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Client Alert
Commentary

Latham & Watkins International Arbitration Practice 7 August 2020 | Number 2771

Successfully Tackling LIBOR Phase-Out in International Arbitration

The discontinuation of LIBOR in 2022 may pose a risk to arbitration proceedings. Preparation is key to a smooth transition.

Key Points:

- LIBOR, which is widely used in financial transactions and is embedded in many commercial contracts, will no longer be published starting on 1 January 2022.
- Under most arbitral rules, tribunals have the authority to decide what interest rate to apply to awards, and many apply LIBOR even if the underlying contract does not contain an express reference to the interest rate.
- Parties should prepare for the discontinuation of LIBOR in order to diminish potential risks to their arbitration proceedings and awards.

The London Interbank Offered Rate (LIBOR) is a benchmark interest rate at which London-based major banks lend and borrow unsecured short-term loans from one another. Administered by the Intercontinental Exchange under the supervision of the Financial Conduct Authority (FCA), LIBOR has served as a globally accepted key benchmark interest rate for over 30 years and is included in many private and public commercial contracts, many of which contain arbitration clauses.

In the aftermath of the highly publicized 2012 LIBOR scandal, the FCA announced that LIBOR would be phased out by 1 January 2022. In a recent speech, Michael Held, executive vice president of the Federal Reserve Bank of New York, warned that the LIBOR phase-out could be disastrous if industry actors are unprepared. While regulators have proposed alternatives to LIBOR that parties may use to ensure a smoother transition, they are unlikely to announce a universally agreed substitute for LIBOR.

This *Client Alert* considers the ways in which the LIBOR phase-out may affect ongoing and future arbitrations, and what actions parties may take to mitigate potential risks.

Mitigating Risk to Dispute Resolution

Since its introduction in the 1970s, LIBOR has been a ubiquitous presence in international commercial transactions. Parties routinely use it as the benchmark interest rate in financial contracts such as derivatives, syndicated loans, bonds, and retail mortgages, as well as insurance and commercial contracts. Many of these contracts likewise contain arbitration clauses. Parties may find themselves in uncertain territory if arbitration ensues or arbitral awards have not been paid in full after LIBOR is no longer published. Below are practical tips on how to mitigate these potential risks.

Contract Solutions

- Review all existing contacts and identify any instruments that refer to LIBOR.
- Some contracts may contain fallback provisions that refer to a replacement interest rate. If these provisions are comprehensive, they may be sufficient to calculate the rest of the interest term after LIBOR has been phased out. However, before deciding to rely on contractual fallback provisions, parties should consider whether they are sufficient because the primary purpose of such fallback provisions may be to address *temporary* interruptions of LIBOR and to aid parties in calculating the remaining term, not to outright replace the contractual interest rate. Furthermore, parties may disagree on whether and at what point the fallback provision is triggered.
- The most straightforward solution is for parties to replace legacy contracts or to renegotiate amendments in advance of LIBOR's phase-out, or at least to ensure that the contract contains a clear fallback provision with an appropriate replacement rate and conditions.

RFRs and IBORs

There are various alternative interest rate benchmarks, some of which appeared after the LIBOR phase-out plan was announced. These benchmarks differ from LIBOR because they are Risk-Free Interest Rates (RFRs) that are used for secured transactions, as opposed to Interbank Offered Rates (IBORs) like LIBOR that are used for unsecured transactions. IBORs are not risk-free because they take into account the credit risk of the borrower. In contrast, RFRs do not generally take such risk into account. IBORs can be set for different maturity periods (overnight, one week, one month, two months, three months, six months, and one year for LIBOR), which allow them to be forward-looking, since a borrower can calculate their interest in advance. In contrast, RFRs are calculated only overnight. Finally, RFRs use different calculation methods, and thus offer very different benchmark rates, while IBOR rates tend to be similar.

The main RFRs for secured transactions include:

- Sterling Overnight Index Average (SONIA)
- Secured Overnight Financing Rate (SOFR), launched by the NY Federal Reserve in April 2018
- Swiss Average Rate Overnight (SARON)
- Euro Short Term Rate (ESTER), launched by the EU in 2019

Strategies for International Arbitrations

If parties have not amended existing contracts that reference LIBOR, arbitral tribunals may apply an inexistent or soon-to-be defunct interest rate to arbitral awards.

Ongoing and Future Arbitrations

- Parties should first raise the issue with the opposing party and attempt to reach an agreement as to what interest rate the tribunal should apply after LIBOR has been phased out.

- If the parties fail to agree, they should raise the issue with the tribunal and request that the tribunal use another appropriate benchmark. Parties may need to engage damages experts to determine and argue for the application of a replacement interest rate.

The tribunal may also address the issue on its own accord, as it will strive to render an award that is enforceable. If the underlying contract does not contain a fallback provision, the tribunal may need to resort to a more complex analysis under the substantive law of the contract in order to determine how to interpret the LIBOR clause, and whether to apply it at all. Depending on the applicable law, the tribunal may find that the LIBOR clause is inapplicable due to frustration.

Existing Arbitral Awards

The LIBOR phase-out may likewise impact existing arbitral awards that reference LIBOR as the applicable interest rate and that are not paid before LIBOR's discontinuation.

- Few options exist once a tribunal issues an award. Parties may attempt to request the revision or correction of an award referring to LIBOR, or even attack its enforceability.

- Correction and interpretation requests are generally not available for substantive changes to awards, such as the change of an interest rate, and instead tend to be used to explain ambiguities or to correct errors.

- It may be more appropriate for parties to request a revision of the award to correct substantive issues that were not addressed in the award or were neglected by the parties. The inherent powers of tribunals generally allow them to revise arbitral awards.

- Arbitral tribunals have widely different approaches to allowing revisions, and most institutional arbitral rules do not address the powers of the tribunal to revise an already published arbitral award. Article 51 of the ICSID Rules is a notable exception, expressly allowing parties to request the revision of an award up to three years after its publication. However, parties must make such requests within 90 days after the discovery of a new fact that is of a nature that may decisively affect the award. Whether this provision could encompass revisions based on the incorrect application of LIBOR is unclear, since the phase-out plan has been public since 2017 and should arguably have been known to the parties.

- Parties may likewise request the national court enforcing the award to apply a different interest rate.

The LIBOR phase-out will inevitably pose risks to contracts and arbitrations. However, parties have a wide range of mitigation strategies at their fingertips.

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