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Loans Are Not Securities

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We have a final answer to the question of whether a term loan is a security. Recently, the Second Circuit Court of Appeals affirmed the District Court's decision in the Kirschner Case that a term loan is not a security. We have ben closely following this case, which has been working its way through New York federal courts for years, and you can find our updates here.

This case has been described as "a potential gamer changer" and even "an existential threat" to the syndicated loan market given the potential consequences it would have to the syndicated loan market if state and federal securities laws were to be applicable to that market. The case has received a lot of attention over the last few months as the participants in the $1.4 trillion loan market have sat up and taken notice on the developments as the Second Circuit heard oral argument and has made certain requests for additional briefing.

Significantly, following a hearing, the Second Circuit entered an order asking the U.S. Securities and Exchange Commission ("SEC") to submit "any views it wishes to share" on whether the loans in the Kirschner case are securities. Much was made of what the SEC might say and what that statement would mean for the Court's decision. In the end, following multiple motions for extensions of time from the SEC, the SEC ultimately declined to submit a legal brief on the subject.

The Loan Syndications Trading Association ("LSTA") has also been quite vocal in this case. As it said in a statement when the opinion was issued, "Maintaining the characterization of Term Loan Bs as non-securities has been a central focus of the LSTA for years. We are gratified that the SEC declined to submit a brief and that the Court adopted the long-standing view that loans." The LSTA also submitted a very thorough and thoughtful amicus brief with the Second Circuit Court of Appeals during the briefing period of the appeal which set forth its view that term loans are not securities and explaining the consequences that a determination otherwise would have for the entire syndicated loan market – borrowers, agents, lenders and others alike.

The Kirschner case in question involved a broadly syndicated $1.775 billion term loan. The credit agreement also facilitated the creation of a secondary market for

the notes. Following certain legal struggles, Millennium filed for bankruptcy seeking relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The litigation we have been following began in the course of the Chapter 11 proceedings. As part of the proceedings, the plaintiff in the case was appointed trustee of the Millennium Lender Claim Trust ("Trust"). The ultimate beneficiaries of the Trust are lenders who purchased notes and have claims in the bankruptcy proceedings.

Litigation ensued in New York federal court, culminating in a decision by the District Court in May of 2020 granting defendants' motion to dismiss, which thereby dismissed the plaintiff's state-law securities claims because it concluded that plaintiff failed to plead facts plausibly suggesting that the Notes are "securities" under the standard set forth in the Supreme Court decision *Reves v. Ernst & Young*, 494 U.S. 56 (1990). The plaintiffs timely appealed bringing the case before the Second Circuit Court of Appeals, which for our non-lawyer readers is a Court that is second only to the Supreme Court.

The decision issued turned principally on whether the Court found that the plaintiff in the case "plausibly suggested that the notes are "securities" under *Reves*" and the Court held that he did not. The relevant test that the Supreme Court set forth in *Reves* is a 4-factor test that is meant to distinguish between notes that are issued for investment purposes, for which securities laws would apply, and those that are for a commercial or consumer context, for which they would not. The Court applied the 4-factor test and analyzed each factor against the facts in the case. Ultimately, the Court determined that the District Court had ruled properly and affirmed its decision in the published opinion.

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