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Legislative solutions to U.S. dollar LIBOR cessation

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Contractual solutions to U.S. dollar LIBOR cessation are essential. These include the use of the Alternative Reference Rates Committee (ARRC)'s "amendment approach" or "hardwired" fallback language for loans and counterparties' adherence to the International Swaps and Derivatives Association (ISDA)'s 2020 IBOR Fallbacks Protocol and related IBOR Fallbacks Supplement to the 2006 ISDA Definitions (or the entry into of their bilateral equivalent) for derivatives. But although contractual solutions are essential, they may not be sufficient. This is because there are an enormous number of U.S. dollar LIBOR-referencing contracts — including mortgages, securitizations, floating rate notes and commercial contracts — with inadequate, ambiguous or non-existent U.S. dollar LIBOR fallbacks, and as to which amendment may not be feasible. Enter possible legislative solutions.

Proposed New York State legislation

On January 19, 2021, Governor Andrew Cuomo introduced proposed New York State legislation addressing U.S. dollar LIBOR cessation, as part of the State's broader budget bill.[1] The legislation closely mirrors the draft legislative bill proposed by ARRC in March of 2020.[2] [3] New York State's budget is due by March 31, 2021, the end of the State's fiscal year. The U.S. dollar LIBOR cessation legislation proposed as part of the budget bill would be implemented via a new Section 18-400 to New York's General Obligations Law and would take effect immediately upon passage of the budget bill.

The legislation provides for the replacement in contracts, securities and instruments of U.S. dollar LIBOR with the "recommended benchmark replacement" — essentially defined as the rate, based on the secured overnight financing rate (SOFR) and including the spread adjustment and any benchmark conforming changes, that shall have been selected or recommended by the Federal Reserve Board, the Federal Reserve Board of New York or ARRC with respect to such type of contract, security or instrument.

Key highlights of the proposed legislation include that it would:

- apply to contracts, securities and instruments governed by New York law, although parties are permitted to opt-out;
- apply by operation of law (mandatory application) to replace U.S. dollar LIBOR with the recommended benchmark replacement where a contract, security or instrument contains no U.S. dollar LIBOR fallback or falls back to a U.S. dollar LIBOR rate;
    - (note that loans customarily fall back to a prime rate, so *the legislation would not typically apply to loans*; whereas the legislation would apply to floating rate notes that fall back to last-quoted U.S. dollar LIBOR, as is typical for such notes);
- provide a safe harbor from litigation to a party that has discretion to replace U.S. dollar LIBOR and elect the recommended benchmark replacement as the replacement

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(permissive application);

- prohibit a party from refusing to perform its contractual obligations or declaring a breach of contract as a result of the discontinuance of U.S. dollar LIBOR or the use of the recommended benchmark replacement;
- establish that the recommended benchmark replacement is a commercially reasonable substitute for and a commercially substantial equivalent to U.S. dollar LIBOR;
- override U.S. dollar LIBOR fallbacks based on polling of dealers, such as those in the 2006 ISDA Definitions (e.g., prior to supplementation via the IBOR Fallbacks Supplement);
- become applicable (mandatorily) or available (discretionarily) upon the occurrence of stated triggering events — namely, a permanent or indefinite U.S. dollar LIBOR cessation or a non-representativeness determination, being essentially the same trigger events recommended by ARRC and adopted by ISDA.[4]

Given that New York law (along with English law) is widely preferred as the governing law of U.S. dollar LIBOR-referencing contracts, the enactment of this legislation would be an important legislative addition to contractual solutions to U.S. dollar LIBOR cessation. Its enactment would also serve as a model for other states.

Draft U.S. federal legislation

On October 13, 2020, a discussion draft bill[5] closely mirroring ARRC's March 2020 legislative bill (and thus definitionally also closely mirroring the proposed New York legislation described above) was circulated in the United States Congress. This bill, sponsored by Brad Sherman, Democrat representative for California's 30th District and Chairman of the House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, was not taken up in the 2020 session of Congress. However, a version of the bill is expected to be formally introduced in Congress in the second quarter of 2021. Importantly, the discussion draft Congressional bill would expressly preempt state law.

Legislative solutions, or just litigation of a different sort?

In the absence of legislative solutions (alongside contractual ones), U.S. dollar LIBOR cessation could give rise to considerable economic disruption and litigation arising from inadequate, ambiguous or non-existent fallbacks. Although legislation addressing U.S. dollar LIBOR cessation would provide considerable relief, it would not necessarily eliminate litigation. The legislative bill proposed by ARRC that formed the basis for the proposed New York and federal legislation has been described as "carefully drafted to pass Constitutional scrutiny";[6] nonetheless, commentators have pointed out that the legislation may be subject to challenge on the following grounds, among others:

- under the Contracts Clause or Due Process Clause of the United States Constitution;
- in the case of securities issued under an indenture subject to the United States Trust Indenture Act of 1939, as a violation of rights under Section 316(b) of that Act;[7] or
- in the case of the draft New York legislation, as a violation of the New York State Constitution's Non-Delegation Clause.[8]

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[1] See https://www.budget.ny.gov/pubs/archive/fy22/ex/artvii/ted-bill.pdf Part PP pages 233-242.

[2] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Proposed-Legislative-Solution.pdf The legislation proposed by Governor Cuomo follows substantially similar New York State Assembly and Senate companion bills (AB A11098 and S9070, respectively) introduced toward the end of the 2020 legislative session, themselves also closely mirroring the legislative bill proposed by ARRC in March of 2020. These companion bills would implement the legislation via proposed new Article 12 of New York's Uniform Commercial Code.

[3] On March 1, 2021, ARRC issued an updated version of its proposed legislative bill, reflecting technical changes: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/libor-legislation-with-technical-amendments

[4] See https://staging.osler.com/en/resources/cross-border/2021/libor-endgame-announced. Note that the "non-representativeness" trigger in ARRC's proposed legislative bill, and in the legislation addressed in this Update, only picks up a statement of *present* non-representativeness, whereas the non-representativeness trigger adopted by ISDA also picks up a statement of *future* non-representativeness.

[5] https://cmbs.informz.net/cmbs/data/images/LIBOR%20Transition%20Assistance%20Act_Discussion%20Draft.pdf

[6] https://www.sifma.org/resources/submissions/joint-letter-on-alternative-reference-rates-committees-legislative-proposal/

[7] Section 316(b) of the United States Trust Indenture Act of 1939 (TIA) provides in pertinent part that "*the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder*…" State legislation generally cannot abrogate rights under federal legislation. Both the draft New York and federal legislation attempt to address TIA Section 316(b) by deeming the use of the recommended benchmark replacement to not impair any person's right or obligations in respect of any contract, security or instrument; it remains to be seen whether this will be effective in the context of State legislation purporting to negate rights under federal legislation.

[8] For example, on the basis of impermissible delegation of State legislature authority to determine the recommended benchmark replacement.