

Kirschner Update: 2nd Circuit Affirms District Court Opinion That Leveraged Loans Are Not Securities

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In its highly anticipated decision, the Second Circuit has answered the question of whether a syndicated term loan qualifies as a “security” with a definitive “no”. On August 24, the Court of Appeals for the Second Circuit issued its ruling, affirming the lower court’s holding in *Kirschner*^[1] that leveraged loans are not securities. After the Securities and Exchange Commission (SEC) declined to submit a brief, the court determined, in its application of the *Reves* test, that three of the four *Reves* factors weighed against concluding that the complaint plausibly alleged that the loans in question are securities.

In *Kirschner*, the lower court held that the loans in question were not securities and thus were not subject to state and federal securities laws. In October 2021, the plaintiff filed an appeal to the Second Circuit to have the decision overturned. In analyzing the question of whether the debt obligations were securities, the court applied the “family resemblance” test first articulated by the Supreme Court in *Reves v. Ernst & Young*.^[2] The Court in *Reves* provided that any analysis into whether a note is a security must begin with the presumption that every note is a security apart from certain enumerated categories of notes, as well as notes bearing a strong family resemblance to one of those categories.

According to *Reves*, the family resemblance test consists of four factors: (1) the motivations of the parties to enter the transaction; (2) the plan of distribution of the instrument in question; (3) the reasonable expectations of the investing public with respect to the instrument in question; and (4) the existence of another regulatory scheme to reduce the risk of the investment, thus making the Securities Act protections unnecessary.

While the Second Circuit decision offers relief to the commercial lending industry, parties should remain vigilant in structuring and documenting loan transactions to fall safely within the confines of the *Reves* test.

[1] 2020 WL 2614765 (S.D.N.Y. 2020)

[2] 494 U.S. 56 (1990)

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