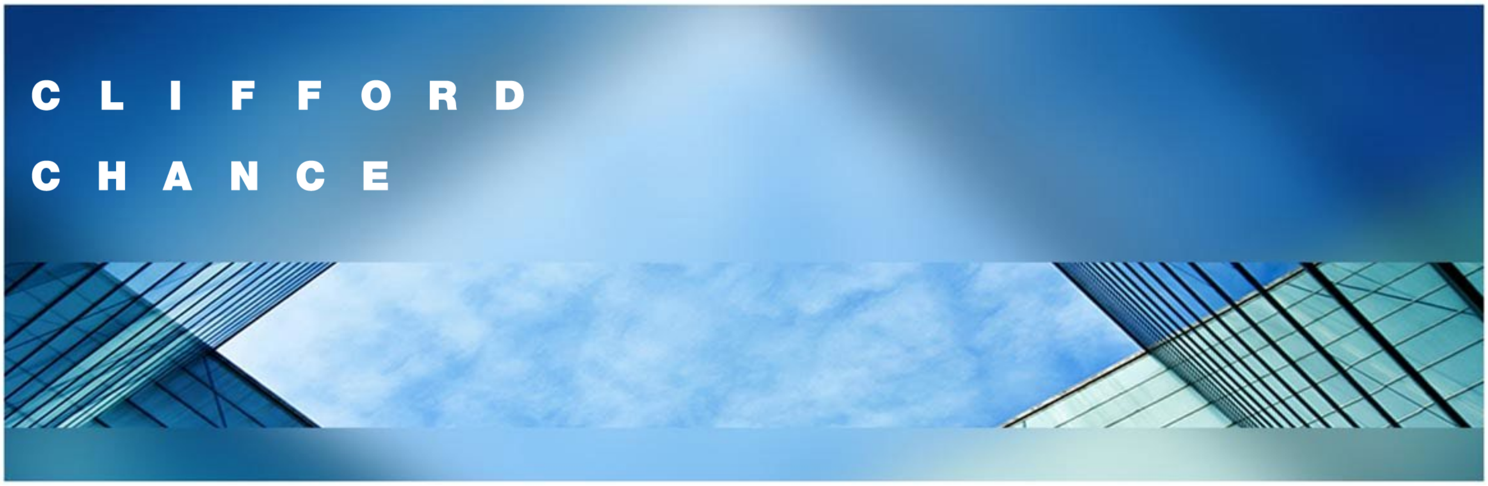

NEW YORK GOVERNOR SIGNS LEGISLATION TO ADDRESS CESSATION OF USD LIBOR

On April 7, 2021, New York Governor Cuomo signed into law Senate Bill 297B/Assembly Bill 164B, available here, to mitigate risks and provide continuity for certain financial products at the time that U.S. dollar ("**USD**") LIBOR is no longer published or is determined to not be representative.

Key Takeaways

- When US dollar LIBOR is no longer published or representative, Article 18-C of the New York General Obligations Law will automatically provide a SOFR-based recommended replacement rate with spread adjustment for certain contracts that reference US dollar LIBOR and lack adequate fallback provisions.
- Details regarding the recommended replacement rate have not yet been specified, may vary by type of contract, and could be recommended by the Federal Reserve Board, the Federal Reserve Bank of New York or the Alternative Reference Rates Committee.
- New York law governed contracts that voluntarily or automatically switch from US Dollar LIBOR to a recommended replacement rate will have the benefit of legislative safe harbor protections that reduce litigation risk.
- If all requisite parties to a contract agree in writing to opt-out, this legislation would not alter or impair the contract, and no negative inference would apply if the contract is amended to provide an alternative replacement rate.

The text of this legislation closely tracks the proposal published in March 2020 by the Alternative Reference Rates Committee (the "**ARRC**"), available here, and addresses the position of financial instruments that do not have effective language to accommodate the transition away from USD LIBOR. It adds a new Article 18-C "LIBOR Discontinuance" ("**Article 18-C**") to the New York General Obligations Law, available here, which applies to any contracts, agreements, mortgages, deeds of trust, securities (including debt securities as well as preferred equity securities), instruments or other obligations that refer to any tenor of USD LIBOR and are governed by New York law ("**LIBOR Contracts**"). For LIBOR Contracts that do not include adequate fallback provisions to replace USD LIBOR, New York law will provide a replacement benchmark based on SOFR with a spread adjustment and conforming changes after the relevant tenor of USD LIBOR ceases to be published or is no longer representative.

The New York legislation is timely, having been approved by the New York legislature less than three weeks after the ICE Benchmark Administration's announcement on March 5, 2021 that it will cease the publication of:

- the 1-week and 2-month tenors of USD LIBOR immediately following publication of such rates on December 31, 2021; and
- the overnight and 1-, 3-, 6-, and 12-month tenors of USD LIBOR immediately following publication of such rates on June 30, 2023.

Overview of New Article 18-C of the NY General Obligations Law

The primary effect of Article 18-C is to provide a statutory framework to modify legacy LIBOR Contracts that otherwise lack adequate fallback provisions to replace USD LIBOR with a recommended benchmark replacement based on

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SOFR. Article 18-C contemplates that a relevant recommending body (which includes the Federal Reserve Board, Federal Reserve Bank of New York ("**NY Fed**"), and the ARRC) will publish recommendations regarding replacement rates, adjustment spreads and conforming changes[1] that will be implemented through a mandatory or voluntary process.

Article 18-C also provides legal certainty in connection with the discontinuance of USD LIBOR by:

- prohibiting parties from refusing to perform their obligations or declaring a breach of contract as a result of the discontinuance of LIBOR or the use of a replacement;
- establishing that a recommended benchmark replacement is a commercially reasonable substitute for and a commercially substantial equivalent to LIBOR; and
- providing a safe harbor from liability for the use of the recommended benchmark replacement and the implementation and performance of any conforming changes.

The following chart provides a high-level overview of the application of Article 18-C based on type of fallback provision.

Type of Fallback Provision	Automatic Switch to Recommended Benchmark Replacement based on SOFR, Spread and Conforming Changes	Application of Safe Harbor Protections
None	Yes	Yes
Based in any way on any USD LIBOR value (such as last published rate)	Yes	Yes
Involving a poll, survey or inquiries for quotes or information concerning interbank lending rates	Yes – these fallbacks will be disregarded as if not included & deemed null and void	Yes
ARRC (or other) amendment approach	No – Article 18-C allows for, but does not require, selection of the recommended benchmark replacement	Will only apply if the selected replacement rate is the recommended benchmark replacement
ARRC (or other) hardwired approach	No	Will only apply if the replacement rate resulting from the fallback waterfall is the recommended benchmark replacement

[1] Article 18-C does not alter or impair the application of any cap, floor, modifier or spread adjustment to which USD LIBOR had been subject prior to the replacement, including as the result of the application of any conforming changes.

Scope and Application

By operation of New York law, Section 18-401(1) replaces USD LIBOR with a recommended benchmark replacement rate on the LIBOR replacement date (discussed below) in any LIBOR Contract that:

- uses USD LIBOR as the basis of, or as a reference for, calculating or determining any valuation, payment or other measurement under, or in respect of, the LIBOR Contract; and
- contains no fallback provisions or one of the following:
    - ***Fallback provisions that are USD LIBOR-based***: Section 18-401(1)(b) applies to any LIBOR Contract that contains fallback provisions that result in a benchmark replacement (other than a recommended benchmark replacement) that is based in any way on any USD LIBOR value. For example, the fallback provisions of older floating rate notes provide that when USD LIBOR is unavailable for a given period, the contract will use the USD LIBOR rate published for a prior interest period (if applied, such fallback would effectively convert a floating rate note into a fixed rate note).
    - ***Fallback provisions that involve a poll, surveys or inquires***: Pursuant to Section 18-401(2), any fallback provisions in LIBOR Contracts that would involve a poll, survey or inquiries for quotes or information concerning interbank lending rates or any interest rate based on USD LIBOR will be disregarded as if not included and will be deemed null and void.

For LIBOR Contracts not otherwise covered under Sections 18-401(1) and 18-401(2), and that contain "amendment approach" fallback language, Section 18-401(3) allows (but does not require) a determining person to select a recommended benchmark replacement rate as the replacement benchmark on or after the occurrence of a LIBOR discontinuance event. Although this section addresses LIBOR Contracts that contain this "amendment approach" language already, the ARRC no longer recommends the use of "amendment approach" fallback language for business loans.

Article 18-C does not alter or impair any LIBOR Contracts that contain fallback provisions using the ARRC's recommended "hardwired approach" or otherwise pre-select any replacement benchmark unrelated to USD LIBOR (the prime rate or the federal funds rate).

Replacement Date

Article 18-C provides for benchmark replacement after a LIBOR discontinuance event, which includes a public announcement by LIBOR's administrator or the regulatory supervisor of LIBOR's administrator that USD LIBOR has ceased or will cease to be published (provided that there is no successor that will continue to publish LIBOR) or a public announcement by the regulatory supervisor of LIBOR's administrator that USD LIBOR is no longer representative.

Section 18-400(3) provides for the specific LIBOR replacement date depending on the LIBOR discontinuance event.

For any public announcement that USD LIBOR has ceased or will cease to be published, the LIBOR replacement date will be the later of the following:

- the date of the relevant public announcement; and
- the date on which the administrator of USD LIBOR permanently or indefinitely ceases to provide USD LIBOR.

For any public announcement that USD LIBOR is no longer representative, the LIBOR replacement date will be:

- the date of the relevant public statement.

From December 31, 2021, for LIBOR Contracts that use 1-week or 2-month USD LIBOR, this Article 18-C would not apply to provide a statutory fallback to the extent that the LIBOR Contract provided for interpolation and such rate could be interpolated from USD LIBOR tenors that continue to be published and are representative.

Based on the LIBOR administrator's March 5, 2021 cessation announcement, we expect that the replacement date for purposes of Article 18-C will occur immediately after December 31, 2021 for 1-week and 2-month USD LIBOR and immediately after June 30, 2023 for all other tenors of USD LIBOR (including 1-month and 3-month USD LIBOR). It is likely that a recommending body, such as the New York Fed or the ARRC, will in the future issue recommendations that will be used with Article 18-C prior to these replacement dates, including recommended adjustment spreads and conforming changes. These recommendations may vary by USD LIBOR tenor and type of LIBOR Contract.

Conforming Changes

The recommended benchmark replacement contemplated by Article 18-C includes benchmark replacement conforming changes selected or recommended by a relevant recommending body which may vary by type of LIBOR Contract.

Such changes would include any technical, administrative or operational changes associated with and reasonably necessary to the use, adoption, calculation or implementation of a recommended benchmark replacement.

If, in the reasonable judgment of a calculating person[2], applicable conforming changes do not apply to a LIBOR Contract or are insufficient to permit administration and calculation of the recommended benchmark replacement, then the benchmark replacement conforming changes shall include such other changes, alterations or modifications that, in the reasonable judgment of such calculating person:

- are necessary to permit administration and calculation of the recommended benchmark replacement under or in respect of such LIBOR Contract in a manner consistent with market practice for substantially similar LIBOR Contracts and, to the extent practicable, the

2 The person responsible for calculating or determining any valuation, payment or other measurement based on a benchmark.

manner in which such LIBOR Contract was administered immediately prior to the LIBOR replacement date; and

- would not result in a disposition of such LIBOR Contract for U.S. federal income tax purposes.

Continuity of Contracts & Safe Harbor Provisions

For contracts that voluntarily or automatically incorporate a recommended benchmark replacement rate, Article 18-C provides statutory continuity of contracts and safe harbor protections that reduce litigation risk.

Section 18-402(1) ensures continuity of contracts covered by the Legislation, by providing that the use of a recommended benchmark replacement rate under or in respect of a LIBOR Contract constitutes:

- a commercially reasonable replacement for and a commercially substantial equivalent to USD LIBOR;
- a reasonable, comparable or analogous term for USD LIBOR;
- a replacement that is based on a methodology or information that is similar or comparable to USD LIBOR; and
- substantial performance by any person of any right or obligation based on USD LIBOR.

Section 18-402(2) provides that the LIBOR discontinuance event, the LIBOR replacement date or the selection or use of a recommended benchmark replacement will not:

- be deemed to impair or affect the right of any person to receive payment, or affect the amount or timing of such payment;
- discharge or excuse performance (e.g. by invoking a force majeure clause), or give any person the unilateral right to suspend performance; or
- constitute the breach, or nullification of LIBOR Contracts.

Section 18-402(3) provides statutory safe harbors for LIBOR Contracts that switch to a recommended benchmark replacement rate by operation of law, as the result of contractual fallback language or voluntary amendment. The safe harbor provisions of this section are two-fold:

- ***"Rate" Safe Harbor***: No person will be liable for damages or subject to any claim or request for equitable relief because of the use of a recommended benchmark replacement. This provision would protect a determining person under "amendment approach" fallback language when irrevocably selecting a recommended benchmark replacement rate only if the determining person does so by the deadline described below. This provision would also apply if a recommended benchmark replacement rate is used as the replacement benchmark as the result of the waterfall included in a "hardwired approach" fallback provision.
- ***"Conforming Changes" Safe Harbor***: No person will be liable for damages or subject to any claim or request for equitable relief because of

the implementation or performance of benchmark replacement conforming changes contemplated by Article 18-C.

To qualify for these safe harbor protections, the selection of the recommended benchmark replacement by a determining person must be:

- irrevocable;
- made by the earlier[3] of either the LIBOR replacement date, or the latest date for selecting a benchmark replacement specified in the relevant LIBOR Contract; and
- used in any determinations of the applicable benchmark under or with respect to such LIBOR Contract occurring on or after the LIBOR replacement date.

Additional legal certainty is provided by Section 18-402(4). The use of a recommended benchmark replacement rate or implementation or performance of conforming changes will not constitute an amendment or modification of any LIBOR Contract. Such use will also be deemed to not impair or have any material or adverse effect on any person's rights or obligations.

Flexibility to Choose Alternative Benchmark Replacements

On November 6, 2020, U.S. bank regulators jointly released a Statement on Reference Rates for Loans, available here, which recognizes that the use of SOFR to replace USD LIBOR is voluntary and that banks are free to choose alternative reference rates other than SOFR. For example, some banks may want to use a replacement rate that is credit sensitive (while SOFR is a risk-free rate), and other banks may prefer not to devote limited resources to redesigning systems to support the administration of SOFR. In line with this guidance, Article 18-C provides banks, financial market participants and other contractual parties with significant flexibility to opt-out and choose alternative replacement rates. If all requisite parties agree in writing that Article 18-C does not apply to their LIBOR Contract, Section 18-401(5)(a) provides that Article 18-C will not alter or impair such agreement.

The flexibility to opt out is supported by Section 18-402(5), which provides that there will be no negative inference or negative presumption regarding the validity or enforceability of the alternative rate and any related spread adjustment or conforming changes. Any such alternative rates, spread adjustments or conforming changes will, however, not benefit from the continuity of contracts and safe harbor provisions discussed above.

Consequences of Article 18-C

Although intended to ease the transition away from USD LIBOR, Article 18-C may be challenged in court. It also does not cover all LIBOR Contracts, and it may not result in the same replacement rates for USD LIBOR as legislative solutions adopted in other jurisdictions.

[3] To facilitate an orderly transition away from USD LIBOR, however, determining persons should consider notifying relevant persons of their replacement rate selections significantly in advance of the LIBOR replacement date. The ARRC Recommended Best Practices for Completing the Transition from LIBOR, available here, encourage determining persons to disclose their planned replacement rate selection to relevant parties at least six months prior to the date that a replacement rate would become effective.

While the drafters of Article 18-C have sought to ensure the validity and enforceability of this legislation under both the U.S. Constitution and New York State Constitution, some commentators have indicated that it could be challenged:

- under the Contracts Clause[4] of the U.S. Constitution;
- under the Non-Delegation Clause[5] under the New York State Constitution; or
- under the Section 316(b)[6] of the U.S. Trust Indenture Act of 1939, as amended (the "**TIA**"), in the case of debt securities issued under an indenture governed by the TIA.

In addition, Article 18-C is only binding under state law. It would not, for example, bind the U.S. Securities and Exchange Commission and it may not bind parties in jurisdictions outside New York. As a result, parties will still need to consider whether amending an outstanding USD LIBOR-based security to provide a replacement benchmark rate could constitute the offer of a "new security" for purposes of complying with the registration requirements of U.S. federal securities law. Non-U.S. parties to LIBOR Contracts may also need to consider whether their home country courts, taking home country public policy considerations into account, would apply New York law to give effect to the contractual terms supplied by Article 18-C.

Legislation similar to Article 18-C is being considered by U.S. federal lawmakers. If adopted, such federal legislation would be helpful in providing additional legacy certainty. We understand that current drafts of such federal legislation contemplate preempting state legislation.

Article 18-C does not apply to any LIBOR Contracts that:

- reference LIBOR for currencies other than U.S. dollars (such as Sterling LIBOR); or
- are governed by the laws of a jurisdiction other than New York.

In the absence of uniform state legislation and/or federal legislation, contracts and other instruments that use USD LIBOR and are governed by the laws of other U.S. states will not benefit from protections similar to the New York legislation unless those states individually adopt equivalent legislation. This is likely to be a factor for consumer loans and other retail products, as well as securitizations based on them.

Similarly, if U.S. federal legislation is adopted, it will likely not apply to any contracts and other instruments that use USD LIBOR and are governed by the laws of any non-U.S. jurisdiction. These jurisdictions may develop legislative solutions that significantly differ from the approach provided by Article 18-C. For example, pursuant to a currently pending proposal, the U.K.'s Financial Conduct Authority could require LIBOR's administrator to continue publishing certain tenors of USD LIBOR based on a modified methodology. If this solution is implemented,

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4 The Contract Clause of the U.S. Constitution prohibits U.S. states from passing any law that would impair contractual obligations.
5 The Non-Delegation Clause of the New York State Constitution prohibits the New York state legislature from delegating its law-making responsibilities to other entities.
6 Section 316(b) of the TIA provides that the right of any holder of any covered debt security to receive interest payments on such debt security may not be impaired or affected without the consent of such holder.

legacy contracts without adequate fallback provisions could reference "synthetic" LIBOR rates. (For regulatory purposes, however, new contracts would not be permitted to reference synthetic LIBOR rates.) If LIBOR's administrator publishes a synthetic version of USD LIBOR after June 31, 2023, U.K. law governed contracts could yield significantly different interest rates than New York law governed contracts that also referenced USD LIBOR. The two approaches are likely to be addressed and reconciled by regulatory pronouncements, but it is still possible that the continued publication of USD LIBOR could conflict with the New York approach.

Conclusion

Article 18-C of the New York General Obligations Law reduces legal uncertainty and adverse economic impacts associated with the discontinuance of USD LIBOR. Article 18-C supplies a replacement benchmark based on SOFR, spread adjustments, and conforming changes for contracts and other instruments that use USD LIBOR as a benchmark, lack adequate fallback provisions and are governed by New York law. While it promotes use of recommended benchmark replacement rates by reducing litigation risk, Article 18-C also provides flexibility to parties that select alternative replacement rates without negative implications. In that respect, it is a helpful step toward an orderly transition away from USD LIBOR, at least for New York law contracts. It is also likely to be just the first of a number of statutory measures to alleviate the risks associated with LIBOR transition.

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C H A N C E

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