated simply because of difficulty in calculating the rate payable (though if LIBOR is incorporated in the contract as a means of speculating on movements in LIBOR as opposed to a means of identifying the time value of money, it may be less counter-intuitive).

If a court were to conclude that a contract was frustrated, the court would then seek to put the parties in the position, to the extent possible, that they would have been in had they never entered into the contract. This process of restitution involves adding up the amounts each party has paid to the other and setting off the two sums in order to produce a net balance payable by one party to the other. This could have serious implications for the financial markets and so for that reason most would seek to avoid this answer except in very narrow factual circumstances.

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LIBOR Scenarios

Scenario 1:

LIBOR is discontinued and is not replaced with an alternative market standard interest rate benchmark. This is already the case in relation to LIBOR for DKK, NZD, AUD, SEK and CAD and for certain tenors of CHF, EUR, GBP, JPY and USD following the implementation of the Wheatley Review.

If LIBOR is discontinued and there is no obvious alternative benchmark (as is the case with DKK, NZD, AUD, SEK and CAD and certain tenors of CHF, EUR, GBP, JPY and USD (the "discontinued currencies") all of which no longer have a LIBOR rate), the starting point is likely to be whether, as a matter of contractual interpretation, any fall-back provisions in the contract apply in the circumstances that have occurred. The LMA Facility Agreement and the ISDA 2006 Definitions both contain fall-back or alternative interest rate provisions.

The LMA Facility Agreement

The LMA Facility Agreement defines LIBOR as the Screen Rate. The Screen Rate refers to the British Bankers' Association Interest Settlement Rate for the relevant currency and period displayed on the Reuters Screen. If no Screen Rate "is available", there is a fall-back to a Reference Bank Rate. If no or only one Reference Bank supplies a rate to the Agent, the market disruption provisions apply and the interest calculation moves to each lender's cost of funding its participation in each loan from whatever source it may reasonably select unless another means is found for determining the rate of interest pursuant to the terms of the agreement.

Fall-backs apply

The LMA Facility Agreement therefore expressly deals with the situation where LIBOR ceases to exist. In this scenario, there would be "no Screen Rate available" and so the rate would move to a Reference Bank Rate and, if that fails, to a cost of funding rate. This LIBOR scenario has already occurred in the loan market in the context of the discontinued currencies. The fall-back to a Reference Bank Rate has been invoked and, in cases where the Reference Bank Rate cannot be obtained because, for example, there is insufficient data for the discontinued currencies, the interest rate is being priced by reference to each lender's cost of funds. The loan market has therefore already adopted this approach in practice, although it has not always proved to be an ideal solution, for example, in syndicated loans with large syndicates and long maturities where the effort required to administer the fall-backs is significant. Whilst it is always possible for the parties to agree an alternative approach in accordance with the terms of their agreement, the fall-back provisions continue to be relied upon. However, in the case of the disappearance of LIBOR rates for certain maturities of CHF, EUR, GBP, JPY and USD, this has been addressed in the LMA recommended form Facility Agreement since July 2013 by the provision of an interpolation mechanism. This reflects the fact that it had become standard practice in the loan market for parties to use interpolation in these circumstances instead of relying on the contractual fall-backs.

Limits on fall-backs?

It is possible, particularly where the fall-backs prove difficult to administer or more costly, that parties may be incentivised to argue that the fall-back provisions in the LMA Facility Agreement are intended to apply only in circumstances where the Screen Rate is temporarily unavailable as opposed to where the Screen Rate has gone altogether. Some loan agreements may have a number of years to run and this raises the question of whether the fall-back mechanics were intended to offer a long term substitute pricing mechanism or simply a short term solution to deal with temporary glitches in the ability to obtain LIBOR rates. The former construction of the fall-back provisions is more compelling in our view. This is because the LMA Facility Agreement goes through a series of layers of interest rate failure. The parties have contemplated the situation where there is no LIBOR and no Reference Bank Rate. An interest rate which is set by the Reference Banks and, failing that, cost of funding (which may be from whatever source the lender reasonably selects) may therefore become the contractual interest rate to be applied under the contract for so long as LIBOR ceases to exist. This is likely to be the case even if the contractual fall-back mechanisms are difficult to administer or viewed as unfortunate (such as administering cost of funds for a very large syndicate).

Agent's discretion?

The definition of Screen Rate also provides that "if the agreed page is replaced or service ceases to be available, the Agent may specify another page or service displaying the appropriate rate after consultation with the Company and the Lenders." Do these words allow the Agent to find another service displaying an appropriate LIBOR alternative thereby overcoming any perceived difficulties with the contractual fall-backs? When read in

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context, it is likely that this statement is mechanical and that the reference to "appropriate rate" refers to LIBOR. It is therefore directed at the situation where Reuters ceases to provide the publication service for LIBOR and allows the Agent to select an alternative page or service which displays LIBOR. In our view, the Agent does not therefore have a free hand to select another electronic source that might look something like LIBOR.

The 2006 ISDA Definitions

In the 2006 ISDA Definitions, the various rate definitions linked to LIBOR refer to the rate for deposits in the relevant currency for the relevant maturity appearing on a specified display page on a named sponsor's screen service (e.g. for "USD-LIBOR-BBA", the Reuters Screen LIBOR01 Page or its "Successor Source"). If the relevant rate does not appear on the relevant display page, there is a fall-back to the arithmetic mean of the rates offered to prime banks by the Reference Banks for deposits in the relevant currency. If fewer than two Reference Banks provide rates, there is a further fall back to the arithmetic mean of the rates quoted by major banks selected by the Calculation Agent for loans in the relevant currency to leading European banks.

Fall-backs apply

As with the LMA Facility Agreement, in our view these contractual fall-back arrangements come into play if LIBOR ceases to exist (including in respect of the discontinued currencies) as the relevant rate will not then appear on the relevant display page, triggering the fall-back to Reference Bank determination. Since the contract already provides for the discontinuance of LIBOR on this basis, there would be no need for the court to intervene. The parties to an ISDA contract are, of course, always free to agree an alternative approach. Like the LMA, ISDA published a guidance note and pro forma amendment in March 2013 to provide for the determination of rates on an interpolated basis where existing transactions are affected by LIBOR maturities discontinuations. Therefore if an ISDA transaction relates to one or more discontinued LIBOR rates for CHF, EUR, GBP, JPY and USD, the parties may agree to adopt the interpolation mechanism provided by ISDA rather than rely on the fall-backs.

Limits on fall-backs?

In our view the application of the provision requiring fall-back to Reference Banks in an ISDA transaction is unlikely to be limited to the circumstances that LIBOR is suspended temporarily. Like the LMA Facility Agreement, the parties have adopted a waterfall of alternative rates from the outset if LIBOR does not appear. This makes it likely that the court would conclude that those fall-backs continue to apply on any Reset Date for which there was no LIBOR and not just for a limited number of Reset Dates irrespective of the reason for the absence of LIBOR. However, unlike the LMA Facility Agreement which moves from Reference Banks to cost of funds if insufficient Reference Banks rates are available, ISDA fall-backs go from Reference Bank rates to the rates of major banks in London, but then stop. Although unlikely, this does perhaps lead to a greater possibility for an alternative view on whether temporal limitations may apply because the ISDA fall-backs do not anticipate a collapse in the interbank market in the same way that the market disruption provisions do in the LMA Facility Agreement.

No fall-back provisions

Although not the case with our example financial contracts, how does the analysis differ in this scenario if the financial contract in question does not contain fall-back provisions or the fall-backs do not work or do not provide for all possible outcomes? In this case, the court is likely to ask what the intention of the parties was in using LIBOR in their contract.

Alternative rate setting machinery-Sudbrook?

If the parties have agreed in their contract that interest is payable at LIBOR (being a reasonable rate calculated on the basis of interbank lending), there is a strong argument that the parties are seeking to use LIBOR as a proxy for an objective rate of interest as opposed to a single subjective calculation of a rate. This arguably would bring such financial contracts within the principles in *Sudbrook* described above (tool three) and the court may determine on the basis of expert evidence a comparable process to establish a reasonable rate. This approach would be consistent with the use of LIBOR as an objectively determined reasonable market rate. Unfortunately it is not possible to predict with certainty what the alternative mechanism would be, particularly given that this scenario does not envisage there being an obvious successor to LIBOR and, indeed, whether in any particular circumstances there is any alternative mechanism.

LIBOR and only LIBOR

The outcome could be different if LIBOR is being used by one or more parties to a contract as a transaction specific rate where LIBOR means LIBOR as opposed to a mechanism for determining the time cost of money (for example where it is referenced as the applicable interest rate

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for a loan or default rate under an ISDA agreement). If so, there is real scope for argument that if LIBOR disappears and there is no equivalent replacement, the contract is no longer performable. The *Sudbrook* principles cannot help in such a case because it is not simply a matter of the contractual machinery for determining the rate breaking down. Similarly, construction cannot help as there is a strong argument that the use of the word LIBOR was meant by the parties to mean LIBOR and only LIBOR. The requirements for implying terms would not be met as it would not be necessary from both parties' perspectives to imply an alternative benchmark as one party specifically has not bargained for an alternative and so contractual continuity could not be achieved by implication of terms. The outcomes are, of course, highly fact specific, but there is a real risk that, in this limited case, there would be an argument that the contract has been frustrated because LIBOR has gone, there is no replacement and the fall-back which is intended to achieve a proxy for LIBOR has failed or was not provided for at the outset.

Scenario 2:

LIBOR is comprehensively reformed in accordance with the ten point plan contained in the Wheatley Review

Of all the proposed Wheatley reforms, the reform that raises the most significant potential difficulty in the context of contractual continuity is the transfer of the responsibility for the administration of LIBOR from the British Bankers' Association to a new administrator, which we now know to be ICE Benchmark Administration Limited ("**ICE**"). The other nine proposals simply tighten up what is already happening in respect of LIBOR and do not involve a fundamental change in the way in which the data is collected or the calculation is made.

Why does the transfer of responsibility for LIBOR matter? It matters because many LIBOR definitions (including historical versions of the LMA Facility Agreement) expressly refer to the British Bankers' Association and this raises a question mark over whether these LIBOR definitions should be treated as referring to LIBOR under ICE's replacement administration. (Although the currently published LMA Facility Agreement expressly provides for a change of administrator for LIBOR and has done so since 24 April 2013 a large number of legacy transactions contain the previous LIBOR definition which references only BBA LIBOR.) On the assumption that the transfer to ICE only involves a transfer of the existing LIBOR processes, we do not consider the change of administrator to be a significant change for the purposes of determining what is meant by "LIBOR" in our example contracts. In addition, this is an area where the court will be keen to avoid getting into the fall-backs. The court will be aware that there will be a real practical problem if contracting parties have to resort to fall-backs in relation to all of these financial contracts and that the cleaner solution is to ensure that the ICE administered rate is substituted for the British Bankers' Association administered rate. The analysis below illustrates how contractual continuity may be achieved in this LIBOR scenario.

The LMA Facility Agreement

The reference to the British Bankers' Association in the definition of LIBOR/Screen Rate is likely to be interpreted as simply part of a label and not as part of the inherent definition of LIBOR. On the assumption that LIBOR continues to be published on a screen, is calculated using the same methodology as previously and the administration of the LIBOR process is taken over by another body with no involvement of the British Bankers' Association, a court is likely to achieve continuity either as a matter of construction or by implication of terms without bringing any contractual interest rate fall-back provisions into play.

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Contractual interpretation

As a matter of contractual interpretation, the court may conclude that when the parties agreed that interest would be paid at the rate of LIBOR as published on a Reuters screen, a reasonable person would conclude that the overriding intention of the parties was that interest would be based on the rates available to banks lending to each other in the London market. This is reinforced by the fact that the first contractual fall-back, in the event that LIBOR is unavailable, is based on the cost to Reference Banks of borrowing in the London inter-bank market. The parties are using BBA LIBOR as the proxy for this rate. If that proxy, BBA LIBOR, no longer exists, the parties' overriding intention can be fulfilled by construing the references to BBA LIBOR as references to the alternative replacement benchmark, ICE LIBOR which retains all the essential attributes of BBA LIBOR.

Implication of terms

Alternatively, as a matter of implication of terms, the court may conclude that the conditions for implying terms set out above are satisfied and so achieve contractual continuity in that way on the basis of the following arguments. First, the parties have not dealt with a change of administrator for LIBOR and the fall-backs do not apply because the fall-back provisions only deal with LIBOR ceasing to be available. Secondly, it is objectively necessary from both parties' perspective to imply a term as they have both agreed interest is payable. Thirdly, a reasonable person would say that had the parties thought of this scenario they would have provided for it at the outset. Fourthly, it can be shown with reasonable certainty that the implied term would be that the reference to BBA LIBOR should be read to include whoever may take over the sponsorship of LIBOR from the BBA which we now know to be ICE. Whilst the presence of the contractual fall-backs make it at least arguable that an implied term is unnecessary, we consider the better view to be that if ICE LIBOR retains the same essential attributes of BBA LIBOR, the court will be persuaded that it is necessary to imply a term to achieve continuity and allow for the smooth operation of the financial markets as a whole rather than adopt the contractual fall-backs.

Precedents for change

The financial markets are used to taking a pragmatic approach to change. When the Minimum Lending Rate was switched to Base Rate by the Bank of England in 1981 it was generally accepted, following publication of an opinion obtained by the Law Society from Queens Counsel, that the courts would imply a term that the nearest equivalent applies. Contracts which referred to the Minimum Lending Rate were therefore read to mean Base Rate and the continuity point was not argued. Whilst the financial markets of 1981 and the financial contracts underpinning those markets were significantly less complex, less global and less inter dependent than they are now, the precedent may nevertheless be helpful.

The tolerance of the financial markets to include some adjustments to LIBOR without disputes arising was also illustrated in 1998 when the British Bankers' Association changed the question asked of LIBOR contributor banks to, "*at what rate could you borrow funds, were you to do so by asking for and then accepting inter bank offers in a reasonable market size just prior to 11am?*" from "*at what rate do you think interbank term deposits will be offered by one prime bank to another prime bank for a reasonable market size today at 11 am?*". Contractual continuity was not a point taken.

Agent's discretion?

The change of administrator for LIBOR also raises the question of the meaning of the words "if the agreed page is replaced or service ceases to be available the Agent may specify another page or service displaying the appropriate rate" in the definition of Screen Rate in the LMA Facility Agreement. The replacement of the administrator for LIBOR would not in our view, result in the "agreed page being replaced or service ceasing to be available". As discussed above in relation to the first LIBOR scenario, these words are likely to be construed as purely mechanical and therefore intended to deal with the situation where Reuters ceases to provide its publication service thereby permitting the Agent (in consultation with the appropriate contracting parties) to use the replacement publisher of LIBOR. It is not intended to allow the Agent to specify a page or service displaying an appropriate rate in circumstances where the British Bankers' Association Interest Settlement Rate no longer exists. As already noted, we consider that the better construction of the definition of LIBOR and its associated provisions in the LMA Facility Agreement is that a change in the LIBOR administrator is not a situation that the agreement has catered for and therefore the court will ask what the parties would have done had they envisaged the situation. We consider the answer to that question is likely to be that the parties would have adopted the obvious equivalent - ICE LIBOR.

Scenario 1 v Scenario 2

Why do the fall-backs apply in our first LIBOR scenario where LIBOR is discontinued but not where the administrator of LIBOR changes? Because in the case of the

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discontinuance of LIBOR, alternatives to LIBOR existed at the outset but the parties did not choose those alternatives; they chose instead LIBOR or, if LIBOR is not available, a series of fall-backs which attempt to replicate LIBOR. In these circumstances, a court cannot construe or imply an alternative to LIBOR. In contrast, the appointment of a new administrator for LIBOR in place of the British Bankers' Association is not something the parties expressly envisaged happening, allowing for construction or a term to be implied.

New LMA definition of Screen Rate

Following the Wheatley Review, the LMA amended its definition of Screen Rate in its recommended form Facility Agreements. It now expressly contemplates a change of administrator. We do not consider that such amendment undermines our conclusion above. The court would not look at a later version of the agreement to determine what the earlier one must have meant. A court could, however, refer to the later version to inform it of how the parties would behave in the circumstances, which is of course helpful.

In practical terms, whether or not the contractual continuity point is actually taken in this scenario may depend on the smoothness of the takeover of the LIBOR process from the British Bankers' Association by ICE. If LIBOR rates were to move significantly following the takeover as a result of a change in the underlying methodology, parties could have more incentive to take the contractual continuity point and indeed the courts may find it more difficult to construe or imply the parties' agreement to the new rate in such a situation. However, it is our understanding that ICE does not plan to change the fundamentals of LIBOR as a quoted, interbank, offered, rate.

ISDA 2006 Definitions

The various rate definitions linked to "BBA" LIBOR in the ISDA 2006 Definitions only refer to the British Bankers' Association in the titles of the various definitions (e.g. "USD-LIBOR-BBA"). Unlike the LMA Facility Agreement, BBA is not referred to in the text of the ISDA 2006 Definitions themselves. The ISDA 2006 Definitions simply refer to a rate for deposits in the relevant currency for the relevant period which appears on the specified display page (e.g. Reuters Screen LIBOR01Page) (or its "Successor Source"). On the assumption therefore that the specified display page remains, is called the same thing and continues to display the rate for deposits in the relevant currency for the relevant period, it is relatively easy to conclude that the contract continues to point towards the rate on the same LIBOR01 page (or its "Successor Source") notwithstanding the change of administrator for LIBOR. The analysis is therefore likely to be as easy if not easier in relation to the ISDA 2006 Definitions as compared to the LMA Facility Agreement. However, if, in addition to the transfer of the LIBOR process, there are changes to the way in which LIBOR is constructed or the way in which the rate is calculated or the resulting rates move significantly, the analysis may be different.

Scenario 3:

LIBOR is discontinued and replaced by the UK/US Regulators or by market-led change with an alternative benchmark which is no longer known as LIBOR and uses new calculation methodologies and procedures.

Implication of terms is likely to be the battleground in this scenario as it is more difficult to construe the reference to LIBOR in these contracts as including a completely new benchmark which has few similarities to LIBOR. For contractual continuity to be achieved through implication of terms the court would need to be satisfied that the conditions for implying terms are satisfied. Have the parties already catered for this scenario in their contract? The court will need to be persuaded that the parties have not dealt with this already and therefore that any fall-back provisions were not intended to apply when the contractual benchmark is discontinued and replaced with something different. As noted above, it is likely that the LMA and ISDA fall-back provisions would apply in this situation and as such likely to be difficult to persuade the court that the parties had not catered for this eventuality. If, contrary to this, the parties had not catered for the disappearance of LIBOR with the fall-back provisions then it would need to be objectively necessary from all parties' perspective to imply a term and be shown with reasonable certainty what the parties would have provided had they thought about it. It is likely that a court would conclude that, if the parties have not catered for this eventuality with the fall-back provisions, it is necessary to imply a term to cope with that change as it is something the parties would have provided for had they thought about it. A key difficulty will come when trying to show with reasonable certainty what the new benchmark should be. The essence of the agreement to choose LIBOR as the contractual benchmark is to peg the rate payable to that which reflects the rate at which banks in the London market lend to each other. If a new benchmark is based on that same premise, it may be relatively straightforward to say that the new benchmark is obviously the replacement for LIBOR. However, it gets harder if more than an insignificant part of the new calculation is based upon anything other than banks lending to each other in the London market. The more the new benchmark departs from that, it becomes more difficult to conclude that the new benchmark is the one that the parties would clearly have chosen had they thought about the issue at the time of contracting.

If it is not possible to imply a term into the contract because, for example, the new benchmark is not based on the same principles as the old benchmark or there are a number of alternative benchmarks, the end result is that the rate which is specified in the contract is not available and the parties are bounced into the fall-back provisions. This analysis is given greater weight because the fall-back to a Reference Bank rate in both the LMA Facility Agreement and the ISDA 2006 Definitions require the identification of the rate at which banks lend to each other in the London market. It is therefore more likely that a court would apply the fall-backs which seek to provide a proxy for LIBOR rather than imply a completely new benchmark which has very little in connection with LIBOR. See also the discussion "*Applicability of LIBOR fall-backs*" above, which would apply equally to this LIBOR scenario.

Scenario 4:

LIBOR is replaced as set out above but in each case is backed up with legislation

For legislation of this nature to be effective, it would need to be co-ordinated at an international level to reflect the multitude of governing laws and the global nature of the financial contracts which use LIBOR as their benchmark.

At a purely national level, if the UK passed legislation to the effect that any reference to LIBOR in a contract shall be taken to mean whatever new benchmark is then created and that parties cannot rely upon the change in the benchmark to terminate, declare a default or declare frustration, it would be binding on all parties who entered into contracts governed by English law. However, in the case of contracts governed by other laws, it is unlikely to be effective. As a result, if LIBOR is discontinued and replaced with an alternative benchmark, the only way that the financial markets can be certain that the LIBOR definition in all their contracts will be replaced with the new benchmark is through the introduction of a legislative framework across all relevant countries to achieve continuity. This would be an ambitious exercise which presupposes a global consensus is reached on what the replacement benchmark or benchmarks would be.

Conclusion

A vast number of financial contracts use LIBOR as a reference rate benchmark in the UK and international financial markets. LIBOR is so deeply entrenched in the financial markets that the question of contractual continuity is fundamental to the global financial markets as a whole. Judges in the English courts will therefore strive to achieve contractual continuity and the English courts have a number of legal tools at their disposal to achieve this. In addition, many contracts, particularly industry standard form contracts, contain interest rate fall-back provisions which will also be relied upon to achieve continuity where applicable.

It appears that in the short term, LIBOR will continue to be reformed according to the Wheatley Review. In the longer term, there seems to be a commitment to wean the financial markets off LIBOR as a benchmark but no consensus on the appropriate alternatives. Where does that leave us on the question of documentation? Given that no-one can predict where the LIBOR debate will end up it is impossible for contracts to provide for all possible outcomes. For now, LIBOR continues to be the interest rate benchmark of choice in financial contracts but the well drafted financial contract will also contain LIBOR fall-backs suited to the needs of the parties

Contractual continuity – Summary

	LMA Facility Agreement	**2006 ISDA Definitions**	**LIBOR definition equivalent to LMA but no fall-back to Reference Bank or cost of funds**	**Financial contract speculating on LIBOR only**
LIBOR discontinued with no replacement.	Fall-backs apply because "*no Screen Rate available*".	Fall-backs apply because "*such rate does not appear on the relevant screen page*".	Interest calculation is subsidiary mechanical process so Court will decide on a replacement mechanism.	Possible frustration of contract.
LIBOR administrator replaced.	LIBOR continues.	LIBOR continues.	LIBOR continues.	LIBOR continues.
New LIBOR methodology	Depends on extent of change. Possible LIBOR continuation/possible fall-back.	Depends on extent of change. Possible LIBOR continuation/possible fall-back.	Possible LIBOR continuation. If not, subsidiary mechanical process so court will decide on a replacement mechanism.	Depends on extent of change but frustration of contract likely.
LIBOR discontinued and replaced with a new benchmark.	Depends on how different new benchmark is. Possible LIBOR continuation with new benchmark if not significantly different otherwise fall-backs apply because "*no Screen Rate available*".	Depends on how different new benchmark is. Possible LIBOR continuation with new benchmark if not significantly different otherwise fall-backs apply because "*such rate does not appear on the relevant screen page*".	Possible LIBOR continuation if new benchmark not significantly different from LIBOR. If not, subsidiary mechanical process.	Depends on extent of change but frustration of contract likely.
LIBOR is replaced but backed up by legislation.	New benchmark applies.	New benchmark applies.	New benchmark applies.	New benchmark applies.

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