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What Happens When the Recently Enacted NY LIBOR Statute Meets the Trust Indenture Act?

Many corporate trustees have been concerned about what happens when the U.S. Dollar LIBOR ("LIBOR") cessation finally occurs (now set for June 30, 2023 for 1-month, 3-month, 6-month and 12-month USD LIBOR settings, among others). There appeared to be some relief on April 6, 2021 when LIBOR legislation was signed into law in New York state (the "NY LIBOR Legislation"), which is designed to facilitate a smooth transition to alternative benchmark rates. Promulgation of the NY LIBOR Legislation was motivated by uncertainty surrounding the future of some $223 trillion in contracts and financial products pegged to LIBOR as of the end of 2020, many of which are governed by New York law and do not contain fallback provisions to transition to an alternate benchmark upon the cessation of LIBOR.

While the NY LIBOR Legislation, on its face, appears to be an effective stopgap measure, the Trust Indenture Act of 1939 (the "TIA"), specifically Section 316(b) of the TIA, raises questions about the enforceability of the NY LIBOR Legislation under the TIA. Specifically, although the NY LIBOR Legislation provides some clarity for indenture trustees who are troubled about governing documents, including indentures, that are silent about LIBOR cessation, the NY LIBOR Legislation simultaneously triggers concerns under TIA Section 316(b), reminiscent of some of the issues highlighted in the 2017 decision of the Second Circuit Court of Appeals in *Marblegate Asset Management, LLC v. Education Management Finance Corp. ("Marblegate").*

In broad terms, the NY LIBOR Legislation provides that, in the case of many New York law-governed contracts that reference LIBOR and that do not have adequate fallback provisions to determine what happens when LIBOR ceases ("Legacy Contracts"), a new "benchmark rate" recommended by the appropriate authorities (e.g., the Secured Overnight Financing Rate ("SOFR")) will, by operation of law, be used for such contracts in lieu of LIBOR.

Since New York law governs a majority of corporate indentures, as well as many other financing documents, the NY LIBOR Legislation will have a broad impact and cover many underlying securities and financings. In the case of indentures qualified under the TIA (and, to an extent, indentures which are not so qualified for private placement issues or municipal bonds, both of which often incorporate the TIA to varying degrees), TIA Section 316(b) provides 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." Accordingly, if bondholders or other parties to financings are negatively impacted by the rate change (to SOFR or otherwise) under the NY LIBOR Legislation and challenge such a change as a violation of Section 316(b) (or the 316(b) analogous language), it is far from clear that the NY LIBOR Legislation would survive the challenge.

The New York City Bar Association (the "NYCBA") issued a report supporting the NY LIBOR Legislation, in which it commented on the TIA issue. The NYCBA acknowledged the issue, supporting a minor amendment to the TIA and concluding that "… whether or not the TIA is amended … New York should proceed with a legislative solution that can be applied to the many

transactions not subject to the TIA."

The well-documented judicial record of prejudiced and disgruntled bondholders that seek, with some success, to be made whole through litigation is a prominent source of anxiety for issuers and corporate trustees related to LIBOR's phase-out. This is reminiscent of *Marblegate*, as well as other cases which speak to the required consent of affected bondholders, where the issue of changes to bond terms without bondholder consent was relevant. While the Second Circuit Court of Appeals ultimately ruled against the bondholders objecting to changes in *Marblegate*, a recent New York case (*CNH Diversified Opportunities Master Account, L.P. v. Cleveland Unlimited, Inc. ("CNH"))*, arguably created contrary precedent for unhappy bondholders to convince a court that an amendment or transaction violated their rights as creditors or was unlawful under state or federal law, notwithstanding the *Marblegate* ruling. It remains unsettled, perhaps to be further clarified by a court, whether *CNH* has indeed created an opportunity for such bondholders. In any case, even though the NY LIBOR Legislation presents different issues under Section 316(b) than were involved in *Marblegate* and *CNH*, the mere mention of Section 316(b) and how it may be interpreted by the courts in relation to LIBOR will be of concern to indenture trustees.

Presumably, New York lawmakers had TIA Section 316(b), *Marblegate* and *CNH* in mind when drafting the New York LIBOR Legislation; hence the legislation's "Safe Harbor Provision." Specifically, the Safe Harbor Provision provides that no person shall have any liability arising out of the use of a recommended benchmark replacement or the implementation of benchmark replacement conforming changes. That said, it remains to be seen how, or if, the Safe Harbor Provision would apply to a dispute arising under the TIA and if the Safe Harbor Provision will adequately protect corporate trust banks acting as trustees and agents.

Accordingly, while the NY LIBOR Legislation provides some comfort, federal statutes such as the TIA might provide bondholders with an avenue to object should they feel aggrieved. Other considerations under federal law, such as the contracts clause of the U.S. Constitution (which prohibits states from passing laws impairing contract obligations), also exist but are beyond the scope of our focus here.

The NY LIBOR Legislation provides relief only for Legacy Contracts governed by the law of New York. A significant number of contracts, including indentures, however, are governed by the laws of other jurisdictions. Due to the existence of Legacy Contracts governed by laws other than those of New York, support for a federal statute mimicking the language and effect of the NY LIBOR Legislation is gaining momentum. On April 14, 2021, major financial industry groups, including the Securities Industry and Financial Markets Association, the Structured Finance Association and the American Bankers Association submitted a joint letter to the United States House of Representatives Committee on Financial Services, calling for the passage of a federal statute achieving the same end as the NY LIBOR Legislation. Consequently, there may be more issues for corporate trust banks to consider. Both the NY LIBOR Legislation and a potential federal statute are, without question, of paramount importance to corporate trustees and may affect risk assessment and the scope of review of transactional documents. As always, the corporate trust community should remain vigilant.

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