2020 Virtual Winter Leadership Conference

Fraud and the Implications for Claims Trading and Plans

Presented by the Claims Trading and Commercial Fraud Committees

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Transfer of Claims Between Insiders and Non-Insiders
Implications for Plan Confirmation

A. The issue of whether a claim that is transferred between an "insider" and a third party has implications in the context of plan confirmation

B. Bankruptcy Code § 1129(a)(10) provides:

> **Confirmation of plan.** The court shall confirm a plan only if all of the following requirements are met:
> * * *
> If a class of claims is impaired under the plan, at least one class of claims that is impaired under the under the plan has accepted the plan, *determined without including any acceptance of the plan by any* ***insider***.

11 U.S.C. § 1129(a)(10) (emphasis added).

C. Accordingly, when a class of creditors is being paid less than the full amount of their claims, at least one class member that is not an "insider" must vote to accept the plan.

D. Courts have distinguished between a "**statutory**" insider and a "**non-statutory**" insider

a. **Statutory insiders** are parties that fall within the Bankruptcy Code's definition of "insider" under Bankruptcy Code §101(31). For a case involving a corporate debtor, that section provides:

The term "insider" includes --- ….

(B) if the debtor is a corporation –

(i) director of the debtor

(ii) director of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner; or

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(v) general partner of the debtor; or

(vi) relative of a general partner, director, officer, or person in control of the debtor…

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor

b. Courts have held that because Bankruptcy Code §101(31) uses the term "includes", the section provides a **non-exhaustive** list of parties that may be considered an "insider" of a debtor.

i. Courts have developed varying tests and factors to determine when an entity is a "**non-statutory insider"** that is not covered by the definition of "insider" under Bankruptcy Code §101(31)

1. This category "includes parties whose business or professional relationship with the debtor compels the conclusion that the individual or entity has a relationship with the debtor, close enough to gain an advantage attributable simply to affinity rather than to the course of business dealing between the parties." *See Freidman v. Sheila Plotsky Broker, Inc. (In re Friedman)*, 126 B.R. 63, 70 (9th Cir. 1991)

E. The vote of a either a statutory or a non-statutory insider cannot be counted for confirmation purposes under Bankruptcy Code § 1129(a)(10). Accordingly, under certain circumstances, the legal consequences of transferring a claim between an insider and a non-insider can be determinative as to whether a plan can be confirmed by a court.

F. Cases considering whether an assignment of a claim between an insider and a third party transfers or negates "insider" status have resulted in conflicting decisions:

G.

a. *In re Concord Square Apartments of Wood County, Ltd.*, 174 B.R. 71, 75 (Bankr. E.D. Ohio 1994) (holding "the 'insider' status of a claimant does not, as a matter of law, transfer with a claim upon the sale or assignment

of that claim to a third party", because "insider" status under Bankruptcy Code § 101(31) refers to the holder, and not to the claim); *accord In re Caviata Attached Homes, LLC,* 2010 WL 8500043 (Bankr. D. Nev. Apr. 12, 2010).

b. *In re Heights Ban Corp.*, 89 B.R. 795, 799 (Bankr. S.D. Iowa 1988) ("if the court were to accept debtor's theory [that an insider can transfer a claim to a non-insider without retaining its insider status], the operation of section 1129(a) would be seriously undermined. Debtors unable to obtain the acceptance of an impaired creditor simply could assign insider claims to third parties who in turn could vote to accept. This the court cannot permit").

c. *In re Greer West Inv. Ltd. P'ship*, 81 F.3d 168 (9th Cir. 1996) (table) (affirming bankruptcy court's holding disallowing a claim transferred by an insider to non-insider, and finding that the bankruptcy court appropriately "focused on the status of the *claim* rather than the identity of the *holder of the claim*, and reasoned that it would violate the meaning of the Code if insider status could be changed by simply transferring the claim to one who is not an insider") (internal quotations omitted) (emphasis in original)

d. *In re Applegate Property, Ltd.*, 133 B.R. 827, 833 (Bankr. W.D. Tex. 1991) (refusing to count the vote of a debtor's insider who purchased claim from a non-insider transferor, finding that "the motivation behind the vote of an insider is precisely the same regardless how the insider came by the claim".)

e. *In re Holly Knoll P'ship*, 167 B.R. 381, 385 (Bankr. E.D. Pa. 1994) (following *Applegate*, the court refused to count the vote of a creditor with claim transferred from a non-insider to an insider, finding that as "a general rule an entity which acquires a claims steps into the shoes of that claimant, enjoying both the benefits and limitation of the claim, as a successor in interest", but that the "general rule should not apply . . . where it would undermine the policy of § 1129(a)(1)) to prevent a debtor from using an insider-dominated class to satisfy the requirement that at least some impaired class of creditors vote in favor of the plan.")

f. *In re Nilhan Developers, LLC*, 620 B.R. 385, 413 (Bankr. N.D. Ga. 2020) ("As a general rule, an entity which acquires a claim steps into the shoes

of that claimant, enjoying both the benefits and limitations of the claim, as a successor in interest. However, a third-party assignee does *not* become an insider as a matter of law by acquiring the claim.") (internal citation omitted) (emphasis in original)

H. The U.S. Supreme Court had the opportunity to address and resolve the split among lower courts in *U.S. Bank Nat. Ass'n v. Village at Lakeridge, LLC*, 138 S. Ct. 960 (2018).

a. In *Lakeridge*, the bankruptcy court found that because a claim against the debtor was transferred from a statutory insider to a third party the transferee's vote in favor of the plan could not be counted pursuant to Bankruptcy Code § 1129(a)(10) because the transferee was considered an "insider" by virtue of the transfer. *See In re Village at Lakeridge*, 2013 WL 139447, at *7 9th Cir. BAP Apr. 5, 2013). The bankruptcy court based its ruling on the *Applegate, Holly Knoll,* and *Greer* decisions, noted above. *Id*. at *7-*8.

b. The 9th Circuit BAP panel reversed the bankruptcy court, finding there is "a logical and legal inconsistency in the bankruptcy court's reasoning that the assignment of a claim by itself may change the insider status of the claimant. If the assignment of an insider claim to a non-insider alone changes the non-insider's status to insider, then it would follow that an assignment or purchase of a non-insider claim by an insider would change the insider into a non-insider. As both the *Applegate* and *Holly Knoll* courts observed, that cannot be allowed because, both before and after the assignment, the insider is still an insider." *Id*. at *8.

c. The 9th Circuit affirmed the 9th Circuit BAP panel, holding that "if a third party could become an insider as a matter of law by acquiring a claim from an insider, bankruptcy law would contain a procedural inconsistency wherein a claim would *retain* its insider status when assigned from an insider to a non-insider, but would *drop* its non-insider status when assigned from a non-insider to an insider. *In re Village at Lakeridge*, 814 3d. 993, 1000 (9th Cir. 2016) (emphasis in original).

d. The 9th Circuit decision was appealed to the U.S. Supreme Court. However, the Supreme Court only granted *certiorari* on the narrow procedural issue of the proper standard of review for a lower court's determination of whether a party is a non-statutory insider, and declined

to address the issue of whether assignment of a claim transferred insider status to the claim purchaser. *See Lakeridge*, 138 S.Ct. at 973, n.1 ("U.S. Bank also contended that [purchaser] automatically inherited [seller]'s statutory insider status when he purchased its loan. We did not grant review of that question and therefore do not address it in this opinion." (internal citation omitted).

Claims Disallowance and Its Impact on Claims Trading

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A. The Value of Holding an Allowed Claim. Creditors in a chapter 11 case have certain rights. They can, among other things, object to relief requested by the debtor or other parties in interest, file a request for relief, vote on a debtor's chapter 11 plan, and receive distributions under the plan. The last two of these examples, however, are conditioned on the creditor holding an "allowed claim." Accordingly, sections of the Bankruptcy Code, such as section 502(d) (authorizing a Court to disallow a claim under certain circumstances), can have a significant impact on a creditor's rights and the value of any claim held by that creditor. This potential impediment is particularly relevant to claims purchasers, who may not know the history of a claim but could suffer the consequences.

B. Claims Allowance Under the Code. A creditor's claim generally is deemed allowed under the Bankruptcy Code unless and until a party in interest objects to it. 11 U.S.C. § 502(a). A debtor, trustee, or other party in interest may object to a claim on any number of grounds, including that the claim is unenforceable, for unmatured interest, or not timely filed. 11 U.S.C. § 502(b).

C. Disallowance of a Claim Under Section 502(d). In addition to the grounds noted in section 502(b), a court also may disallow a claim if the debtor or trustee holds a potential avoidance claim against the claimant. Specifically, section 502(d) provides:

> Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title.

11 U.S.C. § 502(d).

D. General Application of Section 502(d). In a case involving a claim held by the original claimant, section 502(d) has a fairly straight-forward application. If the claimant's conduct (or payments on the claim) fall within one of the noted avoidance sections of chapter 5, the court may disallow the claim, at least temporarily. The implications of section 502(d) are less certain, however, in the claims trading context. Does the transfer of the claim cleanse the claim of any consequences flowing from conduct involving the original claimant?

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[1] This paper is presented for educational purposes only and does not express any opinions or positions regarding any issues that may arise, or any parties that may appear, in any cases before Judge Harner.

E. Purpose of Section 502(d). The legislative history to section 502(d) suggests that it is intended to assist in the enforcement of court orders and level the playing field between the debtor and the creditor. *See* H.R. Rep. No. 95-595, at 354 (1978); S. Rep. No. 95-989, at 64 (1978). Indeed, granting a creditor an allowed claim when it may owe money (or something of value) to the bankruptcy estate seems inequitable. The estate does represent value for all creditors and bankruptcy does try to recoup prepetition value lost by the estate and distribute that value equally among similarly situated creditors. *See, e.g., In re Chase & Sanborn Corp.*, 124 B.R. 368, 371 (Bankr. S.D. Fla. 1991).

F. Application of Section 502(d) in Claims Trading Context. The basic question presented is whether section 502(d) applies if the original claimant no longer owns the subject claim. Are the legislative objectives underlying section 502(d) accomplished when a claims purchaser, rather than the original claimant, holds the claim? And should the bankruptcy estate or the claims purchaser bear the risk and potential loss of value associated with those objectives?

G. Relevant Case Law. Courts have grappled with these issues and the application of section 502(d) to the purchaser of a prepetition claim. Although the majority position appears to be that section 502(d) applies in the claims trading context and that the claims transfer does not cleanse the claim, some courts have taken a different approach. *Compare In re KB Toys Inc.*, 736 F.3d 247 (3d Cir. 2013) *with Enron Corp. v. Springfield Assocs., LLC (In re Enron Corp.)*, 379 B.R. 425 (S.D.N.Y. 2007). Yet, the recent decision in *In re Firestar Diamond, Inc.*, 615 B.R. 161 (Bankr. S.D.N.Y. 2020), appears to strengthen and embed the majority view on this issue. As the case law in this area continues to develop, debtors, claims purchasers, and other creditors should remain sensitive to potential issues with prepetition conduct and transfers involving original claimants and endeavor to mitigate these and other unsettled issues concerning claims allowance.

Fraud and the Implications for Claims Trading and Plans

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Can the holder of a syndicated loan claim use the safe harbor of 11 U.S.C § 546 to shield itself from fraudulent transfer liability (whether its own or that of the original holder/transferor of the claim)?

The possibility of answering that question in the affirmative was presented by the Second Circuit's ruling in *In re Tribune Co. Fraudulent Conveyance Litigation*, 946 F.3d 66 (2d Cir. Dec. 19, 2019).

- Facts: Tribune Media Company ("Tribune") entered chapter 11 in December 2008. In 2007, Tribune was the subject of a leverage buyout ("LBO"). As part of the LBO, Tribune incurred over $11 billion of secured debt. That, combined with a new equity contribution of $315 million from the buyer, was used to refinance Tribune's existing bank debt and to redeem its existing investors' stock above its trading price for over $8 billion. Representatives of Tribune's unsecured creditors brought a state law constructive fraudulent conveyance claim against the shareholders, seeking to recover the payments they received for the benefit of the unsecured creditors.

- Issue: Whether the creditors' state law constructive fraudulent conveyance claims are preempted by Section 546(e).

- Lower Court Outcome: No, creditors' state law constructive fraudulent conveyance claims are not preempted by Section 546(e) because (1) 546(e)'s prohibition on avoiding designated transfer only applied to a bankruptcy trustee and (2) Congress declined to extend Section 546(e) to state law fraudulent conveyance claims brought by creditors.

- Second Circuit Ruling: Yes, creditors' state law constructive fraudulent conveyance claims are preempted by Section 546(e).

- Section 546(e):

  Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101,

[1] This paper is presented for educational and discussion purposes only and does not necessarily represent the views of the presenter or of O'Melveny & Myers LLP.

741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

- Section 101:

(22) The term "financial institution" means --

(A) a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer; or

(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940.

- o Section 741(7):

(7) "securities contract"—

(A) means—

(i) a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including an interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement", as defined in section 101);
….

(ii) any option entered into on a national securities exchange relating to foreign currencies;

(iii) the guarantee (including by novation) by or to any securities clearing agency of a settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, or mortgage loans or interests therein (including any interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such settlement is in connection with any agreement or transaction referred to in clauses (i) through (xi));
(iv) any margin loan;
(v) any extension of credit for the clearance or settlement of securities transactions;
(vi) any loan transaction coupled with a securities collar transaction, any prepaid forward securities transaction, or any total return swap transaction coupled with a securities sale transaction;
(vii) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph;
(viii) any combination of the agreements or transactions referred to in this subparagraph;
(ix) any option to enter into any agreement or transaction referred to in this subparagraph;
(x) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this subparagraph, except that such master agreement shall be considered to be a securities contract under this subparagraph only with respect to each agreement or transaction under such master agreement that is referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix); or
(xi) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this subparagraph, including any guarantee or reimbursement obligation by or to a stockbroker, securities clearing agency, financial institution, or financial participant in connection with any agreement or transaction referred to in this subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562; and

(B) does not include any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan;

- Analysis:
    - Tribune retained Computershare in connection with the LBO tender offer. Computershare is a "financial institution" because it is a trust company and bank. Therefore, Tribune was likewise a "financial institution" with respect to the LBO payments if it was Computershare's customer and Computershare was acting as its agent (as defined in Section 101(22)(A)). Tribune was Computershare's customer using an "ordinary meaning" of

customer given that: (1) Computershare held Tribune's deposit of the purchase price for the shares, (2) Computershare received the tendered shares, (3) Computershare retained the shares on Tribune's behalf and (4) Computershare paid the tendering shareholders on behalf of Tribune. Lastly, the shares purchase agreement constituted a "securities contract" because the definition of securities contracts includes contracts for the purchase of a security.

- The safe harbor of Section 546(e) prevails over state law fraudulent conveyance claims notwithstanding the language limiting its reach to actions brought by trustees because preemption can be inferred where not expressly provided. A presumption against preemption is strong where Congress is legislating in an area traditionally one of state law along, but this is not such a context.

- Takeaways: Payments to selling shareholders under an LBO can be protected from fraudulent conveyance attack under the safe harbor of 546(e).

The holding of the *Tribune* case raises the prospect that all transfers in connection with an LBO--including those to the lenders involved in financing the LBO--might be protected from a fraudulent conveyance attack. So long as a the holder of a syndicated loan claim can show that (1) the original lender advancing the funds for the LBO purchase price was a financial institution, (2) borrower was a customer, and (3) the transfers were made pursuant to a securities contract, then the syndicated loan claim holder can shield itself from fraudulent conveyance liability under Section 546(e). That possibility, however, was seemingly foreclosed recently by the Southern District of New York in *Kirschner v. J.P. Morgan Chase Bank*, 2020 WL 2614765 (S.D.N.Y. May 22, 2020).

- Facts: In 2014, Millennium Laboratories LLC ("Millenium") entered into a $1.775 billion syndicated term loan, which was arranged and underwritten by the defendant banks and broker-dealers (the "Defendants"). In Millennium's subsequent bankruptcy, the bankruptcy trustee, on behalf of investors which were part of the syndicate of lenders who purchased the loans, sued the Defendants. Among other things, the trustee claimed that the Defendants had violated state securities laws by making misrepresentations and omissions in the confidential information memorandum used to market the loan. The Defendants moved to dismiss the state securities law claims, arguing that a syndicated loan is not a security.

- Holding: The court held that syndicated loans are not securities. (See attached article for analysis)

- Takeaway:
  - The effect of *Kirschner* (and similar decisions) may be that syndicated lenders would not be able to take advantage of bankruptcy safe harbors

to shield themselves from fraudulent transfer attack because the requirement for a "securities contract" is not satisfied.

- Taken together with *Firestar*, subsequent purchasers of syndicated loan claims may be at risk of incurring the consequences of the original holder's involvement in a transaction that constitutes a fraudulent transfer or at least may not be able to utilize the safe harbor of Section 546(e).

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Alerts & Publications

In Fact-Specific Decision, New York Federal Court Affirms Long-Held Market Understanding That Syndicated Loans Are Not Securities

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It has long been understood, or perhaps, assumed, that syndicated loans are not securities, and therefore, not subject to state or federal securities laws. Recently, however, the plaintiffs in *Kirschner v. J.P. Morgan Chase Bank, N.A.*,[1] challenged this notion by bringing state securities laws claims in New York state court (the case was later removed to federal court) against arrangers and underwriters in connection with a syndicated bank loan deal. Had the plaintiffs' position been adopted, the decision could have had far-reaching consequences for the availability and cost of syndicated loans. On May 22, 2020, based on the facts of the case, Judge Gardephe of the U.S. District Court for the Southern District of New York (the "Court") ruled that the syndicated loans at issue were not securities.

Background

In 2014, Millennium Laboratories LLC ("Millennium") entered into a US$1.775 billion syndicated term loan (evidenced by notes), which was arranged and underwritten by the defendant banks and broker-dealers (the "Defendants"). Eighteen months later, following an adverse jury verdict and a multimillion-dollar settlement with the U.S. Department of Justice, Millennium defaulted on the loan and filed for bankruptcy protection. Shortly thereafter, the trustee of a litigation trust formed in Millennium's bankruptcy, on behalf of mutual funds, pension funds, and other institutional investors who were part of the syndicate of lenders who purchased the loans, sued the Defendants. Among other things, the trustee claimed that the Defendants had violated state securities laws by including material misrepresentations and omissions in the confidential information memorandum used to market the loans. The Defendants moved to dismiss the state securities laws claims, arguing that a syndicated loan is not a security by pointing to the "family resemblance" test established by the U.S. Supreme Court in *Reves v. Ernst & Young*[2] and subsequently adopted by the Second Circuit in the context of loan participations in *Banco Espanol de Credito v. Security Pacific National Bank*.[3]

The Court's Analysis

In *Kirschner*, the Court applied the "family resemblance" test articulated in *Reves*, which begins with a presumption that every note is a security. *Reves* recognizes, however, that there are certain categories of instruments commonly in the form of notes that are definitively not securities, and that the foregoing presumption may be rebutted if the instrument bears a "strong family resemblance" to one of the enumerated categories of non-security instruments, including "notes evidencing loans by commercial banks for current operations." The Court applied the four factors of the family resemblance test to the syndicated loans at issue in *Kirschner* to determine if the loans are securities:

- *Motivations of a Reasonable Buyer and Seller*. Under the first factor, an instrument is likely to be a security if the buyer is primarily interested in profit and the motivation of the seller is primarily to "raise money" or "finance substantial investment." In *Kirschner*, the Court found that while the syndicated lenders had an investment-related motive, Millennium's motivation in issuing the loans was not investment, but to advance some other commercial purpose, namely refinancing existing debt and paying dividends. Since the motivations of the buyer and seller were mixed, the Court found that this factor did "not weigh heavily in either direction."
- *Plan of Distribution*. The second *Reves* factor looks at whether the plan of distribution for the instrument in question is subject to "common trading for speculation or investment." The Court cited *Banco Espanol*, where the restrictions on transfer prevented the loan participations "from being sold to the general public" and only allowed "institutional and corporate entities" to be solicited. Similarly, the Court in *Kirschner* found the plan of distribution for the syndicated loans was "relatively narrow," as it excluded natural persons and solicited only a few hundred investment managers, "a relatively small number compared to the general public," and therefore, was not typical of a plan of distribution for a security.
- *Reasonable Expectations of Investors*. The third factor articulated in *Reves* considers "the reasonable expectations of the investing public" as to whether an instrument is a security. The Court, again citing *Banco Espanol*, noted that the confidential information memorandum and the credit agreement consistently used terminology, such as "loan documents," "loans," and "lenders" and "potential lenders" rather than "investors," and therefore, a reasonable investor could not conclude that the loans were, in fact, securities. The Court also went on to reject the plaintiffs' claim, calling it "premature at best," that expectations in the market have shifted and that syndicated loans should be considered securities since they share features with high-yield bonds.
- *Existence of Another Regulatory Scheme*: The final factor of the family resemblance test looks at whether there is another regulatory scheme

that reduces the risk of the instrument, such that oversight of securities laws is unnecessary. The Court in *Kirschner* found that federal banking regulators constitute "such a regulatory scheme" and therefore, the final factor weighed in favor of a finding that the loans were not securities.

The Court ultimately found that since three of the four factors weighed in favor of finding the notes comparable to one of the categories of non-security instruments enumerated in *Reves*—loans issued by banks for commercial purposes—the defendants overcame the presumption that every note is a security and dismissed the securities laws claims.

Practical Implications

A contrary decision in *Kirschner* would have had enormous implications on the nearly US$1.2 trillion syndicated term loan market. As the Loan Syndications and Trading Association noted in an amicus brief filed in support of the Defendants' motion to dismiss in the *Kirschner* case, if syndicated loans were treated as securities and the process of syndicating a loan needed to comply with securities laws, obtaining financing would become more costly, time-consuming, burdensome, and perhaps even impossible, for many borrowers. In addition, an alternative outcome could have upended the participation of CLOs, which currently hold nearly 60% of syndicated loans. CLOs depend heavily on bank investment, but banks are prohibited under the "Volcker Rule" from investing in CLOs that hold securities. Had banks been required to pull out from such investments, nearly $90 billion of funding available to CLOs would have been in jeopardy.

While the Court in *Kirschner* upheld the long-held expectation that loans are not securities and preserved the existing framework of the syndicated loan market, we note that this decision was fact specific. Participants in the syndicated loan market should continue to maintain common practices with respect to the issuance and distribution of syndicated loans, such as those described in the second and third *Reves* factors above, to reduce the risk of a court treating loans as securities.

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[1] *Kirschner v. J.P. Morgan Chase Bank, N.A.*, 2020 WL 2614765 (S.D.N.Y. May 22, 2020).

[2] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

[3] *Banco Espanol de Credito v. Security Pacific National Bank*, 973 F.2d 51, 56 (2d Cir. 1992).

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