



REPORT ON LEGISLATION BY THE NEW YORK CITY BAR ASSOCIATION

**A.164-B
S.297-B**

**M. of A. Zebrowski
Sen. Thomas**

AN ACT to amend the general obligations law, in relation to the discontinuance of the London interbank offered rate

A.3008-A / S.2508-A (Budget Article VII) – Part PP

Enacts into law major components of legislation necessary to implement the state transportation, economic development and environmental conservation budget for the 2021-2022 state fiscal year; to amend the general obligations law, in relation to the discontinuance of the London interbank offered rate (Part PP)

SUPPORT FOR THE ENACTMENT OF LIBOR REPLACEMENT LEGISLATION

I. SUMMARY

The New York City Bar Association, through its LIBOR Replacement Legislation Working Group and the constituent Committees thereof (identified in Appendix A to this Report and collectively referred to as the “Working Group”), endorses the enactment in New York of the proposed LIBOR Discontinuance Legislation introduced in the New York State Legislature,¹ and also as part of the 2021-2022 Fiscal Year New York State Executive Budget proposed by Governor Cuomo on January 19, 2021² (the “Proposed Statute”) to avoid substantial disruption to the rights of parties to trillions of dollars of financial contracts that may be affected by the cessation of U.S. Dollar LIBOR (“U.S. Dollar LIBOR” or “LIBOR”), a benchmark rate that is used to calculate interest and payments in many types of financial transactions.

- ICE Benchmark Administration Limited (IBA), the organization that administers U.S. Dollar LIBOR, an interest rate benchmark that is incorporated in trillions of dollars’ worth of financial contracts, published a consultation on December 4, 2020 that closed

¹ 2021 NY Senate-Assembly Bill 297-B, A164-B, <https://www.nysenate.gov/legislation/bills/2021/s297/amendment/b>.

² Budget Bill, see Part PP, <https://www.nysenate.gov/legislation/bills/2021/s2508/amendment/a>.

About the Association

The mission of the New York City Bar Association, which was founded in 1870 and has 25,000 members, is to equip and mobilize a diverse legal profession to practice with excellence, promote reform of the law, and uphold the rule of law and access to justice in support of a fair society and the public interest in our community, our nation, and throughout the world.

on January 25, 2021 regarding its intention to cease publishing most tenors of U.S. Dollar LIBOR after June 30, 2023 and to cease publishing two tenors of U.S. Dollar LIBOR tenors at the end of 2021.³ On March 5, 2021, the UK Financial Conduct Authority announced the “future cessation and loss of representativeness of the LIBOR benchmarks”, and confirmed the dates for cessation for U.S. Dollar LIBOR as June 30, 2023 for the overnight, one-month, three-month, six-month and twelve-month settings.⁴

- Many contracts governed by New York law (“New York Contracts”) using LIBOR do not have adequate provisions to determine what will happen when LIBOR ceases to be published.
- While parties have amended and will likely amend many contracts to address the cessation of LIBOR’s publication, many New York Contracts, referred to as “Legacy Contracts” will not be amended. This could be the result of the parties’ lacking sufficient time or resources to amend their contracts to address LIBOR cessation, the enormous volume of contracts requiring amendment, and/or the difficulties in contacting and coordinating the multiple parties who must consent (or not object) to the necessary amendments.
- The failure to resolve the problem of Legacy Contracts that have not been amended to address the cessation of LIBOR will result in one or more of the following.
 - Uncertainty will exist regarding how New York Contracts will be treated.
 - Disputes will arise and parties will seek redress in the courts, as foreshadowed by a number of parties that have provided notice of their intention to seek interpretative judicial relief. Some parties may attempt to walk away from contracts, alleging that the contracts are impossible to perform, that their purpose has been frustrated, or some other legal defense. The result could be a large volume of cases involving a large volume of transactions and substantial financial market disruption.
 - Investors (including investors located in New York and New York state pension plans) that have invested in securities that reference LIBOR may have their floating rate securities converted to fixed rate securities, potentially to their

³ On November 30, 2020, the IBA announced that it planned to consult on its intention to cease the publication of U.S. Dollar LIBOR for the one-week and two-month tenors immediately after December 31, 2021, and, pending the results of an outstanding market consultation, the U.S. Dollar LIBOR for the remaining tenors (overnight, and one-month, three-month, six-month, and twelve-month settings) immediately after June 30, 2023. See www.theice.com/publicdocs/ICE_LIBOR_Consultation_on_Potential_Cessation.pdf. The consultation period closed on January 25, 2021. The announcement was published on December 4, 2020. See https://www.theice.com/publicdocs/ICE_LIBOR_Consultation_on_Potential_Cessation.pdf.

⁴ See <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>. For the IBA’s accompanying press release, see <https://ir.theice.com/press/news-details/2021/ICE-Benchmark-Administration-Publishes-Feedback-Statement-for-the-Consultation-on-Its-Intention-to-Cease-the-Publication-of-LIBOR-Settings/default.aspx>.

economic detriment. In certain cases, investors may be forced to sell these securities to comply with their investment guidelines.

- Liquidity in securities that reference LIBOR and do not have adequate Fallbacks⁵ will be impaired while the uncertainty is resolved over months, if not years, in the court system, likely with potentially inconsistent results among courts, until binding precedent is established by the New York Court of Appeals or some other court of last resort.
- A similar situation occurred in 1997 when, in anticipation of certain European currencies transitioning from their national currencies to the Euro, the New York State Legislature (the “Legislature”), recognizing the potential disruption that would occur, the importance of New York in the global financial system, and the large number of financial contracts that were governed by New York law, passed legislation mandating in contracts governed by New York law that the Euro replace the sovereign currencies that were being phased out.⁶
- The Proposed Statute seeks to reduce such disruptions and mitigate these issues for some Legacy Contracts by, among other things, providing for a new “benchmark” rate to replace LIBOR as the basis for calculating interest and/or payment obligations and prohibiting parties from terminating contracts or asserting that they are excused from performance due to the unavailability of LIBOR.
- The Proposed Statute provides a safe harbor, and in some cases imposes, the Secured Overnight Financing Rate (“SOFR”) as the replacement rate for these Legacy Contracts in accordance with recommendations made by the Alternative Reference Rates Committee (the “ARRC”), a committee constituted of private sector market participants supported by the Board of Governors of the Federal Reserve System for the purpose of facilitating a successful transition away from U.S. Dollar LIBOR.⁷ The ARRC is more fully described below under “Regulatory Response.”
- The Proposed Statute’s “safe harbor” provision primarily addresses the situation in which a Legacy Contract permits a “Determining Person” unilaterally to select a replacement rate, and thus essentially impose that rate on the other party to the contract. The provision so empowering the Determining Person is not overridden, but the Determining Person would enjoy an immunity for liability with respect to the replacement rate so selected only if that rate is SOFR.
- SOFR has already been adopted as Fallback for a number of LIBOR-referenced products. For example, SOFR has been accepted by the Loan Syndications and Trading Association (“LSTA”) as a replacement for LIBOR in the syndicated and bilateral loan

⁵ Defined below at 5, under “Introduction to LIBOR”.

⁶ Act of July 29, 1997, 1997 N.Y. Laws 2242-43 (ch. 311) codified as General Obligations Law §5-1601 *et seq.*

⁷ See <https://www.newyorkfed.org/arrc/about>.

markets. SOFR (as well as Ameribor⁸) has been adopted by the International Swaps and Derivatives Association (“ISDA”) as a Fallback in the standard definitions ISDA publishes for interest rate derivatives that are used by the over-the-counter derivatives industry and has been used by many issuers of recent LIBOR referenced notes and bonds as a Fallback.

- Importantly, parties retain their ability to enter into modifications to their contracts for the purpose of addressing the cessation of LIBOR, to the extent permitted under the terms of such contracts and feasible. The Proposed Statute does not preclude parties from agreeing to transition contracts, either now or upon a discontinuation of LIBOR, to benchmarks other than SOFR, such as the “prime” rate, Ameribor or one of the benchmarks being developed as a replacement to LIBOR by Bloomberg, IHS Markit or that may be offered by benchmark administrators in the future. In the case of such a mutual agreement by the parties to their contract, the provisions of the Proposed Statute would not apply. The provisions that would not apply include the “safe harbor” provisions, but, if the parties to a contract were able to reach their own agreement as to the terms of a replacement rate (or even the continuance of some type of LIBOR rate) there would be no need for a “safe harbor”.
- Additionally, the Proposed Statute does not impose SOFR as the replacement rate, where contracts contain Fallback provisions that would result in a benchmark replacement that is not based on LIBOR. For example, where parties to a commercial loan have contracted to calculate interest based on the prime rate or the federal funds rate if LIBOR is discontinued, their choice of that fallback rate would be respected and not replaced by SOFR. This limit on the application of the Proposed Statute results in only imposing SOFR as a default in certain circumstances if LIBOR is discontinued, such as where there is a contractual gap.
- While the Proposed Statute will not resolve all issues arising from LIBOR's cessation, the Working Group believes that the Proposed Statute addresses an important need, where contracts cannot be practically amended or are otherwise not amended by the parties in time. Therefore, for the above reasons, the Working Group supports its enactment.

II. CONSTITUTIONAL AND STATUTORY CONCLUSIONS

The Working Group has analyzed the constitutionality of the Proposed Statute under the Contracts Clause,⁹ the Takings Clause¹⁰ and the Due Process Clause¹¹ of the United States

⁸ Ameribor is an interest rate benchmark created by the American Financial Exchange reflecting the actual borrowing costs of U.S. small, medium and regional banks. See <https://ameribor.net/background>.

⁹ U.S. Const. art I, § 10, cl. 1 - prohibiting states from passing laws “impairing the Obligation of Contracts”.

¹⁰ U.S. Const. Amend. V - private property may not be “taken for public use, without just compensation.”

¹¹ U.S. Const. Amend. V - no person shall be deprived of property “without due process of law”.

Constitution, and the Takings Clause,¹² the Due Process Clause¹³ and the Nondelegation doctrine of the New York State Constitution.

The Working Group has concluded that the Proposed Statute would survive a legal challenge based on any of these federal or New York State constitutional constraints. Appendix C contains analyses of the Proposed Statute under each such provision.

The Working Group also has concluded that the Proposed Statute does not violate any existing statutes of New York State.

III. BACKGROUND

A. Introduction to LIBOR

The U.S. Dollar London Interbank Offered Rate (“LIBOR” or “U.S. Dollar LIBOR”) is referenced as the benchmark rate for calculating interest and/or payments in approximately \$200 trillion of financial products worldwide.¹⁴ LIBOR is intended to reflect the average rates at which large banks can borrow U.S. Dollars on an unsecured basis (*i.e.*, without providing collateral) from other large banks and professional investors for different periods of time. Historically, LIBOR has been established through a polling of “panel banks” that supply quotes¹⁵ of rates at which each believes funds may be borrowed for seven different periods (known as “tenors”) ranging from an overnight loan to as long as one year. Transactions are typically priced at an aggregate interest variable rate equal to the applicable LIBOR “benchmark” rate plus a credit “spread.” That spread is a negotiated increase in the interest rate over LIBOR at the specified tenor reflecting the lender’s perceived credit risk of the specific borrower and transaction. The spread is usually expressed as a percentage rate (in “basis points” or one-hundredths of one percent; *e.g.*, “LIBOR+ 50bp,” which would equal LIBOR plus 50 basis points (or LIBOR plus 0.5%)).

As described in this Report, the parties’ agreements may include alternative interest rate indexes or “benchmarks” to be used if LIBOR is unavailable (referred to as “Fallbacks”) that may have different spread adjustments.

LIBOR is referenced in a broad variety of transactions ranging from consumer credit cards and home mortgages to bilateral business loans, syndicated bank loan agreements, structured finance transactions, and swaps and derivatives. J.P. Morgan has estimated¹⁶ the volume of transactions as follows:

¹² N.Y. Const. Art. I, § 7(a).

¹³ N.Y. Const. Art. I, § 6.

¹⁴ J.P. Morgan, *Libor Primer: Setting the Stage for SOFR*, <https://www.jpmorgan.com/solutions/cib/markets/libor-sofr>.

¹⁵ In contrast, as more fully described in this report, SOFR, the proposed replacement benchmark, is based on a very substantial volume of actual overnight transactions in the secondary market for U.S. Treasury securities.

¹⁶ J.P. Morgan, *Leaving LIBOR, A Landmark Transition*, <https://www.jpmorgan.com/solutions/cib/markets/leaving-libor>.

- \$3.4 trillion in business loans.
- \$1.3 trillion in retail mortgages and other consumer loans.
- \$1.5 trillion in floating rate debt.
- \$1.8 trillion in securitized products.
- \$190 trillion in interest rate and other swap transactions.

There is an unmeasured volume of other contracts for goods and services that also reference LIBOR.

Due to regulatory and market changes following the 2007 financial crisis, there has been a significant reduction in the volume of unsecured borrowing among banks in the LIBOR market. As a result, LIBOR has been characterized as a less robust benchmark. The regulator that oversees LIBOR, the Financial Conduct Authority (“FCA”) in the United Kingdom, initially announced in 2017 that the panel banks had agreed to support LIBOR through the end of 2021 while the FCA focused on developing alternative rates.¹⁷ On December 4, 2020 the ICE Benchmark Administration published a consultation on its intention to cease publishing certain tenors (overnight, 1 month, 3 month, 6 month and 12 month) of U.S. Dollar LIBOR at the end of June 2023.¹⁸ The period for feedback on the consultation closed on January 25, 2021 and ICE Benchmark Administration has announced that it expects to publish a feedback statement. The period for the feedback on the consultation closed on January 25, 2021. On March 5, 2021 the UK Financial Conduct Authority, citing to the results of the consultation, declared LIBOR no longer to be representative, and that, as a result, after June 30, 2023, U.S Dollar LIBOR will no longer be available in any tenors.

B. Elements of Benchmark Replacement/Fallback Spread Adjustment

Many existing financial contracts priced using U.S. Dollar LIBOR do not include Fallbacks that address a permanent end to LIBOR, while many others have ambiguous language or provisions that would cause significant unanticipated economic impacts on the contracting parties. An example of the latter includes the relatively common Fallback to the last available LIBOR, discussed in more detail below. After extensive consultations with market participants, the ARRC (and ISDA for financial derivatives) has published recommendations for Fallback language to be included in the parties’ agreements for new and existing transactions that reference LIBOR. This fallback language contemplates a permanent end to LIBOR and transition to SOFR as the replacement benchmark.

¹⁷ See <https://www.fca.org.uk/news/statements/fca-statement-libor-panels>.

¹⁸ ICE Benchmark Administration to Consult on Its Intention to Cease the Publication of One Week and Two Month USD LIBOR Settings at End-December 2021, and the Remaining USD LIBOR Settings at End-June 2023 (November 20, 2020), <https://ir.theice.com/press/news-details/2020/ICE-Benchmark-Administration-to-Consult-on-Its-Intention-to-Cease-the-Publication-of-One-Week-and-Two-Month-USD-LIBOR-Settings-at-End-December-2021-and-the-Remaining-USD-LIBOR-Settings-at-End-June-2023/default.aspx>. The announcement was published on December 4, 2020, see https://www.theice.com/publicdocs/ICE_LIBOR_Consultation_on_Potential_Cessation.pdf As noted above, the IBA announced that it does not intend to cease the publication of U.S. Dollar LIBOR for several tenors until June 30, 2023. The FCA has expressed support for this extension.

The Proposed Statute addresses various legal and practical problems for Legacy Contracts resulting from a permanent cessation of LIBOR, and with SOFR as the replacement benchmark.

A second element of the benchmark replacement is a “spread adjustment” to account for certain differences between LIBOR and SOFR. As a secured overnight interest rate collateralized by obligations issued by the United States Treasury, SOFR is characterized as a “risk-free rate” as opposed to LIBOR, which is an unsecured borrowing rate and has an embedded credit risk premium indicative of the likelihood of its repayment by the institutional borrower. In order to account for these and other differences between these benchmarks when transitioning from LIBOR to SOFR and to minimize value transfer, a spread adjustment is required. Although many market participants are amending existing contracts to include the ARRC Fallback language or other provisions chosen by the parties that address the cessation of LIBOR, amendments will not be possible or effected for some contracts. Some contracts such as floating rate notes or securitizations can be very difficult to amend. Given the scale of the problem, the consents and other mechanisms for amending certain contracts and the relatively short period of time before LIBOR will be discontinued, timely amendments of many affected contracts will remain challenging if at all feasible.

C. How LIBOR pricing operates

A typical pricing clause in a contract using LIBOR provides that the interest rate for the next interest period¹⁹ is fixed two London Business Days in advance based on the “screen rate” -- the LIBOR rate for that tenor displayed on a specified screen of a designated source such as the Reuters or Bloomberg information services. The screens display the LIBOR for available periods as determined by the IBA – the LIBOR “benchmark administrator” – based on averaging the submissions from each “panel” bank, after trimming upper and lower values. In some contracts, there are no provisions to address how the transaction is to be priced if LIBOR is not available. In others, there are contractual Fallbacks that determine the rate to be applied if no screen rate is displayed. Typically, the first Fallback is to a poll by one of the parties to the transaction (or a “calculation agent” that they have selected) for LIBOR quotes from “reference banks” that meet established criteria. If several quotes are obtained, LIBOR for the next period is the average of the quotes; if only one quote is obtained, that bank’s quote may determine the rate. Some contracts permit one of the parties to select the replacement rate either as the only Fallback or as the last Fallback option if none of the other Fallbacks are available.

Many market participants believe that contractual Fallbacks that attempt to replicate a LIBOR rate were designed only for a temporary unavailability of LIBOR and do not reflect the parties’ expectations for a replacement rate in the event of a permanent cessation of LIBOR. The parties to a LIBOR-based legacy contract chose LIBOR as a floating rate that adjusts to reflect current market conditions such that lenders can reasonably fund long-term liabilities (e.g., commercial loans) with short term funds acquired in the market during that loan’s term. A Fallback to the last quoted LIBOR rate in the event of permanent LIBOR cessation, if such a provision were operative in a contract in the context of permanent cessation of LIBOR, would effectively convert a short-term floating rate to a long-term fixed rate for an obligation that may continue for as long as 30 years. Doing so advantages one or the other party to the transaction depending on the LIBOR

¹⁹ The interest period may be 30 days, 90 days or a year or another period chosen by the parties.

rate at the time of the cessation by happenstance, not negotiation. Most importantly, it would not reflect the intent of the parties at the time the contract came into existence.

D. Characteristics of Transactions that are Priced Using LIBOR

Transactions directly involving consumers. Consumers are parties to LIBOR-based transactions that are both very short term, such as credit cards that may be paid off completely at any time without penalty, and very long term, such as 30-year adjustable rate mortgages, that are based on LIBOR and subject to periodic LIBOR-based interest rate resets, often after an initial fixed rate period.

Bilateral Business Loans. Businesses, both large and small alike, have significant reliance on LIBOR-based loans. A loan made by one lending institution to a single borrower is the simplest model for the negotiation of a replacement benchmark and spread adjustment since it only involves those two parties.

Syndicated Business Loans. A significant complication is introduced where there are several parties extending credit as part of the same facility in the form of a syndicated business loan. For example, the consent of each lender or a required majority of lenders may be required to modify the benchmark used to determine the interest rate. There are obvious practical difficulties in negotiating necessary amendments to address LIBOR replacement with the several financial institutions that may be parties to a syndicated loan agreement.²⁰

Floating Rate Debt/Securitizations. There are many LIBOR-based floating rate securities issued by corporations and securitization structures either having no Fallback language or having the potential to convert to a fixed rate security as described above. Amending these contracts is extremely difficult because in many situations 100% of the investors on a particular deal, often a large number, need to consent to the amendment and they will likely be difficult to identify to solicit such consents. Some securitizations have the added complication of underlying assets that are subject to specified Fallbacks, while the securities issued in these securitizations may have different Fallbacks.

Swaps and Derivatives. The parties to transactions such as interest rate swaps and derivatives are generally businesses and sophisticated financial institutions. A challenge to devising applicable Fallbacks for this market is the sheer volume of transactions that must be addressed. Although ISDA published a protocol and a supplement (together, the “ISDA 2020 IBOR Fallbacks Protocol”) to its swap definitions, this will not, by its terms, address all Legacy Contracts. Parties to a contract entered into prior to January 25, 2021 will have to adhere to the protocol or otherwise adopt the protocol to have the Fallback terms therein apply to that contract.

²⁰ Many syndicated and bilateral business loans include fallbacks for LIBOR that result in calculating interest using another benchmark, like the prime rate, and therefore are specifically excluded from the Proposed Statute’s application of SOFR.

E. Impact on New York

New York is particularly susceptible to suffering an adverse impact from the cessation of LIBOR. Many of the financial products and agreements that reference LIBOR are, by the agreement of the parties (which may or may not be located in New York), governed by New York law and choose the courts of New York as the forum for resolution of disputes as a jurisdiction that offers well developed commercial law with a sophisticated bench and bar. The potential legal uncertainty and adverse economic impact caused by a LIBOR cessation may result in disputes that will burden New York's already taxed judicial resources as well as the affected market participants. These adverse effects will also likely be felt by New York State and its agencies and municipalities in their capacities as issuers of LIBOR-based debt and by public pension funds as investors in LIBOR-based assets. Legislative action in New York that addresses this looming problem could reduce these adverse consequences and mitigate potential risks to economic stability.

The Working Group recognizes that the Proposed Statute cannot affect transactions not governed by New York law, e.g., contracts choosing to be governed by the laws of other states. Further, federal law, including the Trust Indenture Act,²¹ may also apply to certain contracts, complicating the legal analysis. Some of these limitations could be addressed through new federal legislation analogous to the Proposed Statute. While this is beyond the scope of the Proposed Statute and this Report, it is worth noting that various media sources have reported that Representative Brad Sherman (D, CA-30) intends to introduce a bill that is substantially similar to the Proposed Statute, and solicited testimony from Jerome Powell, Chairman of the Board of Governors of the Federal Reserve System at a hearing on February 24, 2021 that "federal legislation creating a path for a backup would be the best solution".²²

IV. REGULATORY RESPONSE

U.S. Dollar LIBOR is one of several interbank offered benchmark rates ("IBORs") that are being phased out. Similar to U.S. Dollar LIBOR, the other IBORs are currency-specific (e.g., Euros, Yen, Sterling and Swiss Francs, among others).²³ IBOR replacement has been a concern of policymakers, regulators and market participants both within and without the regions in which these currencies are used for several years. These policymakers and regulators have recognized that the development and ongoing operation of a replacement benchmark for the IBORs will require both an overall set of architectural principles designed to protect the integrity of the IBORs as a group, as well as special expertise, technical competence and a local familiarity with the particular currency.

²¹ 15 U.S.C. § 77 aaa *et seq.*

²² See J. Paul Forrester, Matthew Bisanz & Mary Jo N. Miller, *US FRB Chair Powell Signals Support for Federal LIBOR Transition Assistance Legislation*, (February 26, 2021) <https://www.eyeonibor.com/2021/02/us-frb-chair-powell-signals-support-for-federal-libor-transition-assistance-legislation/>.

²³ Parallel efforts are underway by the participants in other markets that utilize IBORs to develop alternative benchmarks, such as the Sterling Overnight Index Average, or "SONIA", for transactions in British pounds sterling, the Euro Short-Term Rate, or ESTR, for transactions in Euro, the Swiss Average Rate Overnight, or SARON, for transactions in Swiss Francs and the Tokyo Overnight Average Rate, or TONAR, for transactions in Japanese Yen. The Proposed Statute and this Report do not address those other rates and replacement benchmarks.

With respect to all IBORs, an international organization, the International Organization of Securities Commissions (“IOSCO”) has developed a detailed set of principles (the “IOSCO Principles”) relating to the governance, integrity, methodology, quality and accountability for use in selecting replacement benchmarks and related spread adjustments²⁴ for any reference rate used for pricing any category of transactions. The members of IOSCO regulate 95% of the world’s securities markets in approximately 115 jurisdictions and include the U.S. Commodity Futures Trading Commission and the U.S. Securities and Exchange Commission.

In the United States, the Board of Governors of the Federal Reserve System has taken the lead in the U.S. Dollar LIBOR replacement efforts. The Federal Reserve is the central bank of the United States, and is thus charged with overseeing matters relating to the United States currency – the U.S. Dollar. Among the general functions of the Federal Reserve are “promoting financial system stability...[by monitoring] financial system risks and engag[ing] at home and abroad to help ensure the system supports a healthy economy for U.S. households, communities, and businesses” as well as “supervising and regulating financial institutions and activities... [to promote] the safety and soundness of individual institutions and monitor[ing] their impact on the financial system as a whole.”²⁵ The Federal Reserve’s association with the currency and these enumerated functions appear to be the basis for the Federal Reserve’s prominence in the LIBOR transition process in the United States. Under the “Transition of LIBOR” section of the Federal Reserve Bank of New York’s website, the transition is described as being “essential to a more sound and resilient financial system” and as requiring a “significant, coordinated effort.”²⁶

To assist in the LIBOR transition process, the Federal Reserve Board and the Federal Reserve Bank of New York in December 2014 convened a working group of financial system regulators and private-sector market participants known as the Alternative Reference Rates Committee or the “ARRC”. In 2017, the ARRC recommended SOFR as a benchmark to replace LIBOR. The Federal Reserve Bank of New York began publishing SOFR in 2018. SOFR is an overnight benchmark based on the prior day’s transactions in the U.S. Treasury securities lending market.²⁷

²⁴ As noted above, the process of establishing an appropriate successor rate to LIBOR for use with respect to legacy LIBOR contracts is a two-step process: the determination of a replacement for the underlying benchmark rate (e.g., the Secured Overnight Funds Rate, or SOFR) as well as an adjustment factor (the “spread adjustment”) to bring the replacement benchmark into better alignment with historical LIBOR. As explained in the ARRC’s January 21, 2020 *Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR*, available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Spread_Adjustment_Consultation.pdf, SOFR is an overnight, risk-free rate while LIBOR is an unsecured rate that contains elements of bank credit risk and is published for multiple maturities. To account for these differences and thus preserve the economics of the legacy contracts, an adjustment is required. See the referenced ARRC Consultation for more information.

²⁵ Board of Governors of the Federal Federal Reserve System, *Purposes and Functions* <https://www.federalreserve.gov/aboutthefed/pf.htm>.

²⁶ See Alternative Reference Rates Committee, *Transition from LIBOR*, <https://www.newyorkfed.org/arrc/sofr-transition>.

²⁷ References herein to “SOFR” or the “ARRC-recommended” rate or benchmark include the adjustment to the overnight SOFR rate recommended by the ARRC to account for term, credit and other structural differences between SOFR and LIBOR, and also include any conforming changes to contracts required to administer the replacement benchmark. SOFR’s characteristics should make it a more robust benchmark than LIBOR because, as an overnight secured rate, SOFR better reflects the way financial institutions fund themselves today; it is a transparent rate that is

In addition to including many of the country’s largest banks among its members (e.g., Bank of America, Citigroup, JPMorgan Chase and Wells Fargo), the ARRC’s membership also includes major insurance companies (e.g., AXA, MetLife), asset managers (e.g., BlackRock, PIMCO) and trade associations (e.g., American Bankers Association, Government Finance Officers Association, ISDA, LSTA, Independent Community Bankers Association of America). The “ex-officio” ARRC members include, among others, the Office of the Comptroller of the Currency, the New York State Department of Financial Services, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the U.S. Department of the Treasury.

The work of the ARRC is supported by ten “working groups”. The Proposed Statute is largely the work product of the ARRC’s Legal Working Group, which has received comments and input from numerous industry groups, including the LSTA, the Structured Finance Association and SIFMA.

V. THE PROPOSED STATUTE

The application of the Proposed Statute is targeted at what are commonly referred to as “Legacy Contracts,” which, as described above, are generally contracts that pre-date the LIBOR cessation effort and thus do not contemplate and have not been amended to address the possibility of a permanent cessation of LIBOR.

At the time the ARRC released the then-current draft of the Proposed Statute, it also released an accompanying report titled “Proposed Legislative Solutions to Minimize Adverse Economic Outcomes of Legacy LIBOR Contracts” (the “Legislative Solution Report”). The Legislative Solution Report provides both practical and legal observations concerning the Proposed Statute. Among those observations are the following.

- Many legacy financial contracts that reference LIBOR do not include Fallback provisions that adequately address a permanent end to LIBOR, while others have ambiguous or problematic language (e.g., having a party take a poll of banks for their estimated LIBOR quotations).
- Almost all of these Legacy Contracts that lack adequate Fallback provisions would, upon a permanent end to LIBOR, dramatically change the economics of the contracts—in many cases, by converting such contracts from a floating to a fixed interest rate which would likely lead to numerous disputes and a significant amount of litigation.
- The ARRC has developed recommended Fallback provisions that contemplate a permanent end to LIBOR and, if adopted by interested parties, would result in a rate, once LIBOR ceases to be available, designed to make the successor rate as close as

representative of the market across a broad range of market participants, which, in turn, protects against attempts at manipulation; and because it is derived from the active market for repurchase transaction in U.S. Treasury securities, SOFR is not at risk of disappearing. See the ARRC’s white paper, *A User’s Guide to SOFR* (April 2019), at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/Users_Guide_to_SOFR.pdf?34.

possible to what the parties originally intended, subject to necessary modifications required by the nature of the replacement benchmark, such as the accrual of a daily average rate in arrears as opposed to accrual of a term rate in advance.

- The Proposed Statute has been designed to minimize costly and disruptive litigation by providing legal certainty for the issues that arise under New York law. Absent a legislative solution, parties may seek to judicially enforce or reform these contracts, resulting in the expense and uncertainty of a multiplicity of different actions and proceedings with possibly conflicting results.

The Proposed Statute is to be a new Article 18-C of the General Obligations Law.²⁸ The Proposed Statute is designed to provide a stop gap for New York Contracts that do not include non-LIBOR based fallbacks, should LIBOR be discontinued, by aligning Legacy Contracts with the Fallback language recommended by the ARRC. Specifically, subject to the parties' ability to opt out by written agreement to that effect, it imposes a SOFR based rate where a LIBOR-referenced contract is silent as to a Fallback or the Fallback provisions call using of a LIBOR-based value (e.g., the polling of institutions to collect prevailing interbank lending rates).²⁹ The Proposed Statute is discretionary as to use of the ARRC-recommended rate for other New York Contracts, but use of the ARRC-recommended rate enables parties to invoke the Proposed Statute's safe harbor provisions that are protective in the event of the risk of litigation challenging the rate selected.

Where it applies, the Proposed Statute would, upon the occurrence of certain (LIBOR Discontinuance Events" identified by the ARRC that trigger the immediate or eventual permanent cessation of LIBOR:

- (1) prohibit a party from refusing to perform its contractual obligations, declaring a breach of contract or recovering damages as a result of the discontinuance of LIBOR;
- (2) presumptively establish that SOFR is an appropriate replacement for LIBOR;
- (3) provide that the use of SOFR is not an amendment of the contract nor would it be deemed to have a material or adverse effect on any person's rights under the contract; and
- (4) provide a safe harbor from litigation from the use of SOFR to replace LIBOR.

The Proposed Statute would permit parties entering into new contracts or amendments to agree to expressly opt out of the treatment provided under the new law. In addition, the Proposed Statute would not apply where the Fallback is not based on LIBOR and would not affect enforcement of New York Contracts that have Fallback provisions providing for a non-LIBOR alternative (such

²⁸ Proposed Statute to be located at N.Y. General Obligations Law §§ 18-400 to 403. Available at <https://www.nysenate.gov/legislation/bills/2021/s297/amendment/b>.

²⁹ As described elsewhere in this report, in the event of a permanent cessation of LIBOR, continued use of the last available published LIBOR rate converts a floating rate obligation adjusted at negotiated intervals to a fixed rate obligation for the balance of the term, a result that is likely to be contrary to the parties' expectations. With respect to a Fallback based on polling, the market consensus appears to be that "interbank lending" is no longer conducted on a scale that would make such a polling exercise meaningful.

as the “prime” or “base” rate). The Proposed Statute is modeled, in part, on New York legislation enacted in 1997 in anticipation of the discontinuance of sovereign currencies that were being replaced by the Euro. To avoid the uncertainty and disruption that would occur if a New York Contract specified payment in a currency that was replaced by the Euro and no longer available, the statute permitted parties to discharge their contractual obligations by payment in Euro rather than the specified currency.³⁰

Benchmark Transition Events. Benchmark transition events are events that under the terms of an existing or future New York Contract and the terms of the Proposed Statute lead to the replacement of LIBOR with a new benchmark, with any corresponding Recommended Spread Adjustment. They are identified and defined in the § 18-400 of Proposed Statute as “LIBOR Discontinuance Events” and consist of:

- a. A public statement by or on behalf of the administrator of LIBOR announcing that the administrator has ceased or will cease to provide LIBOR, and there is no successor administrator that will provide LIBOR;
- b. a public statement by the regulatory supervisor for the administrator of LIBOR, the United States Federal Reserve System, an insolvency official, a resolution authority or a court or an entity with similar insolvency or resolution authority over the administrator for LIBOR, that the administrator of LIBOR has ceased or will cease to provide LIBOR and there is no successor administrator that will continue to provide LIBOR; or
- c. a public statement or publication of information by the regulatory supervisor for the administrator of LIBOR announcing that LIBOR is no longer representative.

Parties may, and are encouraged to establish their own benchmark transition events in existing and new New York Contracts, such as when such parties conclude that a SOFR-based market is sufficiently developed. With respect to new transactions, the parties may at the inception of the transaction specify SOFR pricing or another benchmark of their choice.

Replacement of LIBOR with another benchmark will necessarily also involve what the Proposed Statute identifies as “Benchmark Replacement Conforming Changes” that deal with the details of implementing the new Recommended Benchmark Replacement in place of the New York Contract’s existing terms. Examples include conventions on the “screen” or other source that will supply benchmark rates, the time fixed to determine the rate, changes to business days that result from different locations, the day count convention and other details. Importantly, the changes are required, in the reasonable judgment of the calculating person not to result in any modification that would result in a “disposition” for federal income tax purposes.³¹

³⁰ N.Y. General Obligations Law §5-1601 *et seq.*

³¹ Sec. 18-400(9)(ii). This limitation is designed to address the risk that the benchmark change would be treated for tax or accounting purposes as a disposition resulting in the recognition of gain or loss for tax and accounting purposes. Rulings have been sought from the Internal Revenue Service, the Commodity Futures Trading Commission and the Financial Accounting Standards Board on the impact of benchmark replacement on the treatment of obligations for tax, accounting and other regulatory purposes.

The Proposed Statute was designed to address the problems that are foreseen in the transition from LIBOR in Legacy Contracts that lack an adequate Fallback for LIBOR cessation. The first point to emphasize is that the Proposed Statute does not impose a solution on anyone, but conditions the availability of a litigation safe harbor with respect to Legacy Contracts on accepting the solution it embraces. Parties to new transactions who wish to have floating rate pricing are free to choose whatever benchmarks and spreads they wish to use and are not compelled to choose SOFR. Similarly, subject to the practical considerations outlined above, parties to existing transactions can, at any point prior to the cessation of LIBOR, choose a replacement benchmark and spread adjustment. To avoid adverse impact on the parties, the Proposed Statute supplies the Recommended Benchmark Replacement for parties who are unable to make appropriate adjustments to their Legacy Contracts by implementing terms that reflect an approach recommended by the ARRC, based on the consensus view from market participants.

A. Proposed Statute under the Contracts Clause, the Takings Clause and the Due Process Clause of the U.S. Constitution, and the Takings Clause, Due Process Clause and the Nondelegation Doctrine of the New York State Constitution.

The Working Group considered the constitutionality of the Proposed Statute under several applicable provisions of both the U.S. and New York State Constitutions. A summary of our conclusions is set forth below, with more detailed analysis appearing in Appendix C hereto.

1. United States Constitution

Contracts Clause (Art. I, §10, cl. 1). The Contracts Clause restricts the power of the states to disrupt, or “impair”, contractual agreements among private parties. The Supreme Court has adopted a two-step test to determine whether a state law violates the Contracts Clause: first, whether the state law at issue operates as a “substantial impairment” to contractual relationships, and, if so, then whether the state law is drawn in an “appropriate” and reasonable manner.

The Working Group concluded that the Proposed Statute would likely not be viewed as resulting in a substantial impairment, in part because the Proposed Statute is intended to reflect the parties’ original intent in adopting a broadly-based, market determined, floating rate. It continues the application of such a rate, SOFR, following LIBOR cessation in order to prevent frustration of the purpose of the contract, particularly in the case of Legacy Contracts, that would result from imposing a fundamentally different sort of benchmark rate than that contemplated by the parties. The Proposed Statute also provides for an opt-out, and serves a broad public purpose. See Appendix C-1.

Takings Clause (Art. V). The Takings Clause of the Fifth Amendment provides that property may not be taken “for public use, without just compensation”. The Working Group concluded that the Proposed Statute does not violate the Takings Clause because the statute does not effectuate the transfer of a property right by private parties for a government use. See Appendix C-2.

Due Process Clause (Art. V). The Due Process Clause, also found in the Fifth Amendment (and which applies to the states through the Fourteenth Amendment), provides that a person may

not be deprived of property without due process of law. The question arises as to whether the Proposed Statute could be seen as depriving a person of property, and, if so, whether it does so in the absence of a sufficiently articulated and important governmental purpose. Since the application of the Proposed Statute is much more likely, in the case of a Legacy Contract, to lead to a result consistent with the parties' original expectations regarding their contract, it is difficult to see how the Proposed Statute deprives a person of "freedom of contract". The Proposed Statute also contains an opt-out provision that in any event preserves freedom of contract. The issues which the Proposed Statute seeks to address are well known, have been the subject of widespread media coverage for years, and have proven exceptionally difficult to address. The Working Group has concluded that it will be difficult to argue that the Proposed Statute is not a "rational response" to the Legacy Contract issue and the likelihood of a successful challenge on due process grounds is remote. See Appendix C-3.

2. New York State Constitution

Takings Clause (Art. I, § 7(a)). The New York State Constitution provides that "[p]rivate property shall not be taken for public use without just compensation." The Court of Appeals has examined New York Constitution Takings Clause challenges using the same two-step test as the Supreme Court utilizes under the federal Takings Clause. More specifically, the Court of Appeals will inquire whether a "vested property interest" has been "adversely impacted by government action", and whether "justice and fairness" would require a finding of unconstitutional action. The Court of Appeals does not generally consider contract rights – such as those that might be impacted by the Proposed Statute – to constitute "vested property interests", and in any event, the replacement of LIBOR with SOFR and the Replacement Benchmark Conforming Changes involve no "taking" in the sense of a government appropriation to itself of a thing of value. The Working Group concluded that there appears to be no basis for a successful challenge to the Proposed Statute under New York Constitution's Takings Clause. See Appendix C-4.

Due Process Clause (Art. I, §6). The New York State Constitution has been interpreted to provide that "the State may not deprive a party to a contract of an essential attribute without due process of law".³² New York courts presume economic legislation to be constitutional, and place the burden on challengers to establish that the Legislature has acted in an arbitrary and irrational way. Given this level of deference to the Legislature, and to difficulties in otherwise addressing Legacy Contracts, the Working Group concluded that any challenge to the Proposed Statute under the New York State Due Process Clause is unlikely to succeed. See Appendix C-5.

Nondelegation Doctrine (Art. III, §1). The nondelegation doctrine differs in kind from the other potential constitutional challenges considered by the Working Group. All of the other potential challenges focus on the parties to the New York Contract, the provisions of which the Proposed Statute may amend by operation of law and thus affect the parties' interests. A challenge based on the Nondelegation Doctrine would be different: it would allege that by mandating a replacement benchmark – SOFR – that it does not control, and with respect to which the New York State Legislature has not established clearly defined standards and limitations, the New York State Legislature has impermissibly delegated away to a private or otherwise impermissible party a

³² *Patterson v. Carey*, 41 N.Y.2d 714, 720, 363 N.E.2d 1146, 1151 (1977).

legislative function.³³ Because the legislative power may only be exercised by the Legislature, such an action would be unconstitutional.

The Working Group has identified three responses to a challenge to the proposed Statute on nondelegation grounds. First, the Legislature has named a specific replacement rate, SOFR, as the basis for the LIBOR replacement rate. The Working Group acknowledges that further administrative steps will be necessary in order to make SOFR a workable replacement through the development of spread adjustments and conforming changes but the Working Group believes that the Legislature will act reasonably in relying upon the Federal Reserve, the Federal Reserve Bank of New York, and/or the ARRC to provide these somewhat administrative, but nonetheless substantive functions. As noted, the ARRC LIBOR replacement process has been undertaken on a currency-specific basis, providing justification for an entity like the Federal Reserve, which oversees the nation's currency, to be that entity. Second, through the Federal Reserve Bank of New York expressed interest to abide by the IOSCO Principles applicable to benchmark administrators, as noted in the "Findings" that the Working Group and the ARRC have recommended be included in the Proposed Statute,³⁴ the Working Group believes that the purported delegation may be sufficiently circumscribed as to be consistent with Court of Appeals precedent. Third, the Working Group believes that the Proposed Statute is likely to be upheld on the grounds that the ARRC has not been delegated the power to set New York State law, nor has the Legislature "yielded any real Sovereign Power". See Appendix C-6.

B. The Proposed Statute and Certain Other Federal Law Matters

The Trust Indenture Act. An issue arises concerning whether the Proposed Statute conflicts with the federal Trust Indenture Act (the "TIA").³⁵ Subsection 316(b) of the TIA provides in relevant part that "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security...shall not be impaired or affected without the consent of such holder."

The TIA applies only to a sub-set of legacy financial transactions, namely, those that are required by the TIA to be documented by an indenture that is "qualified" under the TIA. In general, these transactions are debt offerings that are registered under the Securities Act of 1933, as amended (the "1933 Act"). As registered offerings, TIA-qualified debt will often be widely held, and often held through "street" (nominee) positions that frequently make it difficult to reach, or even identify, the underlying holders of the debt.

The Working Group recognizes that the Proposed Statute "affects" the rights of a holder of debt issued pursuant to a legacy LIBOR TIA-qualified indenture. As a federal law, the TIA, pre-empts a contrary provision of state law such as the Proposed Statute, pursuant to the Supremacy Clause of the U.S. Constitution.

³³ The delegation, under this theory, would be to the Federal Reserve, the Federal Reserve Bank of New York (federal instrumentalities not a part of the New York State government), and/or the ARRC (a collective of interested private-sector market participants).

³⁴ Appearing in Appendix B-1 of this Report.

³⁵ 15 U.S.C. §§ 77aaa–77bbbb.

Nevertheless, to the extent that the provisions of the Proposed Statute conflict with Subsection 316(b) of the TIA, there is no New York State legislative cure. The issues relating to TIA Subsection 316(b) are likely to arise in situations that would be the most challenging to address without a “legislative” or broadly-applicable regulatory solution—transactions where the unanimous consent of a large number of security holders that are difficult, if not impossible, to identify would otherwise be required to address legacy LIBOR issues. The Working Group supports federal action to remove this concern, which could be achieved by a narrow amendment to the TIA essentially providing that the provisions of the Proposed Statute would not be deemed to “impair or affect” a party’s rights under a contract. Regardless of whether or not the TIA is amended, it is the view of the Working Group that New York should proceed with a legislative solution that can be applied to the many transactions not subject to the TIA. See Appendix C-7.

Federal Income Tax Treatment. A second federal law issue which is beyond the scope of any state law to address is whether a modification to a contract made in accordance with the Proposed Statute constitutes a taxable exchange of the “old” (pre-modification) instrument for the “new” (post-modification) instrument for federal income tax purposes. It would serve the purpose of the Proposed Statute for its application not be treated as a taxable exchange. This result could be achieved by incorporating the appropriate language in Treasury Regulation § 1.1001.6 when Proposed Regulation § 1.1001.6 (Transition from Interbank Offered Rates) is finalized or in a revenue procedure modifying Revenue Procedure 2020-44, which provides that certain modifications to a contract with terms referencing an IBOR will not be treated as taxable exchange.

The Working Group would support such a clarification to the federal tax laws and encourages the State of New York to pursue such guidance.

C. Impact on Consumers

LIBOR is used as a benchmark in an estimated \$1.3 trillion in retail mortgage and other consumer loans. Many agreements grant the lender discretion to establish the replacement benchmark without the affirmative consent of the consumer borrower, and as a result consumers will not generally be in a position to negotiate the terms of replacement benchmarks with their lenders. This point was raised in a March 6, 2020 letter from the Student Borrower Protection Center, Americans for Financial Reform Education Fund, the National Community Reinvestment Coalition and the National Consumer Law Center (collectively, the “Consumer Groups”) to the ARRC. In the letter, the Consumer Groups observed that these lender discretion provisions “effectively eliminate any chance for input consumers might hope to have in determinations of their future interest rate”.³⁶ Lenders are incentivized to implement a legislative solution of a market adjustment that provides a “safe harbor” from litigation challenging the fairness of the replacement benchmark if the ARRC recommended terms, which appear to be constructed in a manner not to be to unduly favorable to either lenders or borrowers, are implemented. The Working Group does not believe that the Proposed Statute would negatively impact consumers; both the Proposed Statute and this Report have been endorsed by the City Bar’s Consumer Affairs Committee.

³⁶ See <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2020/03/LIBOR-Spread-Adjustments-Coalition-Letter.pdf>.

Working Group on New York State LIBOR Replacement Legislation

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APPENDICES

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APPENDIX A

Participating and Endorsing New York City Bar Association Committees

Futures and Derivatives Regulation
Investment Management Regulation
Securities Regulation
Structured Finance
Banking Law
Commercial Law and Uniform State Laws
Real Property Law
In-House Counsel
Consumer Affairs

Participants in the Alternative Reference Rates Committee Members³⁷

American Bankers Association
Association for Financial Professionals
AXA
Bank of America
BlackRock
Citigroup
CME Group
Comerica
CRE Finance Council
Deutsche Bank
Fannie Mae
Ford Motor Company
Freddie Mac
GE Capital
Goldman Sachs
Government Finance Officers Association
HSBC
Huntington
Intercontinental Exchange
International Swaps and Derivatives Association
JPMorgan Chase
KKR
LCH
MetLife
Morgan Stanley
National Association of Corporate Treasurers
Pacific Investment Management Company
PNC

³⁷ Source: <https://www.newyorkfed.org/arrc/about#members>.

Prudential Financial
Structured Finance Association
TD Bank
The Federal Home Loan Banks, through the Federal Home Loan Bank of New York
The Independent Community Bankers of America
The Loan Syndications and Trading Association
The Securities Industry and Financial Markets Association
U.S. Chamber of Commerce
Wells Fargo
World Bank Group

Ex Officio Members

Commodity Futures Trading Commission
Consumer Financial Protection Bureau
Federal Deposit Insurance Corporation
Federal Housing Finance Agency
Federal Reserve Bank of New York
Federal Reserve Board
National Association of Insurance Commissioners
New York State Department of Financial Services
Office of Financial Research
Office of the Comptroller of the Currency
U.S. Department of Housing and Urban Development
U.S. Securities and Exchange Commission
U.S. Treasury

Observers

Bank of Canada
BNP Paribas
Cadwalader
Morgan Lewis
Venerable

APPENDIX B

Proposed Legislative Findings

The Legislature of the State of New York hereby finds that:

The U.S. dollar London Inter-bank Offered Rate (LIBOR, or U.S. dollar LIBOR) is an interest rate index that is used in approximately \$200 trillion of financial products worldwide. Due to concerns about the continued reliability and robustness of LIBOR and other interest rate benchmarks, U.S. and global regulators have encouraged the development of alternative replacement indices. The regulator of U.S. dollar LIBOR has announced that the publication of LIBOR will cease, or that LIBOR is not representative of underlying market conditions, as soon as December 31, 2021 for some “tenors” of LIBOR.

Such an event will create legal uncertainty and economic instability for financial transactions and products that reference U.S. dollar LIBOR. Given New York State’s national and international prominence as a jurisdiction of choice for many financial transactions and products, thousands, if not millions, of the legal agreements for financial transactions and products that reference U.S. dollar LIBOR are governed by the laws of New York State, and a great many do not adequately contemplate the permanent cessation or non-representativeness of LIBOR. As a result, parties could be bound by a rate that does not properly reflect their intent and disputes could arise that significantly burden, if not overwhelm, New York courts and judicial resources. The cessation or non-representativeness of LIBOR will have many other potential negative effects on New York. Consumers in New York will be negatively affected because LIBOR is referenced in adjustable rate mortgages, student loans, credit cards and other consumer products. The State, its agencies and municipalities, and other issuers of LIBOR-based debt will be negatively affected, and public pension funds, as investors in LIBOR-based assets, will also be negatively affected.

It is the public policy of the State of New York that (a) the cessation of U.S. dollar LIBOR or a determination by its regulator of non-representativeness should not give rise to the termination or non-performance of existing contracts, securities, or instruments, or give rise to uncertainty, confusion, and indefiniteness among parties to such contracts, securities, or instruments, (b) such contracts, securities and instruments should continue on the basis of a replacement benchmark that is a commercially reasonable substitute for U.S. dollar LIBOR and (c) a safe harbor from litigation should be provided for the use and implementation of such a replacement benchmark and the associated spread adjustment.

Fulfillment of these public policy objectives requires special expertise and technical competence to identify the appropriate replacement benchmark for U.S. dollar LIBOR. Policy makers and regulators world-wide have conducted a process to develop a framework for replacement benchmarks in several currencies, including the U.S. dollar. In addition to determining an appropriate replacement benchmark, the framework must also determine with respect to legacy contracts an appropriate “spread adjustment”, which is an adjustment to be made to the replacement benchmark to account for the effects of the change from U.S. dollar LIBOR to the replacement benchmark. Certain principles relating to the governance, integrity, methodology, quality and accountability of benchmarks and spread adjustments have been published by the International Organization of Securities Commissions (IOSCO), an international organization

whose members regulate 95% of the world’s securities markets in approximately 115 jurisdictions, including the U.S. Commodities Futures Trading Commission and the U.S. Securities and Exchange Commission. In the United States, the effort to replace LIBOR as a benchmark has been led by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York. To assist in this process, the Federal Reserve Board and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (the ARRC), whose membership comprises a broad set of private-market participants and official sector ex-officio members with the necessary expertise and technical competence to assist in the development of a suitable replacement benchmark and the associated spread adjustment for U.S. dollar LIBOR. Those regulators have encouraged private-market participants to collaborate to identify a recommended suitable replacement benchmark and the associated spread adjustment for U.S. dollar LIBOR to prevent disruption to financial markets from the regulatory determination that U.S. dollar LIBOR will cease being published or being representative of underlying market conditions.

The ARRC has recommended that the replacement benchmark to LIBOR be the Secured Overnight Financing Rate, or “SOFR”. According to the Federal Reserve Bank of New York, SOFR is “a broad measure of the cost of borrowing cash overnight collateralized by Treasury Securities”. The Federal Reserve Bank of New York publishes SOFR on each business day.

The Legislature has found and determined that SOFR is a suitable replacement benchmark for U. S. dollar LIBOR, that the ARRC is an appropriate entity within which private-market participants may collaborate, develop, and recommend spread adjustments and necessary conforming changes in contracts to accommodate the use of SOFR, and that doing so is consistent with the public policy of the State and is in furtherance of the continued maintenance of New York State as a center of global finance.

APPENDIX C-1

United States Constitution – Contracts Clause

The Contracts Clause restricts the power of states to disrupt contractual arrangements among private parties. It provides that “[n]o state shall ... pass any ... Law impairing the Obligation of Contracts.” U.S. Const., Art. I, § 10, cl. 1. The New York State Constitution has no counterpart to the federal Contracts Clause. While the origins of the Contracts Clause lie in legislation enacted after the Revolutionary War to relieve debtors of their obligations to creditors,³⁸ the Clause applies to any kind of contract. A debt instrument between private parties that specifies payments of interest at a floating rate based on LIBOR would clearly qualify as a “contract” under the Contracts Clause.

It is well settled, however, that the Constitution’s prohibition against impairing the obligations of contracts is not to be taken literally.³⁹ Instead, the facially absolute language of the Contracts Clause has been interpreted to accommodate the inherent power of the state to “safeguard the vital interests of its people.”⁴⁰

In *Sveen v. Melin*, the Supreme Court reaffirmed decades of precedent upholding state laws against Contracts Clause challenges.⁴¹ *Sveen* involved a state statute revoking a deceased’s designation of his former spouse in an insurance contract. The majority opinion (with one lone dissenter) sets forth a “long applied . . . two-step test” to analyze whether a state law violates the Contracts Clause. The first, threshold issue is whether the state law has “operated as a substantial impairment of a contractual relationship.” Factors a court examines when determining whether “substantial impairment” has occurred is whether the state law undermines a contractual bargain, interferes with a party’s reasonable expectations, and prevents parties from safeguarding or reinstating their rights.⁴² If the state law is found to substantially impair the contractual bargain, then the Court looks at the means and ends of the legislation, asking whether the state law is drawn in an “appropriate” and “reasonable” way to advance “a significant and legitimate public purpose.”⁴³ Under this two-part test, the state statute in *Sveen* was upheld, on a finding of no substantial impairment.

The Court gave three reasons in *Sveen* for its conclusion that there was no substantial impairment, even while recognizing that the statute made a significant change to an insurance contract by revoking the beneficiary designation. First, the statute was designed to reflect a policy holder’s intent, and therefore supported the contractual scheme rather than impairing it. Second,

³⁸ See *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470, 502–503 (1987).

³⁹ *Keystone Bituminous Coal* at 502.

⁴⁰ *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 434 (1934) (approving a mortgage moratorium statute), cited approvingly in *City of El Paso v. Simmons*, 379 U.S. 497, 506–507 (1965) (approving a statute setting a five-year limitation period for reinstatement of forfeited real property).

⁴¹ *Sveen v. Melin*, 138 S. Ct. 1815 (2018)

⁴² See *id.*, at 246 and *City of El Paso v. Simmons*, 379 U.S., at 514–515.

⁴³ *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411–412 (1983).

the statute did the same thing that a divorce court could have done. And third, the statute merely provided a default rule, which the policy holder could undo.

Applying these criteria, the Working Group believes the Proposed Statute would be viewed as not substantially impairing the rights of parties to contracts that specify a floating rate based on LIBOR but are silent as to Fallbacks or have legacy language falling back on a LIBOR-based rate. First, the Proposed Statute is intended to reflect, not overcome, the parties' intent. That is, all of the contracting parties whose contracts would be affected by the Proposed Statute intended to adopt a floating rate of interest through the term of the loan. Absent a legislative cure or other agreed modification by the parties, the disappearance of the LIBOR benchmark for the floating rate could effectively transform a floating rate into a fixed rate, e.g., last available LIBOR, a result contrary to the parties' intention to have a rate reflective of changes in market conditions over time. This dramatic change in the economics could advantage one party over the other, in a way that was not intended. The Proposed Statute would prevent this unintended windfall.

Second, the Proposed Statute accomplishes what a court could do, far more efficiently and with less disruption and risk. Without any standard replacement rate, parties could potentially declare a contract void or otherwise seek judicial relief. Given the huge number of financial contracts using a LIBOR benchmark and specifying New York law to resolve contractual disputes, there would be significant unanticipated burdens and costs on New York courts when LIBOR is no longer available.

Third and most important, the Proposed Statute allows for an opt-out, either before or after LIBOR disappears. Just as the policy holder in *Sveen* could easily have submitted a form stating that he wanted to keep his former spouse as his beneficiary, the Proposed Statute would not apply to parties to a contract with a LIBOR-based benchmark who agree in writing that they choose not to be subject to the statutory replacement rate. As in *Sveen*, the statutory replacement rate is only a Fallback, and the parties can easily circumvent it. The contractual preferences of the parties can be "safeguarded" with only "minimal" effort.⁴⁴

Even if a court were to find that the Proposed Statute substantially impaired the rights of parties to a contract, the Working Group believes it would still survive a Contracts Clause challenge. The Supreme Court has long recognized that a state has an inherent police power to "safeguard the vital interests of its people."⁴⁵ This police power can be exercised, despite the absolute language of the Contracts Clause, if the state has a significant and legitimate public purpose behind the regulation, and the means chosen are reasonable and necessary to meet the stated legitimate public purpose. In other words, a law substantially impairing contractual relations can withstand constitutional scrutiny if it is specifically tailored to meet the problem it is supposedly intended to solve.⁴⁶

⁴⁴ *Texaco v. Short*, 454 U.S. 516, 531 (1982).

⁴⁵ *Energy Reserves Group v. Kansas Power and Light*, 459 U.S. 400 (1983), cited in *Sveen*.

⁴⁶ See e.g. *Sanitation & Recycling Indus. v. City of New York*, 107 F.3d 985, 993 (2d Cir. 1997) (rejecting Contracts Clause challenge against law aimed at terminating corruption in the waste removal industry).

In the case of the Proposed Statute, as described in the ARRC’s Legislative Solution Report (and with which the Working Group agrees):

- The Proposed Statute serves a broad societal interest in New York by attempting to minimize costly and disruptive litigation by providing legal certainty for issues that are likely to arise in New York law governed contracts. Given the uncertainty regarding the future level of floating interest rates, it is not obvious that the application of the Proposed Statute would favor or disfavor any particular class of parties. In the case of consumer contracts, by incentivizing the party in the position of the Determining Person to name a SOFR-based replacement rate, the Proposed Statute reduces the possibility that such Determining Person would select a replacement rate that is manifestly unfair to consumers.
- Given the narrow circumstances in which the Proposed Statute would apply, as well as the “opt-out” provision, the Proposed Statute appears to be narrowly tailored to address the issue of Legacy Contracts for which no other solution to LIBOR transition is available.

Some amount of judicial deference should be expected as well. Courts defer to state legislatures when the legislation at issue affects contracts between private parties.⁴⁷ Here, there is no state, or even municipal interest at stake. Rather, the Legislature has responded to a pressing need of privately contracting parties with a narrowly tailored and reasonable solution.

⁴⁷ *Buffalo Teachers Federation v. Tobe*, 464 F.3d 362, 369 (2d Cir. 2006) (“When a law impairs a private contract, substantial deference is accorded.”).

APPENDIX C-2

United States Constitution Takings Clause

The Takings Clause in Article V of the United States Constitution provides that private property shall not “be taken for public use, without just compensation.” While physical property, such as land, is the classic form of property that is protected from uncompensated taking, some contract rights have been found to be within a scope of the Takings Clause.⁴⁸ A statute that deprives a private citizen of protected interests in a contract could be challenged as a “regulatory,” as compared with a physical, taking.⁴⁹

The Working Group does not believe that the reported cases interpreting the Takings Clause support a challenge to the Proposed Statute as an uncompensated regulatory taking of a contractual right. As a general matter, the Takings Clause prohibits an uncompensated taking from a private citizen when the contract right is taken for the government’s own use.⁵⁰ The nature of the governmental action is the same here: the Proposed Statute would not transfer any property rights from private citizens to the government, but rather would promote the general good, without any specific use of the taken property rights by the government.⁵¹

Beyond the lack of an uncompensated government taking, a further obstacle to a successful Takings Clause challenge would be the incidental nature of the property right at issue. Previously, the Supreme Court has examined the general economic impact of challenged regulations, and found no taking where a law merely barred the most profitable use of a property, but did not deprive the property of all its value.⁵² A diminution in value only will not support a takings claim.⁵³ Similarly, if a government regulation or action only incidentally interferes with the performance

⁴⁸ See e.g., *Lynch v. United States*, 292 U.S. 571, 579 (1934) (involving the repeal of laws pertaining to insurance issued by the United States).

⁴⁹ *Pa. Coal Co. v. Mahon*, 260 U.S. 393 (1922) (involving the impact of a statute prohibiting coal mining on a deed granted by a coal mining company to a private citizen).

⁵⁰ *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986) (upholding pension legislation that required employers to pay a fixed amount into pension plans under certain circumstances on the ground that “[t] his interference with the property rights of an employer arises from a public program that adjusts the benefits and burdens of economic life to promote the common good”).

⁵¹ A holder of LIBOR-indexed debt issued by the State of New York or a municipality thereof may be in a position to allege a “taking”, although the holder would be required to demonstrate damages, presumably in terms of diminished value of the debt due to the application of the SOFR-indexed rate. However, as the cases cited below indicate, the courts take the view that a diminution in value is not generally considered a taking.

⁵² *Pa. Central Transportation Co. v. City of New York*, 438 U.S. 194, 123-24 (1978) (holding that a regulatory taking, in this case a landmark preservation law, does not occur unless there are “serious financial consequences” that stem from the government action).

⁵³ See generally *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1018-19 (1992) (establishing a categorical regulatory taking when a law deprives the property owner of “all economically beneficial uses” of his property); *Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Tr.*, 508 U.S. 602, 645 (1992) (“Mere diminution in the value of property, however serious, is insufficient to demonstrate a taking.”); *Agins v. City of Tiburon*, 447 U.S. 225 (1980) (no taking when plaintiff incurred an 85% reduction in value); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 36 (1926) (no taking with a 75% reduction in value); *CCA Assoc. v. United States*, 667 F.3d 1239 (Fed Cir. 2010), cert. denied, 129 S. Ct. 1313 (2012) (no taking with an 18% economic impact).

of a private contract—rather than appropriating or taking over one of the parties’ obligations—then there is no taking.⁵⁴

On one occasion, the Supreme Court had occasion to decide a Takings Clause claim in a context similar to the LIBOR issue. In that case, the Court upheld the regulation. In 1933, Congress, anticipating that a devaluation of gold would result in windfall gains and losses to individuals, passed a resolution declaring that all contracts providing for the payment of deferred obligations in gold could be discharged through payment in any coin or currency which at the time of payment is legal tender for public and private debts. One of three cases challenging the regulation, *Norman v. Baltimore & Ohio R.R. and United States v. Bankers Trust Co.*, dealt with the refusal by a railroad company to pay a bondholder’s coupon in gold coin or the equivalent of gold coin in legal tender, as required by the bond.⁵⁵ In upholding the regulation against a Takings Clause challenge, the majority distinguished between a contract for payment in gold as a commodity (as in gold bullion) and a contract for payment of money, which happened to be specified as gold. By analogy, a loan agreement specifying a LIBOR-based rate of interest should not be viewed as an agreement to buy or sell a certain LIBOR-based commodity, but viewed instead as an agreement to pay interest which happens to be based on LIBOR but could be paid based on an alternative equivalent benchmark. While this trio of New Deal opinions may have arisen during a different period of American history, this holdings are applicable and should govern and dispose of any objections to the Proposed Statute based on the Takings Clause.

⁵⁴ *Omnia Commercial Co. v. United States*, 261 U.S. 502 (1923).

⁵⁵ *Norman v. Baltimore & Ohio R.R. and United States v. Bankers Trust Co.*, 294 U.S. 240 (1935)

APPENDIX C-3

United States Constitution, Due Process Clause

The Due Process Clause of the Fifth Amendment to the United States Constitution (and which applies to the states through the Fourteenth Amendment) states, “No person shall . . . be deprived of life, liberty, or property, without due process of law[.]”⁵⁶ Historically, Due Process challenges have been split into two general categories: (1) procedural due process and (2) substantive due process. Substantive due process asks the question whether the government’s deprivation of a person’s life, liberty or property is justified by a sufficient purpose. Procedural due process, by contrast, asks whether the government has followed the proper procedures when it deprives someone of life, liberty, or property. The Working Group sees no basis for a colorable challenge to be made against the Proposed Statute on procedural due process grounds. It addresses here a possible challenge based on substantive due process grounds.

Substantive due process has been used to protect economic liberties from government interference.⁵⁷ *Lochner v. New York* is a leading case addressing substantive due process claims arising from contracts. In *Lochner*, the Supreme Court struck down a New York law that limited the maximum number of hours that bakers could work. In doing so, the Court recognized that the freedom of contract was a fundamental right under the Due Process Clause. In reaching its conclusion, the Supreme Court stated, “the limit of the police power has been reached and passed in this case,” as there is “no reasonable foundation for holding this [law] to be necessary . . . to safeguard the public health, or the health or the individuals who are following the trade of a baker.”⁵⁸ The standard for evaluating due process violations like the economic type articulated in *Lochner* is whether the law at issue has a “legitimate purpose that is furthered by rational means.”⁵⁹

⁵⁶ U.S. CONST. Amend. V. The Fourteenth Amendment, ratified in 1868, similarly constrains state governments: “[N]or shall any [s]tate deprive any person of life, liberty, or property, without due process of law[.]” U.S. CONST. amend. XIV. The procedural requirements of both amendments are substantially the same.

⁵⁷ The Court has also used substantive due process to designate non-explicit or non-textual rights as “fundamental” or “core liberty interests,” which have been afforded extraordinary protection. In *Planned Parenthood of SE. Pa. v. Casey*, 505 U.S. 833, 847-48 (1992), the court reaffirmed that it has never accepted the view that the Fourteenth Amendment protects only liberties recognized in the Bill of Rights because that document does not mark “the outer limits of the substantive sphere of liberty which the Fourteenth Amendment protects.” Thus, the Due Process Clause has been used to invalidate state laws that violate substantive, fundamental rights even if such rights do not derive from the text of the Constitution.

⁵⁸ *Lochner v. New York*, 198 U.S. 45, 58, (1905), *overruled in part by Day-Brite Lighting Inc. v. State of Mo.*, 342 U.S. 421 (1952), and *overruled in part by Ferguson v. Skrupa*, 372 U.S. 726 (1963), and *abrogated by W. Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937).

⁵⁹ *See generally General Motors Corp. v. Romein*, 503 U.S. 181 (1992) (holding that the retroactive aspects, as well as the prospective aspects, of economic legislation must meet the test of the Federal Constitution’s due process provisions by having a legitimate purpose that is furthered by rational means, because retroactive legislation presents problems of unfairness that are more serious than those posed by prospective legislation, since retroactive legislation can deprive citizens of legitimate expectations and upset settled transactions); *Concrete Pipe & Products of Cal., Inc. v. Construction Laborers Pension Trust for Southern Cal.*, 508 U.S. 602 (1993) (finding no substantive due process violation by virtue of the fact that legislation imposed upon it a higher liability than its contract contemplated); *Hoffman v. Warwick*, 909 F.2d 608 (1st Cir. 1990) (Due Process is satisfied “simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.”); *Peick v. Pension Ben. Guar. Corp.*, 724 F.2d 1247, 1263-64 (7th Cir. 1983) (finding no violation of the Due Process or Contracts

The challenger is required to establish that its liability under the statute is “arbitrary and irrational.”⁶⁰

The Working Group has not identified any cases since the *Lochner* era where the court has invalidated an economic regulation as a violation of substantive due process. This result can be attributed to two main reasons. First, because legislative enactments are the end result of a legislative process where the affected constituencies have an opportunity to be heard, most enactments cannot be successfully attacked.⁶¹ Second, post-*Lochner*, while the Supreme Court has not per se rejected the application of a substantive due process analysis to economic legislation, it has made clear its reluctance to question such legislation, and “has expressed concerns about using the Due Process Clause to invalidate economic legislation.”⁶² See, for example, *Eastern Enterprises v. Apfel*, where the plurality acknowledged that while “Congress has considerable leeway to fashion economic legislation, including the power to affect contractual commitments between private parties; and that it may impose retroactive liability to some degree, particularly where it is ‘confined to short and limited periods required by the practicalities of producing national legislation,’” such legislation “might still be unconstitutional if it imposes severe retroactive liability on a limited class of parties that could not have anticipated the liability, and if the extent of that liability is substantially disproportionate to the parties’ experience.”⁶³ The Court has also noted elsewhere that “[it] has expressed concerns about using the Due Process Clause to invalidate economic legislation.”⁶⁴ Thus, while parties continue to bring due process challenges, the extreme deference courts afford to legislatures when enacting economic legislation has proven a significant hurdle to pass.

Clauses because Congress made a reasoned decision as to how to protect the pensions. The Act was not arbitrary and irrational and was sufficiently tailored so that the employers’ responsibilities were based upon reasonable conditions); *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717 (1984) (Due Process is satisfied “simply by showing that the retroactive application of the legislation is itself justified by a rationale legislative purpose.”).

⁶⁰ *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976) (Only if Congress legislates to achieve its purposing an “arbitrary and irrational way” is due process violated.).

⁶¹ See *Diaz v. United States Postal Service*, 853 F.2d 5, 10 (1st Cir. 1988) (“In challenging the constitutionality of a regulation under the Due Process Clause, the appellant must show that there is no rational relation between the regulation and a legitimate governmental objective.”); see, e.g. *El Paso v. Simmons*, 379 U.S. 497 (1965) (upholding state law even though it limited rights of landowners to reclaim land that was forfeited since it had a legitimate purpose “to restore confidence in the stability of land tides” and was reasonably designed to achieve these goals; *Exxon Corp. v. Eagerton*, 462 U.S. 176, 191 (1983) (upholding state law notwithstanding impairment of contract rights because it is a “generally applicable rule of conduct designed to advance a broad social interest” in preventing oil and gas producers from passing on the costs of severance tax); *Keystone Bituminous v. DeBenedictis*, 480 U.S. 470 (1987) (upholding state law limiting coal mining that impaired existing contracts because it served a significant government interest in preventing damage to property and was reasonable way to prevent and repair environmental damage caused by coal mining); cf. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978)

⁶² See *Ferguson v. Skrupa*, 372 U.S. 726, 731 (1963) (noting “our abandonment of the use of the ‘ague contours’ of the Due Process Clause to nullify laws which a majority of the Court believ[e] to be economically unwise”); see also *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483, 488 (1955) (“The day is gone when this Court uses the Due Process Clause . . . to strike down . . . laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thoughts.”).

⁶³ *Id.* at 500.

⁶⁴ See note 62 *supra*.

The Working Group believes the likelihood of a successful challenge to the Proposed Statute being maintained as a violation of the federal Due Process Clause as very remote. The issues which the Proposed Statute seeks to address are well-known, and have been the subject of widespread media coverage for years, as well as sustained, ongoing discussions in the financial community. The issues raised by LIBOR cessation have long been anticipated, and it is difficult to see how the Proposed Statute imposes “severe retroactive liability”. Moreover, the problems posed by Legacy Contracts have proven exceptionally difficult to address. The Proposed Statute has a legitimate purpose, namely settling the rights of parties to Legacy Contracts that will be otherwise thrown into doubt or confusion by the cessation of the publication of a LIBOR rate. One would further have a difficult time arguing that the Proposed Statute is not a “rational means” to address the situation. The Proposed Statute by its terms includes an “opt out” provision, which the Working Group believes would further dilute any claims that a party is “deprived” of any rights by its application.

APPENDIX C-4

New York State Constitution, Takings Clause

The New York State Constitution’s takings clause is found in Section 7(a) of the New York Constitution and provides that “private property shall not be taken for public use without just compensation.” The New York Court of Appeals, which has generally not construed the New York Constitution’s Takings Clause in a more rights-protective manner than its federal counterpart, has examined Takings Clause challenges using the same two-step analysis that federal courts used to evaluate Takings Clause challenges under the U.S. Constitution. First, “[t]he threshold step in any Takings Clause analysis is to determine whether a vested property interest has been identified.”⁶⁵ Second, if the plaintiff can demonstrate that there is a vested property interest “adversely impacted” by government action, the court will then inquire into whether “justice and fairness” requires a finding of unconstitutionality of the government action.⁶⁶ In evaluating “justice and fairness,” the New York Court of Appeals has not employed a factor-based test, and instead, conducts an ad hoc, fact intensive inquiry.⁶⁷

New York courts have not considered whether contracts are considered “property interests” for the purposes of a Takings Clause analysis. The most factually analogous case is *American Economy Insurance Company v. New York*.⁶⁸ There, insurers sued the state, alleging that an amendment to the Worker’s Compensation Law that retroactively imposed liability costs on them under their pre-existing policies violated, among other things, New York’s Takings Clause. The Court of Appeals, in applying a takings analysis, stated, “[a]s a general matter, the government does not ‘take’ contract rights pertaining to a contract between two private parties simply by engaging in lawful action that affects the value of one of the parties’ contract rights” and accordingly, the effect of the amendment (which required plaintiffs to pay money), was not a “vested property interest.”⁶⁹ The Court of Appeals distinguished its holding in *American Economy* from its previous decision in *Alliance of American Insurers v. Chu*, where it held that plaintiff insurers did have a vested property interest in the income produced by a security fund to which the insurers were statutorily obligated to contribute.⁷⁰ In *Alliance*, the state had previously established a “Property and Liability Insurance Security Fund” into which insurance companies were required to make contributions. As originally established, certain earnings on the Fund’s investments were credited to the Fund and could be returned to the contributors or credited towards future contributions. The law governing the Fund was later amended to provide that the earnings past a certain level would instead be turned over to the State’s general fund. The Court of Appeals held

⁶⁵ *Alliance of Am. Insurers v. Chu*, 77 N.Y.2d 573, 585-587 (1991).

⁶⁶ See *Am. Econ. Ins. Co. v. State*, 30 N.Y.3d at 155, cert. denied, 138 S.Ct. 2601 (2018); see also *McRae v. New York State Thruway Auth.*, 2016 WL 4179990, at *8 (N.D.N.Y. Aug. 5, 2016); *E. Enters v Apfel*, 524 U.S. at 523 (1998).

⁶⁷ See *Am. Econ. Ins.*, 30 N.Y.3d at 156 (citing *Apfel*, 524 U.S. at 523), *Cienega Gardens v. United States*, 503 F.3d 1266 at 1282 (Fed. Cir. 2007).

⁶⁸ 30 N.Y.3d at 155.

⁶⁹ *Id.* at 155-156.

⁷⁰ *Id.* (citing to 571 N.E.2d 672 (N.Y. 1991)).

that the amendment violated several federal and New York State constitutional provisions, including New York’s Takings Clause. The principal basis for the court’s holding was its determination that the law, prior to the amendment, gave the contributors to the Fund “constitutionally protected property interests.”⁷¹ Accordingly, the court remarked that the statutory provisions safeguarding the funds in *Alliance* created a definitive “property right” whereas in *American Economy*, there was no statutory language establishing the plaintiff’s right to the funds and consequently no “property right” because the funds were “inchoate and subject to contingencies.”⁷²

American Economy relied on the case of *Palmyra Pacific Seafoods, L.L.C. v. U.S.*,⁷³ a 2009 Federal Circuit case: “As a general matter, the government does not ‘take’ contract rights pertaining to a contract between two private parties simply by engaging in lawful action that affects the value of one of the parties’ contract rights”.⁷⁴ The Working Group has not identified any New York cases where a court found that a contract can constitute in and of itself a “vested property interest”.⁷⁵

It is arguable whether the Proposed Statute could be deemed to affect “contract rights.” Under no circumstances, however, does this appear to rise to the level of a “vested property interest.” It is not even clear which party to a legacy LIBOR contract to which the Proposed Statute would apply would be affected by such application. For these reasons, the Working Group finds it highly unlikely that a successful challenge could be mounted to the Proposed Statute under the New York State Constitution’s Takings Clause.

⁷¹ *Id.* at 155-157.

⁷² *Id.* at 148.

⁷³ 561 F.3d 1361 (2009).

⁷⁴ *American Economy* at 156 quoting *Palmyra Seafoods* at 1365.

⁷⁵ *Am. Econ. Ins.*, 30 N.Y.3d at 157; see also *McRae v. New York State Thruway Auth.*, 2016 WL 4179990, at *1 (N.D.N.Y. Aug. 5, 2016) (holding that the New York State Thruway Authority did not violate the Takings Clause when it deprived plaintiffs of their earned salary increases without just compensation for use in the management of a public highway because “plaintiffs have no property interest and therefore fail the first element of a takings claim.”).

APPENDIX C-5

New York State Constitution Due Process Clause

Article I, Section 6 of the New York Constitution tracks the federal Due Process Clause and provides, “[n]o person shall be deprived of life, liberty or property without due process of law.” Under this provision, “the State may not deprive a party to a contract of an essential contractual attribute without due process of law.”⁷⁶ New York courts have applied the same standard as federal courts in evaluating substantive due process claims—requiring “a legitimate legislative purpose furthered by rational means.”⁷⁷ New York courts presume economic legislation is constitutional and “the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way.”⁷⁸

American Economy Insurance Co., described more fully above, is instructive. In *American Economy*, plaintiff insurance companies challenged the retroactive impact of a 2013 amendment to the New York’s Workers’ Compensation Law that closed a “fund” reserved for certain claims and imposed liability for such claims on plaintiffs. Plaintiffs alleged that this amendment had a retroactive impact on their contractual duties with the insureds and thus, violated the Due Process Clauses of both the U.S. and New York Constitutions. The New York Court of Appeals assessed whether the retroactive impact of the amendment was “justified by a rational legislative purpose” and concluded that there was no violation of the Due Process Clause because “the closure of the fund was intended to save New York businesses hundreds of millions of dollars in assessments per year” and would allow certain compensation claims to be “administered more efficiently by insurance carriers.”⁷⁹ The court further emphasized that a statute “will survive rational basis review so long as it is rationally related to any conceivable legitimate State purpose.”⁸⁰ Given this level of deference to the Legislature, and based on the same reasons cited in the discussion of the federal Due Process Clause, the Working Group concludes that any challenge to the Proposed Statute under the New York State Due Process Clause is unlikely to succeed.

⁷⁶ *Patterson v. Carey*, 41 N.Y.2d 714, 720, 363 N.E.2d 1146, 1151 (1977) (holding that the State may not deprive a party to a contract of an essential contractual attribute without due process of law. “Depriving an owner of property of one of its essential attributes, is depriving him of his property within the constitutional provision” and, absent due process, works an impermissible forfeiture of the right given by the contract).”

⁷⁷ *Am. Econ. Ins.*, 30 N.Y.3d at 157-158 (citing *Romein*, 503 US at 191); see also *Patterson*, 41 N.Y.2d at 720-721 (“Where a statute is challenged on nonprocedural grounds as violative of due process, the test is whether there is ‘some fair, just and reasonable connection’ between the statute and ‘the promotion of the health, comfort, safety and welfare of society.’”).

⁷⁸ *Held v. State of New York Workers’ Comp. Bd.*, 85 A.D.3d 35, 44.

⁷⁹ *Am. Econ. Ins.*, 30 N.Y.3d at 158.

⁸⁰ *Id.* (quoting *Myers v. Schneiderman*, 30 N.Y.3d 1, 15 (N.Y. 2017)); cf. *Patterson*, 41 N.Y.2d at 720. In *Patterson*, the New York Court of Appeals struck down a statute that deprived bondholders of “the right given by [] contract.” In assessing whether there was “some fair, just and reasonable connection” between the statute and “the promotion of the health, comfort, safety and welfare of society,” the court concluded that “there is no fair, just or reasonable connection between the statutory procedure for increasing tolls and the goal of curtailing traffic congestion” and as a result, invalidated the statute.

APPENDIX C-6

New York State Constitution, Nondelegation Doctrine

Article III, section 1 of the New York State Constitution vests the state’s legislative power in the Senate and Assembly. Courts have held that this section prohibits the Legislature from delegating its legislative power. Although delegations to duly authorized political subdivisions are commonly upheld,⁸¹ statutes with broad delegations of authority to private bodies have been held invalid. One group of such cases involve the Legislature’s delegation of its licensing authority to private associations.⁸² Another group of such cases involve the delegation of inspection rights to a private party.⁸³ As discussed below, delegations to private bodies have been upheld, however, in contexts distinct from licensing and inspections, particularly when the statute in question limits the discretion of the private body and the Legislature retains some supervisory authority over the matter.

The Proposed Statute, as currently drafted, might be challenged as an improper delegation of legislative authority. It provides in relevant part that when LIBOR is discontinued, New York Contracts that have no Fallbacks, or Fallbacks based either on LIBOR or on the process by which LIBOR was determined, shall use SOFR as the “Recommended Benchmark Replacement” with “Benchmark Replacement Conforming Changes” recommended by the “Relevant Recommending Body,”⁸⁴ which is defined as “the Federal Reserve Board, the Federal Reserve Bank of New York, or the Alternative Reference Rates Committee, or any successor to any of them.” The “Relevant Recommending Body” would also be responsible for determining a Recommended Spread Adjustment to supplement SOFR to avoid unintended value transfer. The Working Group’s understanding is that the Federal Reserve Bank of New York, will be the primary administrator of SOFR and the ARRC will, as the Relevant Recommending Body, be responsible for determining the Recommended Spread Adjustment(s) and the Benchmark Replacement Conforming Changes.

⁸¹ See, e.g., *Boreali v. Axelrod*, 71 N.Y.2d 1 (1987) (upholding as valid the Legislature’s broad delegation to the state’s Public Health Council to promulgate regulations on matters concerning the public health, although finding that the council’s decision to promulgate a comprehensive code to govern tobacco smoking in public areas exceeded its authority and constituted an impermissible usurpation of the legislature).

⁸² See, e.g., *Matter of Fink v. Cole*, 302 N.Y. 216 (1951) (invalidating delegation of licensing authority over horses and jockeys to the Jockey Club) and *Farias v. City of New York*, 101 Misc. 2d 598 (Sup. Ct. 1979) (enjoining a statute requiring consent of the Society for the Prevention of Cruelty to Children in order for a permit to be issued to allow employment of children under the age of 16 in circus performances).

⁸³ *Builders' Council v. Yonkers*, 106 Misc. 2d 700 (Sup. Ct. 1979) (finding that an ordinance empowering private actors to carry out inspections of dwellings to be an abdication of legislative power or sovereign power to a private party, relying on *Fink*) and *Atlantic Royal Ins. Co. of America v. Ru-Val Elec.*, 918 F. Supp. 647, 654 (E.D.N.Y. 1996) (town exceeded its authority to delegate its police power when it not only designated the Board of Fire Underwriters as its representative for electrical inspections, but permitted the Board to set, collect and retain the town's inspection fees).

⁸⁴ The Relevant Recommending Body is an entity with expertise, to whom the responsibility to determine the details of the implementation of the replacement rate is delegated. In the Proposed Statute, this entity may be the Federal Reserve Board, the Federal Reserve Bank of New York, or the ARRC. See the definition of “Relevant Recommending Body” in the Proposed Statute, at Section 18-400(11).

A challenge to the Proposed Statute on nondelegation grounds may be defeated on three separate grounds. In the first place, the Legislature has itself specified the rate by specifically naming SOFR. The Legislature has, from time to time, specified interest rates in legislation in various contexts.⁸⁵ In this situation, the Legislature is acting in a somewhat unique circumstance to assist private actors similar to how it acted in 1997, when it addressed the replacement of European currencies with the Euro.⁸⁶ Its action in response to the cessation of LIBOR could be distinguished from improper delegations on the ground that whatever discretion the Relevant Recommending Body would be exercising with respect to the Recommended Spread Adjustment(s) and the Benchmark Replacement Conforming Changes is not a power that customarily “resides exclusively with the State and its duly authorized political subdivisions, and simply cannot be exercised by a private corporation.”⁸⁷ Several cases have found that the incorporation of professional standards and codes were not impermissible delegations of sovereign or legislative functions.⁸⁸

Second, the statute confers less discretion on the Relevant Recommending Body than the impermissible statutes addressed in *Fink* and related cases. Limiting discretion protects against possible self-interested decisions by the private body.⁸⁹ Where discretion is properly circumscribed by guidelines, a delegation can be found proper. In this situation, by naming SOFR specifically, coupled with the expressed intent of the Federal Reserve Bank of New York that the IOSCO Principles of benchmark governance, integrity, methodology, quality and accountability

⁸⁵ For example, interest charged on commercial loans over \$100,000 and subject to a UCC security interest is not subject to usury statutes if the interest rate does not exceed eight percent above the “prime rate,” defined as “the average prime rate on short term business loans which is published by the board of governors of the federal reserve system for the most recent week which was publicly available from the board of governors of the federal reserve system on the previous business day.” General Obligations Law § 5-526. Assignments of payment streams from lottery winnings are permitted if the purchase price paid represents a present value of the payments being assigned, discounted at an annual rate not exceeding ten percentage points over the Wall Street Journal prime rate published on the business day prior to the date of execution of the contract. N.Y. Tax Law, § 1613. See also N.Y. Banking Law §14-a, N.Y. General Obligations Law Article 5, Titles 5 (Interest and Usury...) and 6 (Interest on Certain Deposits), N.Y. General Obligations Law §§5-501 *et seq.*, N.Y. Civil Practice Laws and Rules, Article 50 (Judgments Generally).

⁸⁶ Act of July 29, 1997, 1997 N.Y. Laws 2242-43 (ch. 311), codified as General Obligations Law § 5-1601 *et seq.*

⁸⁷ *Cuomo v. Long Island Lighting Company*, 27 A.D.2d 626 (N.Y. App. Div. 1987) (invalidating a utility’s emergency response plan). See also *Motor Vehicles Mfrs. Ass’n v. State*, 75 N.Y.2d 175 (1990) (upholding a statute that created a new limited class of disputes and provided a procedure for resolving them) Note that this case was decided by the New York Court of Appeals three years after *Boreali*, and treats *Fink* as good law. See also *Saumell v. New York Racing Ass’n*, 58 N.Y.2d 231, 238 (N.Y. 1983) (“*Matter of Fink* held no more than that the Legislature cannot constitutionally delegate to a private corporation its power to license participants and employees at race meetings”).

⁸⁸ See, e.g., *People v. Shore Realty Corp.*, 486 N.Y.S.2d 124, 127 (Dist. Ct. 1984) (finding that Nassau County Fire Prevention Ordinance which incorporated the standards of the private National Fire Protection Association “provides adequate notice of the conduct proscribed and does not effect an unconstitutional delegation of legislative power”); *Syracuse v. Penny*, 300 N.Y.S.2d 679, 683 (Sup.Ct. 1969) (Cardamone, J.) (finding that Syracuse Common Council “has not delegated its lawful authority to set the standards by which electrical work is to be done” but rather “merely adopted the National Electrical Code and has incorporated this code into its ordinance”).

⁸⁹ *International Serv. Agencies v. O’Shea*, 104 Misc. 2d 1071, 1074 (Sup. Ct. 1980) (finding insufficient guidelines and procedures to be used by the United Way when selecting charities as recipients for withholding from state employee pay checks).

will apply to the administration of the SOFR and to the process of developing the Recommended Spread Adjustment(s) and the Benchmark Replacement Conforming Changes, and placing the process under the jurisdiction of the Federal Reserve Board, it appears to the Working Group that sufficient guidelines have been established.

A federal district court's decision upholding a New York City ordinance pertaining to baseball bats allowed in high schools demonstrates this point.⁹⁰ The ordinance at issue in the *USA Baseball* case allowed either wood bats or "wood laminated or wood composite bats that are approved by Major League Baseball ("MLB"), pursuant to its official rules, for major league or minor league baseball play." In holding that the ordinance did not delegate to MLB the responsibility to establish regulations for the City, the court found that the ordinance adopted "a very limited existing set of standards to a specific type of product that the City has determined to regulate in specific situations." Further, the ordinance did not "rely solely on MLB's guidance, because it limits bats allowed under the MLB rules by further requiring that they be wood laminated or wood composite and that they contain no metal."⁹¹

Just as New York City did not impermissibly delegate its legislative authority to MLB when it relied upon that organization's determination of what constituted an allowable wood laminated or wood composite bat, the Legislature could be determined to not have impermissibly delegated its legislative authority to the Relevant Recommending Body by relying on that entity's determination of what constitutes suitable "spread adjustments" and "conforming changes".

The Proposed Statute, as drafted, contains guidance restricting Relevant Recommending Body discretion. The Proposed Statute specifically requires that the LIBOR replacement rate be based on SOFR. It contains a finding that the Relevant Recommending Body is expected to act in compliance with IOSCO Principles. Further, the Federal Reserve Bank of New York has stated that it would annually issue a "Statement of Compliance" with respect to the administration of the reference rates in a manner consistent with the IOSCO Principles.⁹² Although the Relevant Recommending Body will have an important role in determining the Recommended Spread Adjustment and the Benchmark Replacement Conforming Changes, it is appropriate for the Legislature to rely on a more competent entity to perform these necessary non-legislative tasks. These functions must be performed by some entity, and it appears impractical for the Legislature to attempt to fill these voids. In its designation of SOFR and as well in the Findings section of the Proposed Statute, the Legislature has made its intent clear, and this does not appear to be a clearly impermissible delegation of legislative power.

Finally, the statute may be upheld on the ground that the Relevant Recommending Body's role in determining the Recommended Spread Adjustment and the Benchmark Conforming Changes has not resulted in the Legislature having "yielded any real sovereign power", under the precedent of cases such as *8200 Realty Corp. v. Lindsay*, 27 N.Y.2d 124, 132 (N.Y. 1970), which involved the 1969 New York City Rent Stabilization Law. Although its predecessor was administered entirely by a city agency, the 1969 law was administered in part by an association

⁹⁰ *USA Baseball v. City of New York*, 509 F. Supp.2d 285 (S.D.N.Y. 2007).

⁹¹ *Id.* at 300.

⁹² See <http://www.newyorkfed.org/markets/reference-rates/iosco-compliance>.

made up of apartment owners, the "Real Estate Industry Stabilization Association". The association was required to be registered with the city's Housing and Development Administration, which could only occur if statutory preconditions, such as mayoral appointment of members and agreement bound by various city mandates, were met. The court found that "[w]hatever delegation may be said to have come down to the Real Estate Industry Association described in this statute, closely circumscribed and regulated as this is, no one could seriously entertain a fear that government has yielded any real sovereign power."⁹³ As explained in *People v. Mobil Oil Corp.*, 101 Misc. 2d 882 (Dist. Ct. 1979), "the delegation which may have come down to the Real Estate Industry Association was closely circumscribed and regulated so that no one could seriously entertain a fear that the government had yielded any real sovereign power."

In summary, the Working Group believes that the Legislature has acknowledged institutional guardrails within which it expects the Relevant Recommending Body to perform, and has made its intent sufficiently clear such that any purported delegation is sufficiently circumscribed as to be consistent with Court of Appeals precedent.

⁹³ 8200 *Realty Corp.* 27 N.Y. 2d at 132.

APPENDIX C-7

Trust Indenture Act Issues

As noted above, another issue that the Working Group has considered is the interplay of the Proposed Statute with § 316(b) of the Trust Indenture Act of 1939, as amended (the “TIA”).⁹⁴ Section 316(b) provides that, for any indenture covered by the TIA,

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

It is important to note at the outset two things about the TIA: first, that the TIA is a federal law which, under the Supremacy Clause of the United States Constitution (Art. VI, cl. 2), could preempt that application of state laws that conflict with the provisions of the TIA and, second, that the TIA applies only to a subset of financial contracts that require the “qualification” of an indenture under the TIA; this subset generally consists of securities that are registered under the Securities Act of 1933 and that are “debt in form” securities.

The legislative history indicates that TIA 316(b) appears to have been enacted primarily to prevent majority oppression of minority bondholders by forcing minority noteholders to accept reductions or postponements in principal and interest.

The TIA was adopted in large part as a response to a report published by the SEC in 1936 (the “1936 SEC Report”).

In the 1936 SEC Report, the SEC expressed concern about the ability of noteholder majorities to utilize so-called collective-action clauses—provisions in indentures that permit amendments to be made by consent of a requisite percentage of noteholders—as a means to force minority noteholders to accept out-of-court debt reorganizations. The SEC was concerned about such amendments carried out by less than unanimous consent of noteholders and without judicial supervision of the type found in a reorganization proceeding conducted through a foreclosure or bankruptcy.

Then-SEC Chair (and later Supreme Court Justice) William O. Douglas served as of the principal draftsman of the 1936 SEC Report, and explained in testimony to Congress⁹⁵ the purpose of the provision as follows:

⁹⁴ 15 U.S.C. § 77ppp(b)

⁹⁵ *Trust Indentures: Hearing on H.R. 10292 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 75th Cong. 12–13 (1938).

The effect of this exception is merely to prohibit provisions authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for principal, or a reduction of his claim for interest or a postponement thereof for more than 1 year.

Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this exception. . . . In other words, the bill does place a check or control over the majority forcing on the minorities a debt-readjustment plan. It does go that far; but it does not prohibit any other restriction or appropriate amendments of the indenture by the consent of the parties. [Emphasis added.]

The legislative history of TIA § 316(b) thus suggests that the underlying public interest purpose of the provision is to protect investors by requiring that amendments reducing or delaying payments owed to investors must be approved either in a judicial proceeding or by each affected investor.

The black-letter text of the provision itself, however, does not use a “reduce or delay” formulation, but rather “impair or affect”: Black’s Law Dictionary defines “impair” to mean, “[t]o diminish the value of,” while “affect” is defined to mean, “to produce an effect on; to influence in some way.” As to the term “affect,” in particular, at least one federal appeals court has, in another context, commented on the “breadth of [that] word” and observed that a statute containing it has “potential for broad applicability” and “might apply in a wide variety of circumstances.”⁹⁶

Consistent with those ordinary meanings of “impair” and “affect,” a number of courts have assumed (without actually having to decide) that any amendment to an instrument’s “core payment terms”—“that is, the amount of principal and interest owed, and the date of maturity,”⁹⁷ would violate § 316(b) of the TIA or a contract provision modeled on it. For example:

- “[I]t seems to us” that the TIA “prohibits non-consensual amendments of core payment terms (that is, the amount of principal and interest owed, and the date of maturity).”⁹⁸
- “It is indisputable that if [the issuer] had unilaterally adjusted the amount of principal or interest it would pay on a note that would be an impairment under section 316(b).”⁹⁹

⁹⁶ *United States v. Johnson*, 130 F.3d 1352, 1354 (9th Cir. 1997) (quoting the definition of “affect” from the Sixth Edition of Black’s Law Dictionary: “to act upon; influence; change; enlarge or abridge; often used in the sense of acting injuriously upon persons and things”).

⁹⁷ *Marblegate Asset Management, LLC v Education Management Corp.*, 846 F.3d, 7 (2d Cir. 2017)

⁹⁸ *Marblegate*, 846 F.3d at 7.

⁹⁹ *BOKF, N.A. v. Caesars Entm’t Corp.*, 144 F. Supp. 3d 459, 472 (S.D.N.Y. 2015).

- “[The plaintiff] does not allege a violation of any specific term of the Indenture or Supplemental Indentures that deals with the timing of interest payments or the amount of interest payments made, in the sense that [the issuer] failed to make an interest payment when due or tampered with or failed to apply the required interest rate formula.”¹⁰⁰

On the basis of § 316(b)’s use of the terms “impair or affect,” and given courts’ general approach to those terms, the Working Group has concluded that the Proposed Statute would, if not “impair”, at least “affect”, a “core payment term” of a contract containing only legacy LIBOR Fallback provisions. An interest rate formula is likely a “core payment term” of an indenture. We do not see the Proposed Statute’s effect as necessarily “reducing” the interest payable on an indenture security due to the substitution of SOFR for LIBOR; we rather see that result as unknowable. The Working Group sees no reason to conclude that a change from LIBOR to SOFR would “delay” any payments.

The Working Group acknowledges that there is nothing in the legislative history of the TIA that addresses a fact pattern such as that presented here – a state legislative action to reform existing contracts in a manner deemed consistent with the public interests of the state. However, the Working Group does find support in the legislative history for the proposition that § 316(b) requires either a judicial action or the consent of the related investor to make certain amendments to TIA qualified indentures. The Proposed Statute’s approach does not involve either of those two options.

Since the TIA is a federal law, a court could hold the Proposed Statute, as a state law, is preempted by any contrary provisions of the TIA pursuant to the U.S. Constitution’s Supremacy Clause, Article VI.

As a result of the foregoing, the Working Group is unable to express a view as to whether the Proposed Statute, if it became law, would be held to apply to modifications to the interest rate of securities issued under indentures that are required to be qualified under the TIA. The resolution of that question would best be addressed by federal action, in the form of either a statute or guidance issued by the U.S. Securities and Exchange Commission. A federal statute, broadly modeled on the Proposed Legislation is expected to be introduced in the House of Representatives.

¹⁰⁰ *RBC Capital Mkts., LLC v. Educ. Loan Tr. IV*, 2011 WL 6152282, at *5 (Del. Ch. Dec. 6, 2011) (Strine, C.).