21-2726

In the United States Court of Appeals for the Second Circuit

MARC S. KIRSCHNER, solely in his capacity as
Trustee of The Millennium Lender Claim Trust,
Plaintiff-Appellant,

v.

JP MORGAN CHASE BANK, N.A., JP MORGAN SECURITIES LLC, CITIBANK, N.A., BANK OF MONTREAL, BMO CAPITAL MARKETS CORP., SUNTRUST ROBINSON HUMPHREY, INC., SUNTRUST BANK, CITIGROUP GLOBAL MARKETS INC.,
Defendants-Appellees,

CITIBANK GLOBAL MARKETS INC.,
Defendant.

On Appeal from the United States District Court
for the Southern District of New York
Case No. 1:17-cv-6334-PGG-SLC, Hon. Paul G. Gardephe

BRIEF OF AMERICANS FOR FINANCIAL REFORM AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFF-APPELLANT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, *amicus curiae* Americans for Financial Reform states it has no parent corporation, and no publicly held company has 10% or greater ownership in it.

February 24, 2023

/s/ Thomas Burns
Thomas A. Burns

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STATEMENT OF *AMICUS CURIAE*'S IDENTITY, INTEREST IN CASE, AND SOURCE OF AUTHORITY TO FILE

Amicus curiae Americans for Financial Reform,[1] "the leading voice for Wall Street accountability on Capitol Hill,"[2] is a nonpartisan and non-profit coalition of over 200 civil rights, consumer, labor, business, investor, faith-based, civic, and community groups. Launched in the 2008 financial crisis's wake, AFR seeks to build a strong, stable, and ethical financial system that serves the economy and nation as a whole. Its vision is a world in which the rules governing the economy justly and sustainably focus on human needs and help all families and communities thrive. To that end, AFR routinely submits comment letters to regulators and government entities such as the CFPB, CFTC, Department of Labor, Department of Justice, Federal Reserve, and SEC, among others.

AFR is keenly interested in this case because the issue whether securities laws protect investments in modern syndicated loans has

[1] The Trustee consents to *amicus* filing this brief, whereas the banks oppose. No party's counsel authored this brief in whole or in part, and no person or entity other than *amicus*, its members, or its counsel made any monetary contribution to its preparation or submission. *See* Fed. R. App. P. 29(a)(4)(E).

[2] Zachary D. Carter, *House Votes To Audit The Fed... And Deregulate Wall Street*, Huffington Post (Sept. 17, 2014), *at* https://tinyurl.com/yz5v7a5b (visited Feb. 24, 2023).

significant economic implications for families and communities that invest through pensions, mutual funds, or ETFs.[3] For starters, the enormous syndicated loan market recently eclipsed $2.5 trillion. That's rapidly approaching the $15 trillion market for corporate bonds, which all parties agree are securities. Thus, any ruling in this appeal would have significant impacts on how business entities raise capital and the extent to which regulators and the securities laws can protect investors.

ARGUMENT

The parties have comprehensively and thoughtfully briefed whether Millenium's $1.775 billion syndicated loan, which was julienned into hundreds of slices and distributed to over 400 investors—few if any of which was a bank—was a security. *Compare* Trustee's Br. 29–48, *and* Trustee's Reply Br. 6–22, *with* Banks' Br. 32–52. Quite naturally, their arguments focus on what the Supreme Court meant in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), and what this Court meant in *Banco Español*

[3] AFR takes no position on the parties' separate disputes regarding EDGE Act jurisdiction, the dismissal of the Trustee's common law claims, or other skirmishes. But AFR does note that, if adopted, the Banks' suggestion that the Trustee "waive[d]" his state securities claims by not repleading them after they were dismissed with prejudice (Banks' Br. 33 n.7) would squarely split with at least one other circuit. *See Jacob v. Mentor Worldwide, LLC*, 40 F.4th 1329, 1334–35 (11th Cir. 2022).

de Credito v. Sec. Pac. Nat'l Bank, 973 F.2d 51 (2d Cir. 1992), and *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808 (2d Cir. 1994).

This *amicus* brief doesn't retrace that ground. Instead, AFR makes a far more aggressive argument: *Banco Español* should be overruled.[4] As the SEC, Chief Judge Oakes, and the Solicitor General then recognized (and as legal academics still complain), it was wrong when it was decided. Subsequent developments have undermined it even further. Now, the Court should finally cast it aside. At minimum, even if the panel doesn't exercise its "mini-*en banc*" power to overrule *Banco Español*, *see United States v. Smith*, 949 F.3d 60, 65 & n.2 (2d Cir. 2020) (collecting authorities), it definitely shouldn't extend its holding from loan participations to loan syndications.

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[4] AFR candidly acknowledges the Court isn't necessarily *required* to consider this argument. Normally, an *amicus* brief is "not a method for injecting new issues into an appeal, at least in cases where the parties are competently represented by counsel." *Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 445 (2d Cir. 2001); *accord Tiffany (NJ) Inc. v. eBay Inc.*, 600 F.3d 93, 105 n.10 (2d Cir. 2010) (declining to consider novel arguments of *amici*). And this is a high-stakes appeal in which the parties' representation isn't merely competent, but fabulous.

Still, the views of *amici* "can be helpful in elaborating issues properly presented by the parties." *Corley*, 273 F.3d at 445. And the parties have already briefed the implications of *Reves*, *Banco Español*, and *Pollack* extensively. Thus, whether *Banco Español* should be overruled is merely an elaboration of the parties' existing arguments.

More fundamentally, if the Court is intrigued by the possibility of overruling *Banco Español*, this brief might at minimum help the parties prepare for oral argument or suggest a necessity to give them additional time at oral argument or invite them thereafter to submit supplemental briefing. It is primarily for that reason—*i.e.*, so this Court can thoughtfully rule after soliciting the parties' positions and considering all possible views—that AFR submits this brief.

I. The panel should exercise its "mini-*en banc*" authority to overrule *Banco Español*

Banco Español should be overruled, and the panel should exercise its "mini-*en banc*" authority to do so. From inception, *Banco Español* was always controversial and far from unanimous.

During its appellate briefing, the SEC submitted two *amicus* briefs to this Court that repeatedly argued the unique loan participation at issue there was a security.[5] Even after the majority revised its opinion in response to a rehearing petition and the SEC's criticisms, Chief Judge Oakes still criticized it for "misread[ing] the facts, mak[ing] bad banking

[5] Richard Y. Roberts & Randall W. Quinn, *Leveling the Playing Field: The Need for Investor Protection for Bank Sales of Loan Participations*, 63 Fordham L. Rev. 2115, 2121–23 (1995).

law and bad securities law, and stand[ing] on its head the law of this circuit and of the Supreme Court in *Reves v. Ernst & Young*." 973 F.2d at 56 (Oakes, C.J., dissenting) (citation omitted). When the investors sought certiorari, the Solicitor General disavowed numerous aspects of *Banco Español* as errors "open to 'serious question.'"[6] And in the decades since, legal academics have subjected *Banco Español* to withering criticism.[7]

But to better appreciate *Banco Español*'s flaws, one must first understand how securities have been policed for the past century.

A. For almost a century, regulators and courts have struggled how to define a security

If the past century of securities regulation and litigation indicates anything, it's that it's difficult to define what a security is with precision.

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[6] Roberts & Quinn, *supra* note 5, at 2123–25.

[7] *E.g.*, *id.* at 2121–25, 2129–31; Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. Corp. L. 725, 749–51 (2014) (criticizing *Banco Español* as "puzzling," "cursory," "misleading," and potentially "wrongly decided at the time"); John C. Cody, Note, *The Dysfunctional "Family Resemblance" Test: After Reves v. Ernst & Young, When Are Mortgage Notes "Securities"?*, 42 Buff. L. Rev. 761, 786 n.139 (1994) ("*Banco Español* has been widely criticized" (collecting authorities)); Robert F. Kornegay, Jr., *Bank Loans as Securities: A Legal and Financial Economic Analysis of the Treatment of Marketable Bank Assets Under the Securities Acts*, 40 UCLA L. Rev. 799, 840–49 (1993) (*Banco Español* was "wrongly decided").

Casting wide nets, the Securities Act and Securities Exchange Act set forth lengthy definitions. *See* 15 U.S.C. § 77b(a)(1), § 78c(a)(10). Deluged by those texts, the Supreme Court has acknowledged Congress "did not attempt precisely to cabin the scope of the Securities Acts." *Reves*, 494 U.S. at 949. Rather, Congress "painted with a broad brush" while "recogniz[ing] the virtually limitless scope of human ingenuity, especially in the creation of 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Id.* (quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946)).

For this appeal, the key legislative actions to understand include parts of the New Deal legislation, such as the Banking Act of 1933, the Securities Act of 1933, and the Securities Exchange Act of 1934, and more recently the repeal of the Banking Act's separation of commercial banking from investment banking and the Dodd-Frank Act of 2008 (including its so-called Volcker Rule prohibition against banks holding securities). *See infra* Argument I.A.1–2, 7. Similarly, the key judicial actions to understand include the Supreme Court's and this Court's efforts to define securities in various contexts. *See infra* Argument I.A.3–6. And practically, it's important to understand the essentially unregulated $2.5 trillion syndicated loan market's sheer size. *See infra* Argument I.A.9.

1. Before the Great Crash of 1929, state regulation and *caveat emptor* rule the day

Before the Great Crash of 1929, there was essentially no federal regulation of securities. *See* de Fontenay, *supra* note 7, at 726 n.1 (citing Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va. L. Rev. 669, 669–70 (1984)). Rather, securities regulation, such as it was, had been left to the states in the form of blue sky laws. Cody, *supra* note 7, at 786 n.139 ("State securities laws are colorfully referred to as 'blue sky laws,' after a Supreme Court decision characterized speculative investment schemes as having 'no more basis than so many feet of blue sky.'" (quoting *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917))).

2. As part of the New Deal, Congress enacts the Banking Act of 1933, the Securities Act of 1933, and the Securities Exchange Act of 1934, which set forth statutory language defining securities

That state-centric model of regulation changed dramatically due to due to the Great Crash of 1929 and the Great Depression. In response to those events, Congress began federalizing securities regulation through

New Deal legislation. *See SEC v. Capital Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 186 (1963). Alongside the Banking Act of 1933 (often called the Glass-Steagall Act), other important statutes were the Securities Act of 1933 and the Securities Exchange Act of 1934. *See id.*

"A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Id.* It "'requires but little appreciation … of what happened in this country during the 1920s and 1930s to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. *Id.* (quoting *Silver v. NYSE*, 373 U.S. 341, 366 (1963)).

Targeting banks, the Banking Act erected a wall of separation between commercial banking and investment banking. *See Sec. Indus. Ass'n v. Fed. Reserve Sys.*, 839 F. 2d 47, 49, 54–56 (2d Cir. 1988). Targeting issuers of securities in the primary market, the Securities Act required registration of certain securities along with disclosures of material information. *See Capital Gains Rsch. Bureau, Inc.*, 375 U.S. at 186. Targeting securities transactions in secondary markets, the Securities Exchange Act regulated how exchanges operate. *See id.*

Crucially, both the Securities Act and the Securities Exchange Act set forth definitions of a "security." For instance, in relevant part, the Securities Act's 145-word definition of a security includes "any note, stock, … investment contract, … or, in general, any interest or instrument commonly known as a 'security.'" 15 U.S.C. § 77b(a)(1). Similarly, in relevant part, the Securities Exchange Act's 181-word definition of a security includes "any note, stock, … investment contract, … or, in general, any interest or instrument commonly known as a 'security.'" *Id.* § 78c(a)(10). Unlike the Securities Act, however, the Securities Exchange Act also specifies that its definition of a security "shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months." *Id.*

3. Addressing those statutory definitions, the Supreme Court sets forth judicial tests to differentiate securities from other economic arrangements

At any rate, despite their slightly different formulations, the Supreme Court has repeatedly held each Act's definitions are identical. *E.g.*, *Reves*, 494 U.S. at 949 n.1. And interpreting their supposedly identical texts, the Supreme Court has decided close issues about what does and doesn't qualify as a security in foundational decisions like *SEC v. W.J.*

Howey Co., 328 U.S. 293 (1946) (investment contracts),[8] *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985) (stock in closely held corporations), and *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (promissory notes).[9]

a. ***SEC v. W.J. Howey Co.*** holds investment contracts are securities

In *Howey*, the Supreme Court considered whether "an offering of units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor" qualified as an "investment contract" subject to securities regulation. 328 U.S. at 294. Essentially, citrus companies would sell investors a grove and a service contract to cultivate it, which included a leaseback arrangement . *Id.* at 295. In return, the investors would receive "an allocation of the net profits based upon a check made at the time of picking." *Id.* at 296.

The SEC had sought to enjoin their sales because, in its view, those offerings were unregistered, nonexempt securities. *Id.* The district court denied the injunction, and the Fifth Circuit affirmed. *Id.* But the Supreme Court granted certiorari and reversed. *Id.* at 294–301.

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[8] The Supreme Court reaffirmed and honed *Howey*'s holding in *SEC v. Edwards*, 540 U.S. 389 (2004).

[9] Neither the Supreme Court nor this Court has ever had to decide whether a loan syndication of any kind qualifies as a security.

State blue sky precedents had held an "investment contract" meant "a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.'" *Id.* at 298 (citation omitted). Thus, *Howey* held, although Congress hadn't expressly defined the term "investment contract," it had written that phrase in light of the state law backdrop. *Id.*

"In other words, an investment contract … means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." *Id.* at 298–99. As such, the "test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301.

This economic-reality test had two obvious benefits. The first was it "permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" *Id.* at 299 (quoting legislative history). And the second was it "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.*

Applying that test, *Howey* held the transactions "clearly involve investment contracts." *Id.* The crux of the transactions was "an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by [the citrus companies]." *Id.* In contrast, the transfer of land was "purely incidental." *Id.* at 300. As such, the transactions were subject to SEC regulation, "even though the [citrus companies'] failure [to follow securities laws] result[ed] from a *bona fide* mistake as to the law." *Id.* at 300–01.

Thus, after *Howey*, the question whether an instrument qualified as a security seemed to turn solely on a transaction's economic realities.

b. *Landreth Timber Co. v. Landreth* holds stock in closely held companies is a security

In *Landreth*, however, the Supreme Court threw cold water on that interpretation of *Howey*'s economic-reality test. The issue it considered was whether "the sale of all of the stock of a company is a securities transaction subject to the antifraud provisions of the federal securities laws." 471 U.S. at 683.

A family that owned all the stock of a lumber business sought to sell it. *Id.* Before finding a purchaser, a fire heavily damaged its sawmill. *Id.* "Despite the fire, the brokers continued to offer the stock for sale." *Id.* "Potential purchasers were advised of the damage, but were told that the mill would be completely rebuilt and modernized." *Id.* Eventually, an investor purchased all the stock and assigned it to a new company. *Id.* at 683–84. Alas, the lumber business didn't live up to expectations. *Id.* After the new company went into receivership, it sued the original owners for rescission and $2.5 million in damages under the securities laws. *Id.*

Granting summary judgment, the district court dismissed the complaint for lack of jurisdiction because, under the so-called "sale of business" doctrine, the stocks weren't securities. *Id.* Relying on *Howey* and another case, the district court ruled the stock wasn't a security "unless the purchaser had entered into the transaction with the anticipation of earning profits derived from the efforts of others." *Id.* at 684–85. Because "managerial control of the business had passed into the hands of the purchasers," the district court deemed the transaction to be "a commercial venture rather than a typical investment." *Id.* at 685. The Ninth Circuit affirmed. *Id.* But the Supreme Court granted certiorari and reversed. *Id.*

Landreth acknowledged that "the fact that instruments bear the label 'stock' is not of itself sufficient to invoke the coverage of the Acts." *Id.* Rather, they must also "possess 'some of the significant characteristics typically associated with' stock," such as dividends, negotiability, ability to be pledged or hypothecated, voting rights, and capacity to appreciate in value. *Id.* (citation omitted).

Applying that test, *Landreth* held it was "undisputed that the stock involved here possesses all of the characteristics we [previously] identified … as traditionally associated with common stock." *Id.* at 687. Additionally, the transaction's "context," which involved the sale of a corporation's stock, was "typical of the kind of context to which the Acts normally apply." *Id.* Thus, it was "much more likely" that "an investor would believe he was covered by the federal securities laws." *Id.*

Proceeding further, *Landreth* rejected the argument "that our cases require us in every instance to look to the economic substance of the transaction to determine whether the *Howey* test has been met." *Id.* at 690. Rather, "the Court has never foreclosed the possibility that stock could be found to be a "security" simply because it is what it purports to be." *Id.* at 691. It further noted that *Howey*'s "economic reality test" was "designed to determine whether a particular instrument is an 'investment contract,' not whether it fits within any of the examples listed in the statutory definition of 'security.'" *Id.*

Finally, *Landreth* "expressly le[ft] until another day the question whether 'notes' or 'bonds' or some other category of instrument listed in the definition might be shown 'by proving [only] the document itself.'" *Id.* at 694. "We hold only that 'stock' may be viewed as being in a category by itself for purposes of interpreting the scope of the Acts' definition of 'security.'" *Id.*

c. ***Reves v. Ernst & Young*** **holds promissory notes are securities**

In *Reves*, the Supreme Court began addressing the question left open by *Landreth* about notes. More specifically, the issue was whether an agricultural co-op's promissory notes were securities. 494 U.S. at 58.

The 23,000-member co-op raised money by selling to members and nonmembers promissory notes payable on the holder's demand. *Id.* Those uncollateralized, uninsured notes paid variable rates of interest adjusted monthly. *Id.* at 58–59. Eventually, the co-op went bankrupt, leaving over 1,600 investors holding $10 million in unpaid notes. *Id.* at 59.

During the bankruptcy, a class of note holders sued the co-op's auditor for securities fraud in intentionally failing to follow generally accepted accounting principles, thereby inflating the co-op's assets and net worth. *Id.* At trial, the class obtained a $6.1 million judgment. *Id.* On appeal, the Eighth Circuit reversed, holding the notes weren't securities. *Id.* But the Supreme Court granted certiorari and reversed. *Id.* at 59–60.

At the outset, *Reves* recognized Congress had "painted with a broad brush" when it defined securities, recognizing "the virtually limitless scope of human ingenuity, especially in the creation of 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Id.* at 60–61 (quoting *Howey*, 328 U.S. at 299). Thus, on one hand, Congress "did not attempt precisely to cabin the scope of the Securities Acts," but instead "enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment." *Id.* at 61. On the other hand, Congress didn't "'intend to provide a broad federal remedy for all fraud.'" *Id.* (quoting *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982)).

Thus, *Reves* navigated those alternatives by acknowledging "we are not bound by legal formalisms, but instead take account of the economics of the transaction under investigation." *Id.* That's because "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called." *Id.*

Unlike *Howey*, a "commitment to an examination of the economic realities of a transaction does not necessarily entail a case-by-case analysis of every instrument." *Id.* at 62. Rather, some investments, such as the stock in *Landreth*, always qualify as securities if they have the "economic characteristics traditionally associated with stock." *Id.*

In contrast, notes were different. *Id.* Although common stock is "the quintessence of a security," the same "simply cannot be said of notes, which are used in a variety of settings, not all of which involve investments." *Id.* Thus, "the phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts." *Id.* at 62–63.

To assess that backdrop, *Reves* considered and rejected both the *Howey* test and the *Landreth* test. *Id.* at 63. *Landreth*'s "formula cannot sensibly be applied to notes," and *Howey*'s test was limited to determining whether an instrument is an investment contract. *Id.* at 63–64.

Instead, *Reves* considered other tests adopted by lower courts. In particular, the most palatable option, which *Reves* ultimately adopted with one modification with respect to nine-month instruments, was this Court's "family resemblance" test. *See id.* at 64–67. Under that test, all notes are presumed to be securities. *Id.* But that presumption can be rebutted if the note bears a "strong resemblance" to a list of notes that don't qualify as securities (*e.g.*, mortgage note, consumer financing, etc.) by considering a four-factor test.

First, "we examine the transaction to assess the motivations that would prompt a *reasonable* seller and buyer to enter into it." *Id.* at 66 (emphasis added). Second, "we examine the 'plan of distribution' of the instrument to determine whether it is an instrument in which there is 'common trading for speculation or investment.'" *Id.* (citations omitted). Third, "we examine the reasonable expectations of the investing public." *Id.* Finally, "we examine 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." *Id.* at 67 (emphasis added).

Applying that test, *Reves* held the co-op's promissory notes were securities. First, the co-op "sold the notes in an effort to raise capital for its general business operations, and purchasers bought them in order to earn a profit in the form of interest." *Id.* at 67–68. Second, although the notes weren't traded on an exchange, they were offered to all 23,000 members and held by 1,600 members and nonmembers at the time of bankruptcy. *Id.* at 68. Third, the co-op's advertisements characterized the notes as investments, "and there were no countervailing factors that would have led a reasonable person to question this characterization." *Id.*

4. Triangulating between those tests and their precursors, courts routinely hold *traditional* loan participations don't qualify as securities

Triangulating between the tests announced in cases like *Howey* (investment contracts), *Landreth* (stocks), and *Reves* (notes), courts in the 1980s routinely held traditional loan participations weren't securities.[10] But that was a different time, and those courts were dealing with very

[10] *See, e.g.*, *United Am. Bank v. Gunter*, 620 F.2d 1108, 1115 (5th Cir. 1980); *Union Planters Nat'l Bank v. Com. Credit Bus. Loans, Inc.*, 651 F.2d 1174, 1181 (6th Cir. 1981); *Am. Fletcher Mortg. Co. v. U.S. Steel Credit Corp.*, 635 F.2d 1247, 1255 (7th Cir. 1980); *Union Nat'l Bank v. Farmers Bank*, 786 F.2d 881, 885 (8th Cir. 1986); *First Citizens Fed. S&L Ass'n v. Worthen Bank & Trust Co.*, 919 F.2d 510, 516 (9th Cir. 1990); *McVay v. W. Plains Serv. Corp.*, 823 F.2d 1395, 1399 (10th Cir. 1987).

different debt instruments that "contained features that justify the courts' decisions." Roberts & Quinn, *supra* note 5, at 2117.

"A loan participation traditionally is an arrangement by which a bank or other financial institution makes a loan to a corporate borrower and then sells all or a portion of the loan to one or more participants." *Id.* The participants in traditional a loan participation "were in the business of making loans, and the sale or purchase of loan participations was only a part of the business." *Id.* Additionally, traditional loan participations "usually involved only a handful of participants" that could realistically expect to "engage in one-to-one negotiations with the lead bank and, if they wished, could perform their own credit analysis of the borrower." *Id.* at 2117–18. In other words, participants traditionally "had substantial bargaining power and the ability to access information regarding the creditworthiness of the borrower." *Id.* at 2118. And given those characteristics, AFR agrees those traditional loan participations "arguably did not raise serious investor protection concerns." *Id.*

5. For the first time in *Banco Español*, however, this Court extends that prior judicial approval of *traditional* loan participations to a *modern* one

Banco Español, in contrast, involved a loan participation of a different breed altogether. Although it bore "a superficial resemblance to traditional loan participations," it "differ[ed] from those traditional participations in several important respects, including (1) who the participants are; (2) what the purposes of the purchasers or participants are; and (3) what the promotional basis used in marketing the loan notes is." 973 F.2d at 56 (Oakes, C.J., dissenting).

First, the participants weren't "commercial lenders who engage in traditional loan participations," but rather were nonfinancial entities "making an investment." *Id.* Indeed, even the few banks that purchased those notes "generally did so not through their lending departments but through their investment and trading departments." *Id.* Second, the participants were motivated by investment purposes, "not by the commercial purpose of operating a lending business in which participations are taken as an adjunct to direct lending operations." *Id.* Third, the arranger's promotional literature "advertised the so-called loan notes as competitive with commercial paper, a well-recognized security under the Securities

Act, and on the basis of the return that they offered over that of other investments." *Id.*

Nonplussed, the *Banco Español* majority held the loan participation "as marketed in this case" was "analogous to the enumerated category of loans issued by banks for commercial purposes." *Id.* at 56. But leaving itself future wiggle room, the majority "recognize[d]" that the "manner in which participations" are "used, pooled, or marketed might establish that such participations are securities." *Id.*

6. Almost immediately, this Court curtails *Banco Español*'s scope in *Pollack*

Two years after deciding *Banco Español*, this Court whittled it down in *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808 (2d Cir. 1994). "The marketing scheme in *Banco Español* was more analogous to a group of highly sophisticated commercial entities engaging in short-term commercial financing arrangements than to the securities markets." *Id.* at 813. "In contrast, the record before us does not suggest that the participations here were restricted to sophisticated investors who had 'the capacity to acquire information about the debtor.'" *Id.* at 813–14.

7. Congress largely repeals the Banking Act's separation of commercial banking from investment banking and enacts the Dodd-Frank Act of 2008, § 619 of which includes the Volcker Rule

In 1999, Congress largely repealed the Banking Act's separation of commercial banking from investment banking. *See Bd. of Trustees of Aftra Ret. Fund v. JPMorgan Chase Bank, N.A.*, 806 F. Supp. 2d 662, 667 (S.D.N.Y. 2011). A decade later, in response to the financial crisis of 2008, Congress enacted the Dodd-Frank Act of 2008. *See State Nat'l Bank of Big Spring v. Lew*, 795 F.3d 48, 51 (D.C. Cir. 2015). In § 619, Congress included the so-called Volcker Rule, which prohibits banks from using customer funds to trade securities. *See* 12 U.S.C. § 1851.

8. Today, the modern syndicated loan market eclipses $2.5 trillion and is growing geometrically

The syndicated loan market grew "rapidly in the last decade."[11] In 2010, its value was $497 billion. [12] In 2018, its value was $1.2 trillion.[13]

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[11] Aidan D. Mulry, Note, *A True Sense of Security: How Kirschner v. J.P. Morgan Chase Illustrates the Failings of the Reves Family Resemblance Test and the Need to Recognize Some Syndicated Loans as Securities for the Sake of the Financial System*, 87 Brook. L. Rev. 979, 980 (2022).

[12] Joel Crank, *Rethinking Kirschner v. J.P. Morgan: How Securities and Banking Laws Should Apply to Syndicated Loans*, 93 U. Colo. L. Rev. 1095, 1099 & n.21 (2022).

[13] Mulry, *supra* note 11, at 980.

In 2020, its value was $1.5 trillion.[14] And in 2022, its value eclipsed $2.5 trillion. LTSA *Amicus* Br. 4 & n.2.

But syndicated loans aren't usually taken by financially strong companies; instead, they're typically "made to companies that have maxed out their borrowing and can no longer sell bonds directly to investors or qualify for a traditional bank loan."[15] The lack of investor protection under securities laws for these weaker, more heavily indebted borrowers is also repeatedly harming investors who are deceived by the asymmetric information between the loan issuer and themselves.

For instance, on July 12, 2022, JP Morgan and Goldman Sachs syndicated a $350 million loan for Avaya Holdings Corp. (a telecommunications company). But merely weeks later, Avaya warned that its previous earnings projections would miss by 60% and there was "substantial doubt about the Company's ability to continue as a going concern."[16] Avaya officially filed for bankruptcy on February 14, 2023 and bondholders

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[14] *Id.*

[15] *See* Frank Partnoy, *The Looming Bank Collapse*, The Atlantic (July/Aug. 2020), *at* https://tinyurl.com/5dppx9r4 (visited Feb. 24, 2023).

[16] Matt Wirz, *Avaya's Collapsing Debt Deal Hits Clients of Goldman, JPMorgan*, The Wall Street Journal (Aug. 9, 2022), *at* https://tinyurl.com/2hv9f9fc (visited Feb. 24, 2023).

(whose holdings are subject to securities laws) sued Avaya's board of directors, alleging "massive fraud."[17]

B. *Banco Español* should be overruled because its reasoning cannot withstand scrutiny

As a matter of horizontal *stare decisis*, most federal appellate courts require panels to obey a prior panel precedent unless or until it's been abrogated or overruled by the Supreme Court or that court sitting *en banc*.[18] This Court usually applies a similar rule. *United States v. Wilkerson*, 361 F.3d 717, 732 (2d Cir.2004). But like the Seventh and D.C. Circuits,[19] this Court also has a different practice by which, after circulating a slip opinion to all active judges, a panel may proceed to overrule a prior panel precedent. *United States v. Smith*, 949 F.3d 60, 65 (2d Cir. 2020).

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[17] Chris Dolmetsch, *Avaya Board Accused of "Massive Fraud" in Suit by Bondholders*, Bloomberg (Feb. 6, 2023), *at* https://tinyurl.com/s4v7y8ts (visited Feb. 24, 2023).

[18] *See United States v. Barbosa*, 896 F.3d 60, 74 (1st Cir. 2018); *Reilly v. City of Harrisburg*, 858 F.3d 173, 177 (3d Cir. 2017); *Taylor v. Grubbs*, 930 F.3d 611, 619 (4th Cir. 2019); *Young v. Gutierrez*, 895 F.3d 829, 830 (5th Cir. 2018); *United States v. Ferguson*, 868 F.3d 514, 515 (6th Cir. 2017); *United States v. Hataway*, 933 F.3d 940, 946 (8th Cir. 2019); *United States v. Arriaga-Pinon*, 852 F.3d 1195, 1199 (9th Cir. 2017); *United States v. Meyers*, 200 F.3d 715, 720 (10th Cir. 2000); *Smith v. GTE Corp.*, 236 F.3d 1292, 1302–03 & n.11 (11th Cir. 2001); *In re Hodges*, 882 F.3d 1107, 1120–21 (Fed. Cir. 2018).

[19] *See Russ v. Watts*, 414 F. 3d 783, 784 n.1 (7th Cir. 2005); *Jackson v. Modly*, 949 F.3d 763, 776 n.14 (D.C. Cir. 2020).

Thus, this panel could theoretically exercise that "mini-*en banc*" power to overrule *Banco Español*. *See id*. And it should do so here.

Modern syndicated loans, just like modern loan participations, allow banks to evade securities laws and non-banks to evade banking laws. Congress didn't intend to allow such a huge $2.5 trillion syndicated loan market to evade securities regulation.

1. During *Banco Español*'s appellate briefing, the SEC submits two *amicus* briefs arguing *modern* loan participations are securities

While *Banco Español* was being briefed, the SEC submitted two *amicus* briefs. Roberts & Quinn, *supra* note 5, at 2121–22 & nn.45–49. The first brief, submitted before the initial panel opinion, acknowledged traditional loan participations didn't involve securities. *Id.* But because the nonfinancial participants were acting as investors rather than adjunct to other lending activities, it argued the modern loan participation was a security. *Id.*

When the participants sought rehearing, the SEC submitted a second brief in support. *Id.* at 2122 & nn.56–57. As a result of that brief, the *Banco Español* majority added wiggle room about ruling solely about the participation "as marketed in this case." *Id.* at 2122 & nn.58–59.

2. In dissent, former Chief Judge Oakes criticizes the *Banco Español* majority for misreading the facts, making bad securities law and bad banking law, and standing precedent on its head

Chief Judge Oakes dissented vigorously, asserting the majority misread the facts, made bad banking and securities law, and stood precedent on its head. 973 F.2d at 56 (Oakes, C.J., dissenting).

He explained the modern loan participation superficially resembled traditional participations, but differed in important respects regarding *who* the participants were, *what* purposes they had, and *how* they were promoted. *Id.* Additionally, "the scope of information available to the purchasers" was lesser, because there was no one-to-one negotiation with the lead lender or borrower or disclosure of all material nonpublic information. *Id.* at 56–57. Thus, the participants "were not in a position to approach the hundred or more possible borrowers in the program and conduct their own examinations." *Id.* at 57. Moreover, 53% of the participants "were not financial institutions." *Id.* And often daily solicited, sometimes by cold calls, the participations were promoted and distributed as liquid investments. *Id.* at 57–58. Lastly, he noted the SEC's *amicus* briefs had described loan participation markets as exceeding $100 billion, so it wasn't "exactly about chicken feed." *Id.* at 58.

Thus, per *Reves*, he would have reversed. *Id.* at 58–60.

3. When opposing certiorari, the Solicitor General disavows key aspects of *Banco Español*

There was further appellate review when the participants sought certiorari. Roberts & Quinn, *supra* note 5, at 2123–24 & nn.60–69.

Initially, the Supreme Court called for a response from the Solicitor General. *Id.* But the SEC disagreed with federal banking regulators what the government's position should be. *Id.* Ultimately, the SEC didn't join the Solicitor General's brief. *Id.*

Still, despite opposing certiorari given the lack of a circuit split and the potential that bank regulators might provide further guidance, the Solicitor General conceded *Banco Español* was "open to 'serious question.'" *Id.* at 2124 (citation omitted). Specifically, he admitted *Banco Español* "erred" in two respects: the first was "'in the significance it attached to the fact that the notes were sold only to supposedly sophisticated institutions, and not individuals,'" and the second was "'in concluding that the mere existence of banking guidelines for the purchase of loan participations weighs against the conclusion that loan participations are securities.'" *Id.* at 2124 n.64 (citation omitted).

Ultimately, the Supreme Court denied certiorari. *Banco Español de Credito v. Sec. Pac. Nat'l Bank*, 113 S. Ct. 1042 (1993).

4. For decades, *Banco Español* is repeatedly subjected to scathing academic criticism

For decades thereafter, *Banco Español* has been repeatedly subjected to scathing academic criticism for being puzzling, cursory, misleading, and wrongly decided. *See supra* note 7. For instance, a correct *Reves* analysis "suggests that leveraged loans, which are widely traded, highly risky investments, fit very poorly within the commercial loan framework that has until now justified their treatment as non-securities."[20] And one commentator suggested *Reves* itself is "outdated" and due for a glowup.[21]

C. Although *stare decisis* usually has special force with respect to statutory interpretation, there aren't any reliance or retroactivity concerns here because the loan participation market no longer exists meaningfully

If the Court is inclined to overrule *Banco Español*, the last hurdles to overcome would be the securities industry's apparent concerns about the potential danger of market turmoil, which relate to its reliance on this Court's prior statutory interpretation and whether this Court's ruling should have retroactive or prospective effect.

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[20] de Fontenay, *supra* note 7, at 754.
[21] Mulry, *supra* note 11, at 995–1003.

Whenever it sees even a hint of regulation on the horizon, the securities industry invariably runs to courts and regulators with melodramatic, overwrought, skies-are-falling stories. *E.g.*, LSTA *Amicus* Br. 7 (adverse ruling would "upend[] … settled expectations" and "wreak[] havoc in the vitally important market for syndicated loans" with "devastating effect" on "the lifeblood of a large sector of American business"). But honestly, Hollywood knows how to play that script much better. *Ghostbusters* (Columbia Pictures 1984) (warning of "disaster of biblical proportions"), *at* https://tinyurl.com/p9j5sab2 (visited Feb. 24, 2023).

At any rate, *stare decisis* ordinarily has "special force" with respect to prior interpretations of statutes. *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989). That's because such rulings implicate legislative powers and reliance interests. *Hubbard v. United States*, 514 U.S. 695, 714 (1995) (plurality). Thus, courts are "normally and properly reluctant to overturn our decisions construing statutes." *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989). But when reliance interests are "modest," and "coherence and stability in the law will best be served" by "taking a different course," courts will "correct" an "erroneous construction." *Hubbard*, 491 U.S. at 714–15.

Here, the securities industry's reliance interest is nonexistent. As even the district court recognized, no court has ever blessed the notion that a syndicated loan isn't a security. Moreover, the traditional loan participation market would remain as is, because courts have correctly held those aren't securities. *See supra* note 10. And now that loans are routinely assigned, the modern loan participation market no longer exists in any meaningful sense.

The next concern is the potential that a ruling in the Trustee's favor would cause market turmoil. First, that isn't properly a concern. The statutory interpretation issue is what Congress meant, not what the market wants. Indeed, in *Howey*, *Landreth*, and *Reves*, the Supreme Court always ruled in favor of regulation even though each of those defendants had good-faith beliefs, based on their interpretation of prior precedents, that they weren't dealing with securities. *See supra* Argument I.A.3.a–c. Second, it isn't clear that market turmoil would result.[22] In fact,

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[22] The Volcker Rule implications are overblown. If syndicated loans are held to be securities, they would be exempt from the Volcker Rule insofar as banks held them in underwriting or market-making capacities. *See* 12 U.S.C. § 1851(d)(1)(B) (exempting banks from prohibition on trading securities when acting "in connection with underwriting or market-making-related activities" for "reasonably expected near term demands of clients, customers, or counterparties"); *id.* § 1851(b)(2)(A)–(B) (giving

securities regulation is likely to *prevent* market turmoil due to the threat of default rising in an essentially unregulated market. *See* Harriet Clarfelt, *Defaults on US junk loans expected to climb as rate rises squeeze earnings*, The Financial Times (Dec. 13, 2022), *at* https://tinyurl.com/33v7mwe7 (visited Feb. 24, 2023) (Federal Reserve's "aggressive" interest rate increases are "set to trigger a surge of defaults" in syndicated loan market). Third, even the *Banco Español* majority left itself future wiggle room when it "recognize[d]" that the "manner in which participations" are "used, pooled, or marketed might establish that such participations are securities," 973 F.2d at 56, so reliance on it was always risky. Fourth, nothing about disclosure of material nonpublic information is likely to change. Indeed, if the allegations are to be believed, the banks and their executives involved are lucky they aren't paying millions in restitution, forfeiture, and fines while serving life sentences for wire fraud.[23]

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rulemaking authority to SEC and CFTC to distinguish banks' proprietary trading from market-making activities). There'd be no fire sale.

[23] Wire fraud, 18 U.S.C. § 1343, involves schemes to obtain money or property. *See Kelly v. United States*, 140 S. Ct. 1565, 1571 (2020). Per U.S.S.G. § 2B1.1(a)(1), (b)(1)(P), and (b)(2)(C), the guidelines calculation for a $1.765 billion scheme would be 43, which even for defendants with a spotless criminal record could equate to a life sentence under U.S.S.G. § 5A so long as a sentencing court exercised discretion to run multiple-count sentences consecutively.

Nevertheless, if the Court shares the securities industry's concerns about market turmoil and reliance, it could make its ruling prospective only. *See Rodriguez de Quijas*, 490 U.S. at 485. And either way, if over-ruling *Banco Español* is under consideration, the Court should consider giving the parties more time at oral argument or invite them to submit supplemental briefing. *See City of New York v. Mickalis Pawn Shop, LLC*, 645 F. 3d 114, 125 (2d Cir. 2011).

CONCLUSION

The Court should overrule *Banco Español*, reverse the dismissal order, vacate the judgment, and remand the case for further proceedings.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

1. This brief complies with Federal Rules of Appellate Procedure 29(a)(5)'s and 32(a)(7)(B)'s and Second Circuit Rule 29.1(c)'s and 32.1(a)(4)(A)'s type-volume requirements. As determined by Microsoft Word 2010's word-count function, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f), this brief contains 6,966 words.

2. This brief further complies with Federal Rule of Appellate Procedure 32(a)(5)'s typeface requirements and with Federal Rule of Appellate Procedure 32(a)(6)'s type-style requirements. Its text has been prepared in a proportionally spaced serif typeface in roman style using Microsoft Word 2010's 14-point Century Schoolbook font.

February 24, 2023

/s/ Thomas Burns
Thomas A. Burns

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I filed the original and six paper copies of the foregoing brief with the Clerk of Court via CM/ECF and regular mail on this 24th day of February, 2023, to:

Catherine O'Hagan Wolfe, Clerk of Court
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I FURTHER CERTIFY that I served a true and correct copy of the foregoing brief via CM/ECF on this 24th day of February, 2023, to all counsel of record.

February 24, 2023

/s/ Thomas Burns
Thomas A. Burns