CLIENT ALERT

Arranger Liability in the Loan Market

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May an arranger of a syndicated loan be held liable for alleged misstatements and omissions contained in offering materials provided to a syndicate of lenders? That is the surprisingly novel question presented in *Kirschner v. J.P. Morgan Chase Bank, N.A.*, et al., 17-cv-6334 (PGG) (SDNY).

Kirschner is an action by the trustee of a litigation trust ("Plaintiff"), acting on behalf of investors in a $1.775 billion syndicated loan transaction, against the underwriters and arrangers of the syndicated loan ("Defendants"). Defendants offered and sold to investors debt obligations of Millennium Health LLC ("Millennium"), a drug testing company. Millennium filed for bankruptcy approximately nineteen months after the loan was syndicated. The crux of the trustee's allegations is that Defendants conducted inadequate due diligence and misrepresented or omitted facts in the offering materials and representations made to investors regarding the legality of Millennium's sales, marketing and billing practices. It is further alleged that the material risks posed by a pending investigation by the DOJ into the potential illegality of such practices, as well as a civil litigation against Millennium by a competitor, were misrepresented or omitted. Notwithstanding that the credit agreements contained standard disclosures obligating the lenders to conduct their own due diligence and disclaiming any reliance on the representations or omissions by Defendants, Plaintiff argues that the underwriters' due diligence was deficient.

Plaintiff brings common law causes of action for negligent misrepresentation, breach of fiduciary duty, breach of contract and breach of the implied covenant of good faith and fair dealing. In addition, Plaintiff states causes of action under various state securities statutes ("Blue Sky Laws"), alleging that the leveraged loans were "securities" and that Defendants violated these statutes by making material misstatements and omissions concerning the loans.

Defendants' motion to dismiss the complaint, which was fully submitted as of June 28, 2019, is currently pending before the Court. In addition, the application filed by the Loan Syndications and Trading Association ("LSTA") and the Bank Policy Institute ("BPI") for leave to file an amici brief, which Plaintiff opposed, also remains pending.

On January 15, 2020, Magistrate Judge Cave entered an Order denying Defendants' request to stay discovery during the pendency of the motion to dismiss. In ordering that discovery proceed while the motion to dismiss remains pending, the magistrate judge noted the District Court's "preliminary view" at the April 2019 pre-motion conference that it was "unlikely" to grant the motion to dismiss in its "entirety." Moreover, in support of its ruling, the Court took note of the case law cited by Plaintiff holding that "[w]hether an instrument constitutes a 'security' under state or federal law is a fact intensive question and generally 'not appropriately resolved on a motion to dismiss.'" The Court's ruling suggests that several of the fundamental legal issues underlying Plaintiff's allegations – including the status of a syndicated loan as a security – will likely not be decided on Defendants' motion to dismiss and will most likely be addressed at the summary judgment phase after the parties have developed a factual record. If the Court does, in fact, refuse to dismiss the action in its entirety, this will be an important victory for Plaintiff, as it allows for further discovery to proceed and provides Plaintiff with significant leverage in future settlement negotiations.

On February 20, 2020, the Court entered a Case Management Plan, providing that all fact discovery be completed by February 2021 and that expert discovery be completed by June 2021. These and all interim discovery deadlines were recently extended by 30 days in connection with the Court's response to the COVID-19 pandemic. Most recently, Plaintiff sought leave from the Court to amend the complaint to add causes of action for fraudulent misrepresentation and conspiracy to defraud, which Defendants have opposed. This motion was fully briefed as of April 28, 2020 and is currently pending before the Court.

If the Court grapples with the fundamental questions at the heart of *Kirschner*, participants in the trillion-dollar US syndicated loan market may need to re-assess and revise fundamental assumptions about the loan product, as well as the structure of the modern loan market. We will continue to follow *Kirschner* and provide future updates as the case progresses.

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