REPORT ON LEGISLATION BY THE
NEW YORK CITY BAR ASSOCIATION

H.R. 4616 **Rep. Sherman**

To deem certain references to LIBOR as referring to a replacement benchmark rate upon the occurrence of certain events affecting LIBOR, and for other purposes.

Adjustable Interest Rate (LIBOR) Act of 2021

THIS BILL IS APPROVED

I. SUMMARY

The House Financial Services Committee has reported out of Committee a bill (the Adjustable Interest Rate (LIBOR) Act of 2021 or "Bill") that addresses the problem of certain categories of contracts that will continue to rely on LIBOR as a reference rate for floating interest rates even after LIBOR ceases to be published in June 2023. These "legacy" contracts pose a difficult challenge, because their nature is such that borrowers and lenders are generally not in a position to negotiate a replacement rate. The Bill would substitute a comparable reference rate for these legacy contracts and provide a safe harbor from lawsuits based on adoption of the new reference rate. New York State has put in place a law (the "New York Statute")[1] similar to the Bill that will be superseded by the federal Bill once it becomes law, which will apply to all contracts in the United States and not just those that specify New York law as the governing law.

A law that affects contracts between private parties could conceivably give rise to a claim that the government—either federal or state—has impermissibly "taken" private property without compensation, in violation of the Article V of the United States Constitution, which provides that private property shall not "be taken for public use, without just compensation." 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 "City Bar Working Group") prepared a report evaluating the constitutionality of the New York Statute.[2] In that report, the Working Group analyzed a number of issues relating to the New

[1] A.164-B/S.297-B, Chp. 94 (NYS 2021).

[2] "Support for the Enactment of LIBOR Replacement Legislation," March 2021, https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/libor-replacement-2021.

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.

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York Statute, including the "takings" issue, and reported its conclusion to the legislature that the New York Statute would survive a legal challenge based on the Takings Clause as the statute does not effectuate the transfer of a property right by private parties for a government use. This report conveys the same conclusion with respect to the federal Bill.

II. NEED FOR A REPLACEMENT RATE AND SAFE HARBOR

The failure to resolve the problem of 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 legacy LIBOR contracts will be treated.

- Disputes will arise and parties will seek redress in the courts, as foreshadowed by a number of parties that have already sought interpretative judicial relief. Some parties may attempt to escape liability from their contractual obligations, 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 number of court cases involving a large volume of transactions, resulting in both burdens on the judicial system and substantial financial market disruption.

- Investors that have invested in securities that reference LIBOR may have their floating rate securities converted to fixed rate securities, potentially to their 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 will be impaired while the uncertainty is resolved over months, if not years, in the court system, with potentially inconsistent results among courts in different states.

- Particular concerns arise in the case of legacy LIBOR consumer contracts, as the potential for abuse is seen as greater than in the commercial context. The Bill would seek to encourage the adoption of the specified benchmark rate by providing a "safe harbor" incentive to select that rate as the replacement rate.

Like the New York Statute, the Bill seeks to prevent such disruptions and address these issues for legacy LIBOR 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. Contracting parties retain their ability to enter into modifications to their contract in order to replace LIBOR, including by selecting a different benchmark such as the

"prime" rate, Ameribor[3] or BSBY[4] but are protected by the statute to have their contracts continue with SOFR replacing LIBOR, rather than finding themselves with a fixed rate or without certainty as to the rate, requiring judicial intervention. While the Bill will not resolve all issues arising from LIBOR's cessation, the City Bar believes that the Bill addresses an important need, where contracts cannot be practically amended or are otherwise not amended by the parties in time. Moreover, since the Bill would apply to contracts governed by federal laws or by the laws of any state, the coverage of the Bill is broader than that of the New York Statute, or any similar statute enacted by any state. Therefore, for the above reasons, the City Bar supports its enactment.

III. THE 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. 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). When the government, rather than appropriating private property for itself or a third party, instead imposes regulations that restrict an owner's ability to use its own property, a flexible test is used to determine whether there has been a taking, which balances factors such as the economic impact of the regulation, its interference with reasonable investment-backed expectations, and the character of the government action. *Cedar Point Nursery v. Hassid*, 594 U.S. __ (2021) (Slip op. at 6), citing *Penn Central Transportation Co. v. New York City*, 438 U. S. 104 (1978). In *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), the Court established the proposition that "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Id.*, at 415.

The City Bar does not believe that the reported cases interpreting the Takings Clause support a challenge to the Bill 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 but does not prohibit regulations that deprive private citizens of property rights but promotes the public good. *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"). The nature of the governmental action is the same here: the Bill would not transfer any property rights from private citizens to the government, but rather would promote the general good, without any specific use by the government of the private property rights.

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[3] An interest rate benchmark created by the American Financial Exchange reflecting the actual borrowing costs of U.S. small, medium and regional banks. https://ameribor.net/background.

[4] The Short Term Bank Yield Index developed by Bloomberg Indices to measure the overage yields at which large global banks access US Dollar Senior Unsecured marginal wholesale funding. https://www.bloomberg.com/professional/introducing-the-bloomberg-short-term-bank-yield-index-bsby/.

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. In the *Penn Central* case, the Court held 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). A diminution in value only will not support a takings claim. 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 the owner's 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). Similarly, if a government regulation or action only incidentally interferes with the performance of a private contract—rather than appropriating or taking over one of the parties' obligations—then there is no taking. *Omnia Commercial Co. v. United States*, 261 U.S. 502 (1923).

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 was 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.,* 294 U.S. 240 (1935), 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. In upholding the regulation against a Takings Clause challenge, the Court's 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, their holdings are applicable to the Bill and should govern and dispose of any objections to the Bill based on the Takings Clause.

IV. CONCLUSION

The City Bar believes that the Bill would survive a challenge that it violates the federal Takings Clause. The issues which the Bill 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. Moreover, the problems posed by legacy LIBOR Contracts have proven

exceptionally difficult to address. The Bill has a legitimate purpose, namely settling the rights of parties to legacy LIBOR Contracts that will be otherwise thrown into doubt or confusion by the cessation of the publication of a LIBOR rate.

For these reasons, the City Bar supports the enactment of the Bill.

City Bar Working Group on LIBOR Replacement Legislation

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APPENDIX A

Participating New York City Bar Association Committees:

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