

Southern District of New York Rules That Syndicated Term Loans Are Not Securities

May 28, 2020

On May 20, 2020, in a much anticipated decision, the Southern District of New York granted the defendants' motion to dismiss in the matter of *Marc S. Kirschner, solely in his capacity as trustee of The Millennium Lender Claim Trust vs. JP Morgan Chase Bank, N.A. et al.* The court dismissed plaintiffs' claims under the "blue sky" securities laws of four states on the grounds that syndicated term loans are not securities and would not have been reasonably considered as such by "highly sophisticated purchasers."

Background. Millennium, a diagnostic testing company, was sued by a competitor in 2011 alleging that Millennium's violation of federal healthcare statutes constituted unfair competition. Additionally, in March 2012, the Department of Justice began investigating Millennium for violations of federal healthcare laws. In April 2014, Millennium obtained a syndicated term loan with the defendants as the arrangers, the proceeds of which were used to repay existing debt and to pay a dividend to the shareholders.

Two months later, the jury returned a verdict in favor of the competitor, awarding it compensatory and punitive damages. In October 2015, Millennium finalized a global settlement with the Department of Justice for violations of federal healthcare laws and, in November 2015, defaulted on the term loan and filed a bankruptcy petition. The plaintiffs subsequently filed a complaint asserting, among others, claims of actionable misstatements and omissions under the "blue sky" securities laws of California, Massachusetts, Colorado and Illinois. Given the significance of the question on term loan markets, the LSTA and the Bank Policy Institute filed an amicus brief arguing that term loans are not securities.

The Court's Opinion. The court applied the *Reves* test to determine whether the term loans were a security. The court in *Reves vs. Ernst and Young* held that the presumption that a note is a security may be overcome by showing that the note bears a family resemblance to one of several categories, including loans issued by banks for commercial purposes. The court applied the four factors in the *Reves* test as follows:

- **Motivations of Buyer and Seller:** The first factor did not weigh strongly in either direction, as the buyers were motivated by investing in an enterprise, but the seller did not use the proceeds for investment in the business, instead using them to repay debt and pay a dividend.
- **Plan of Distribution:** The second factor weighed strongly in favor of ruling the term loans not to be securities. There was a minimum denomination of \$1 million in order to invest and tight restrictions on transfer (including prohibition on transfers to natural persons) that assured that the term loans would not be offered to the general public.
- **Expectations of Investing Public:** The third factor also weighed in favor of the position of the defendants, as the offering materials for the term loans used terminology that was generally understood in the market to indicate the investment was in private loans and not securities.
- **Existence of an Alternate Regulatory Regime:** Finally, the fourth factor also weighed in favor of ruling the term loans not to be securities. The Office of the Comptroller of the Currency has issued guidelines on loan participations that obviate the need for SEC oversight.

Key Takeaway. The court's ruling in *Kirschner* is significant in that it affirms decades of market expectations that syndicated term loans are not securities. A ruling to the contrary would have upended term loan markets and created significant uncertainty and burden for borrowers and arrangers, especially in the current situation where access to liquidity is of the utmost importance.



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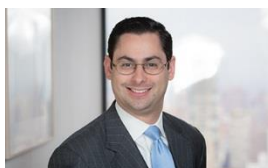
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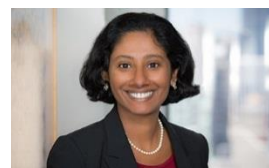
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