

***Kirschner* Underscores the Importance of Perfecting Security Interests**

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Commercial lenders can breathe a collective sigh of relief with the recent opinion from the United States Court of Appeals for the Second Circuit. In *Kirschner v. JP Morgan Chase Bank, N.A.*, the court affirmed a lower court's ruling that a syndicated term loan is not a security. Had the Court of Appeals found differently, participants in the commercial loan markets would have to comply with securities laws and regulations regarding issuance, trading, and disclosure.

In reaching its decision on this issue, the Court in *Kirschner* analyzed the facts under the "family-resemblance" test as enunciated by the U.S. Supreme Court in *Reves v. Ernst & Young*, 494 U.S.56 (1990) to determine if a note is a security. The four factors are:

1. the motivations that would prompt a reasonable seller and buyer to enter into the transaction;
2. the plan of distribution of the instrument;
3. the reasonable expectations of the investing public; and
4. whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.

The Court in *Kirschner* found that the note at issue was not a security even though the pleaded facts arguably supported a finding that under the first factor, the lender had investment motivations rather than commercial. The motivations of the borrower to use the proceeds of the loan for commercial purposes such as redeeming warrants, debentures, and stock options were dispositive.

In applying the pleaded facts to factors 2), 3), and 4), the Court found that there were no plausible suggestions that the note was a security. The Court applied great weight to the terms of the Credit Agreement to support these findings. In its analysis of factor 4), whether "some factor of another regulatory scheme significantly reduces the risk of an investment," the Court noted that under the Credit Agreement, the Notes were "secured by a perfected first priority security interest in all of [Millennium's] tangible and intangible assets." The Court also found that the risks to the lenders were further reduced by a step-up in the interest rate payable if the borrower failed to repay the loan on time and supervisory guidance from federal regulators addressing risk management of notes.

In the context of broader lending, perfecting a security interest in collateral is one tool lenders use to protect their interests in a loan transaction. The Court in *Kirschner* shows that a carefully drafted credit agreement that includes perfecting a security interest in the collateral is also one of the facts that courts will look at to determine whether a note should be a security.