KEY POINTS

- Under the NY Statute, references to "LIBOR" under "legacy" contracts are treated as references to another recommended benchmark.
- Persons having discretion to select or apply benchmarks are authorised to utilise the recommended benchmark, enjoying a "safe harbor" from litigation.
- In contrast UK legislation addresses the risk of contracts being frustrated by permitting the continuous publication of some or all of the ceasing LIBORs ("synthetic LIBORs") for specific purposes.

Feature

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USD LIBOR succession legislation at home and abroad

In this article the authors review the current status of the various "legislative fixes" for dealing with agreements which refer to USD LIBOR but which cannot be actively amended to remove those references before the benchmark ceases to exist.

As most readers know by now, ICE Benchmark Administration Ltd (IBA) and the UK's Financial Conduct Authority (FCA) announced on 5 March 2021 (5 March Announcements) that most USD LIBOR tenors would cease being published on 30 June 2023, with a pair of lesser-used USD LIBOR tenors (one-week and two-month) ceasing to be published on 31 December 2021 at the same time as other LIBOR currency settings. The transition away from LIBOR is a hugely complex endeavour that borders on the impossible, particularly when it comes to so-called "tough legacy" contracts. These are contracts that do not adequately provide for LIBOR's demise and cannot reasonably be amended due to, for example, requirements of unanimous consent by lenders or bondholders, which are endemic in the massive market for New York law instruments.

Adding to the complexity of LIBOR transition is its rapidly evolving nature. Regulators, industry groups, financial market utilities and other private sector actors have been making significant announcements on what seems like a weekly basis. Although portions of this article will undoubtedly be out of date by the time of publication, this article focuses on the status, as of late August 2021, of legislative efforts in the US and in the UK to mitigate the impact of USD LIBOR cessation on "tough legacy" contracts.

On 6 April 2021, New York Governor Andrew Cuomo signed "An act to amend the general obligations law, in relation to the discontinuance of the London interbank offered rate" (NY Statute) into law. Three weeks later the Financial Services Act 2021 (the UK legislation) received Royal Assent, giving the FCA new powers (which came into force on 1 July 2021) to deal with the cessation of LIBOR.

THE NY STATUTE

The Alternative Reference Rates Committee (ARRC), which is the private sector group convened by the US Federal Reserve and the Federal Reserve Bank of New York (FRBNY) to guide the transition away from USD LIBOR, recognised early on that "tough legacy" contracts pose a significant obstacle to LIBOR transition and began drafting proposed legislation under New York law in 2019. The ARRC released its legislative proposal to the public at the outset of the COVID-19 pandemic, and this proposal ultimately evolved into the NY Statute. The stated purpose of the NY Statute is "to minimise costly and disruptive litigation by providing legal certainty for the issues arising in New York contracts resulting from the permanent discontinuance of LIBOR". The NY Statute has been codified as Art 18-C of the New York General Obligations Law, ss 18-400 *et seq*.

Importantly, the NY Statute can and will only apply to New York law contracts (although choice of law provisions and related jurisprudence should be carefully considered). Additionally, the legislation only addresses USD LIBOR and will accordingly be of no assistance or relevance for New York law-governed contracts that, for example reference, British pound LIBOR.

The NY Statute at its most basic level articulates three principles: (i) references to "LIBOR" in certain contracts will, upon cessation, be deemed, "by operation of law", to be references to the "recommended benchmark replacement" or "RBR" (Operation of Law Rule); (ii) persons having discretion or responsibility for selecting or applying benchmarks are "authorised" by statute to utilise the RBR (Discretionary Authorization Rule) and will enjoy a "safe harbor" from litigation if they do so; and (iii) all LIBOR fallbacks involving a "poll, survey or inquiries for quotes" concerning interbank lending rates or LIBOR "shall be disregarded . . . and shall be deemed null and void and without any force or effect" (the Dealer Poll Rule).

The NY Statute adopts the "two-step" LIBOR transition structure from the work of the ARRC, ISDA and other industry working groups globally. Under the NY Statute, a "LIBOR replacement date" (which is when the fallbacks under the NY Statute come into effect) is *always* accompanied by a "LIBOR discontinuance event". A "LIBOR discontinuance event" is the familiar series of announcements: (i) by IBA, the FCA, the Federal Reserve or the like that the production of LIBOR has ceased or will cease on a permanent or indefinite basis; or (ii) by the FCA that LIBOR has become non-representative. The LIBOR replacement date under a non-representativeness announcement is the date of that announcement and under the remaining LIBOR discontinuance events is the later of the announcement and the date on which IBA actually ceases to publish LIBOR in the relevant currency or tenor.

The fact that the 5 March Announcements pre-dated enactment of the NY Statute raises an intriguing (if not academic) question as to whether the NY Statute requires *another* LIBOR discontinuance event in order for a LIBOR replacement date to occur. Although this would readily be remedied by a duplicate set

of announcements from IBA and the FCA, these institutions have no obligation to do so.

THE OPERATION OF LAW RULE AND THE RBR

The Operation of Law Rule applies to any contract that either: (a) contains no fallback provisions; or (b) contains fallback provisions that result in a benchmark replacement (other than the RBR) "that is based in any way on any LIBOR value" (a prototypical example of which would include fallbacks that contemplate the use of the final LIBOR fixing prior to cessation).

The Operation of Law Rule is thus readily stated but the expression "RBR" requires further explication. The RBR is the benchmark replacement which must be a SOFR-based rate (the secured overnight financing rate) that shall have been "selected or recommended" by the "relevant recommending body" (which is expected to be the ARRC, although the defined term includes the Federal Reserve and the FRBNY as well). The NY Statute accommodates RBRs "with respect to any particular type of contract". This suggests that the ARRC may recommend different SOFR-based fallbacks for different products or asset classes.

The RBR also includes any "recommended spread adjustment" and "benchmark replacement conforming changes" (sometimes herein, "Conforming Changes"), both of which are to be recommended by the ARRC and, again, are capable of differentiation across products. The tenor-specific "recommended spread adjustments" are meant to minimise any value transfer that may occur as a result of using a SOFR-based rate instead of a LIBOR rate. Barring a radical reversal of course by the ARRC, any "recommended spread adjustment" is expected to match the spread adjustments that have now been fixed by the ISDA LIBOR transition scheme for non-consumer segments of the market by virtue of the 5 March Announcements.

Nothing in the NY Statute compels the ARRC (or anyone else) to issue the contemplated recommendations, much less in a format that would make the NY Statute workable. That said, it seems likely that the NY Statute contemplates the publication of a set of formal and readily identifiable recommendations that will allow parties to confidently determine how their contracts will transition, particularly those that will transition pursuant to the Operation of Law Rule. Among these recommendations are those for Conforming Changes, which are defined by the statute to mean "any technical, administrative or operational changes, alterations or modifications that are associated with and reasonably necessary to the use, adoption, calculation or implementation of a recommended benchmark replacement". A mundane but significant "benchmark replacement conforming change", for example, might involve shifting interest rate determinations from a London business day calendar (to accommodate LIBOR fixings) to a SOFR business day calendar. Other such Conforming Changes may prove more significant or controversial depending on what SOFR-based rate the ARRC recommends.

Once the ARRC has recommended Conforming Changes, they will automatically form part of the contract, "by operation of law", unless the "Calculating Person" (which is defined to mean the person responsible for calculating any payment or other benchmark-based measurement) in its "reasonable judgement" determines the ARRC-recommended Conforming Changes either "do not apply" to a particular contract or are "insufficient to permit administration and calculation" of the RBR.

In these circumstances, the Calculating Person is directed to develop, in its reasonable judgment, additional Conforming Changes that are "necessary to permit administration and calculation" of the RBR in a manner: (i) consistent with market practice; (ii) to the extent practicable, consistent with the contract's administration prior to LIBOR cessation; and (iii) so as not to alter the contract's status under federal tax law. These too will become an "integral part" of the applicable contract "by operation of law". Curiously, the NY Statute does not indicate whether, when or how the calculating person is to communicate these Conforming Changes to the other party or parties to a particular contract.

Additionally worth noting is that the definition of "benchmark replacement" expressly includes *any* LIBOR replacement, whether "temporary, permanent or indefinite". This implicitly leaves parties to their own devices if LIBOR ceases to be available on a "temporary" basis unless and until a LIBOR replacement date occurs.

THE DISCRETIONARY AUTHORITY RULE

The Discretionary Authority Rule addresses contracts under which a person (the Determining Person) has discretion to select a benchmark replacement. The Determining Person is the person specified as such under the contract or the person that has specific responsibilities relating to LIBOR transition (and may be the Calculating Person if the contract, for example, specifies no such person). The Determining Person is "authorised" (but not mandated) to select the RBR under LIBOR contracts containing fallback provisions that "permit or require" the selection of a benchmark replacement that is "based in any way on LIBOR" or more specifically to track some of the language variants in existence: (i) a "commercially reasonable replacement for and commercially substantial equivalent to LIBOR"; (ii) a "reasonable, comparable or analogous term for LIBOR"; or (iii) a "replacement that is based on a methodology or information that is similar or comparable to LIBOR". The NY Statute later explicitly deems the RBR to satisfy all of these criteria as a sufficient and adequate one-for-one LIBOR substitute.

The Discretionary Authority Rule, however, contains some notable limitations and traps for the unwary. First, to be eligible for "safe harbor" protections, the Determining Person must select the RBR "on or after the occurrence of the LIBOR discontinuance event". It further requires the selection to be made "by the earlier of" the LIBOR replacement date or the latest date for selecting the RBR under the contract. This may lead to unintended consequences or confusion when the contract requires LIBOR to be replaced later – sometimes *years later* in certain common consumer mortgages for example – than the LIBOR replacement date. Moreover, if the Determining Person under a given transaction fails to select a fallback for whatever reason (for example, if it has ceased

to be in existence), then that transaction may well cease to be operable, which could in turn lead to an unanticipated shifting of gains and losses and litigation.

LIABILITY "SAFE HARBOR" AND CONTRACT CONTINUITY PROVISIONS

As noted above, the NY Statute confers certain immunities on persons utilising RBRs pursuant to or under the Operation of Law Rule or the Discretionary Authority Rule and contains other "continuity of contract" provisions. The NY Statute creates a broad "safe harbor" in the form of a liability shield against claims for damages as well as equitable relief arising out of the selection or use of the RBR, or for the "determination, implementation or performance" of any Conforming Changes. This "safe harbor" and liability shield are central to the purpose of the NY Statute.

The NY Statute aims to reduce disputes and litigation risks in other ways. For example, it includes the "deemed equivalence" provision referenced above. It also provides that the "selection or use" of the RBR shall be deemed to be "substantial performance by any person of any right or obligation" based on LIBOR. In addition, it provides that selection, implementation or use of an RBR, including Conforming Changes, shall be deemed not to "impair the right of any person to receive a payment . . . or affect the amount or timing of such payment"; be a breach of contract or the basis for invoking such doctrines as discharge for voidness, impossibility, frustration or *force majeure*; or, counter-factually, be an amendment or modification of the relevant contract.

EXCEPTIONS TO OPERATION OF THE NY STATUTE

The NY Statute does not "alter or impair" certain LIBOR contracts, which are therefore in effect "carved out" from the scope of the statute. First, the NY Statute creates an expansive but vague ability on the part of contracting parties to "opt out" of its application, "retrospectively or prospectively . . . without necessarily referring to this article". This "opt-out" right may prove illusory for certain transactions other than those that are bilateral in nature. Second, LIBOR contracts that "would result in" a RBR not based on LIBOR such as the prime rate or the federal funds rate, will not be altered or impaired by the NY Statute. This leaves parties free to debate latent ambiguities that arguably exist in such contracts, including whether and to what extent rates like prime were intended to apply in the context of the permanent cessation of LIBOR (as opposed to a situation when LIBOR was temporarily unavailable). It also forces parties to grapple with thorny interpretation questions about how the "carve out" and the Operation of Law Rule interact in the context of common fallback formulations – like alternate base rate mechanisms found in many commercial loans – that utilise a "blend" of LIBOR and non-LIBOR rates such as the "higher of" the prime rate, fed funds or LIBOR.

OTHER OPEN QUESTIONS UNDER THE NY STATUTE

The NY Statute will certainly reduce disputes and litigation risks. But it is not a panacea for all ills. Some of the NY Statute's limitations are noted above, but there are additional, more fundamental, potential challenges to overcome. First and most importantly is that the NY Statute may be vulnerable to challenges under the US and New York constitution on various grounds, including pre-emption by federal legislation such as the Trust Indenture Act; prohibitions on impairment of contracts; improper delegation to a private sector body such as the ARRC and "due process" violations (such as the inability to challenge the ARRC's recommendations and removal of third party rights of consent to "amendments"). Whether such challenges would be successful or not is beyond the scope of this article. However, the uncertainty that such challenges may create, by themselves, are important to keep in mind as parties plan for 30 June 2023 and beyond. Parties may conclude that obtaining certainty by means, for example, of negotiated amendments or interpleader-like actions, may be the prudent or necessary course despite the promise of the NY Statute.

Additionally, market participants remain in limbo as to the contours of any ultimate "legislative solution" in the US because there is similar but different federal legislation moving through Congress that would likely "preempt" the NY Statute and thereby render it null and void. Our understanding is that this federal legislation is being positioned for an October 2021 enactment, but it is, of course, impossible to say what will in fact transpire. Indications based on current versions in circulation are that the Federal Reserve, rather than the ARRC, will be required to select the RBR and credit spread adjustments through a formal rule-making process in accordance with the Administrative Procedures Act.

Finally, the NY Statute is resolutely focused on "SOFR" and mandates that the RBR be "based on SOFR". Although the NY Statute purports not to create any negative inference or presumption against any benchmark replacement that is not the RBR, *only* the RBR is part of the Operation of Law Rule and *only* the RBR is entitled to the important liability safe harbors and continuity of contract provisions. This leaves parties that may wish to use "credit-sensitive" SOFR rivals such as Ameribor and the Bloomberg Short-Term Bank Yield Index (BSBY) facing uncertainties that they will have to weigh as they continue to chart their course through the LIBOR transition.

THE UK LEGISLATION

The UK Legislation is also designed to deal with the situation where a contract refers to LIBOR and there are either: (i) no "fallbacks" as to what should happen if LIBOR ceases to be published; or (ii) any such "fallbacks" are not appropriate for a permanent cessation, having been drafted with a temporary cessation in mind.

CURRENT STATUS

The UK Legislation received Royal Assent on 29 April 2021, and those provisions which relate to the FCA's powers to deal with benchmark transition came into effect on 1 July 2021. The FCA has been consulting on how to use its new powers to implement synthetic LIBOR rates for sterling and yen and has published a proposed decision on six sterling and yen LIBOR settings. Given the later date for the cessation of the main USD LIBOR settings, they have not yet made any statements or opened consultations

Feature

Biog box

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about how they intend to use their powers in relation to them. The FCA are proposing that the non-USD synthetic LIBOR rates would be based on forward-looking term RFRs, so SONIA for sterling and TONA for yen, plus the relevant ISDA spread adjustment. The FCA also need to confirm who will be able to use the rates, and in what circumstances, which is subject to a current consultation. They have indicated that they intend to confirm their final decisions as soon as practicable in Q4 2021. There therefore remains considerable uncertainty as to many of the details of this "legislative fix".

CONTRASTING APPROACHES

In contrast to the approach taken in the NY Statute, the UK Legislation does not deem that references to "LIBOR" should be treated as references to another benchmark, nor does it address the position of a "determining person" or deem that LIBOR fallbacks involving a "poll, survey or inquiries for quotes" should be deemed null and void. Instead, the UK Legislation addresses the risk of contracts being frustrated by giving powers to the FCA to give instructions to IBA (as the administrator of LIBOR) to continue to publish some or all of the various ceasing LIBORs for specific purposes, for a limited period of time and on a specified basis. All the indications from the FCA are that this will involve the IBA being required to publish so-called "synthetic LIBORs" for some (but not necessarily all) currency/tenor pairings.

The other main points of contrast worth bearing in mind are that these FCA powers: (i) apply to all LIBORs, and not just those for USD; and (ii) are arguably not limited in their jurisdictional reach, as they do not operate by amending contracts, but rather they fundamentally change the nature of the LIBORs themselves while preserving their names, (being those used in legacy contracts), so as to enable those contracts to continue to be performed.

Finally, there are no "safe harbor" provisions which offer immunity to any parties, again because the UK Legislation is not aimed at specific contracts or contracting parties, but rather at the rates themselves.

The overriding idea is that for "tough legacy" contracts, which cannot practically be amended to remove references to LIBOR, there will continue to be a "LIBOR" rate which can be used, so the relevant contracts are not frustrated.

POTENTIAL ISSUES

As mentioned above, in relation to any entity which is authorised by the FCA, the use of any synthetic LIBOR will be limited to specific purposes (most notably it will not be available for use in any new contracts) and for a limited period of time to be defined by the FCA (again these details are subject to an FCA consultation). These restrictions will not, however, apply to any entities which do not fall within the regulatory remit of the FCA. This raises the possibility of certain market participants using synthetic LIBOR either for new contracts, or for a wider range of legacy contracts than those which are permitted by the FCA. It should be noted, however, that synthetic LIBOR will cease to be published at some point in the future, potentially leaving parties who choose to use it with another benchmark cessation issue, depending on the duration of the relevant instrument.

The FCA has stated its intention that the synthetic LIBORs should avoid frustration of contracts which cannot be actively transitioned to another rate. In other words where those contracts refer to LIBOR then they should simply continue to operate using the published rate (albeit that the rate will be calculated on a different basis). This seems likely to work for contracts which have no provisions relating to the cessation of the relevant LIBOR. It should probably also work for contracts which have inappropriate fallbacks which operate if LIBOR ceases to be published on a temporary basis, as there should be no such cessation. Given, however, the wide range of contractual terms relating to LIBOR and the variety of "fallbacks", some uncertainty remains as to whether the continued publication of LIBOR on a different basis, especially after the 5 March Announcements that LIBOR would cease to be published, will provide a complete solution. If, for example, a contract provides for a switch to "whatever new rate is recommended by the relevant regulatory body" if there is an announcement of the cessation of LIBOR (which has already occurred) then does that operate to switch to synthetic LIBOR or to another risk-free rate (especially as the FCA has not recommended a single replacement rate for USD)?

CONCLUSION

The NY Statute and the UK legislation offer as yet incomplete solutions for LIBOR cessation, although the NY Statute seems likely to provide workable and, more importantly, predictable outcomes under the vast majority of contracts governed by NY law if it can overcome some of its more fundamental challenges. This frees up resources to identify and manage "outliers". The UK government has also announced that it intends to bring forward further legislation to address some of the remaining issues.

The differing approaches of the NY Statute and the UK legislation also raises the prospect of a potential conflict should the FCA use its powers to cause a synthetic USD LIBOR to be calculated and published that results in a different economic result than the ARRC-recommended rate. What happens to a New York law USD LIBOR contract that provides a party with discretion to select a new index only if LIBOR is no longer available? Does synthetic USD LIBOR prevent that right or obligation to exercise discretion from arising, thereby requiring the party to use synthetic LIBOR?

Potential gaps, conflicts and even flaws notwithstanding, "tough legacy" USD LIBOR contracts probably almost by definition require legislative intervention. The financial markets should be gratified that Parliament, Congress and the legislatures of States such as New York and Alabama (which has passed "look-alike" legislation to the NY Statute) have found room in their busy and very disparate dockets to confront intractable issues with LIBOR transition. ■

Further Reading:

- LIBOR transition: ISDA Protocol first mover disadvantage and other international perspectives (2021) 1 JIBFL 5.
- RFR Term Rates in a post-LIBOR landscape (2021) 7 JIBFL 471.
- LexisPSL: Banking & Finance: Practice Note: Running a transition project.