

The Crossroads of Alt Finance and U.S. Securities Laws

Gregory J. Nowak, Partner, Pepper Hamilton LLP
Mark T. Dabertin, Special Counsel, Pepper Hamilton LLP

Pepper Hamilton LLP
Attorneys at Law

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We will start at 5:00pm ET. All lines are muted.

Audio

The screenshot displays the Cisco Webex Events interface. At the top, the title bar reads "Cisco Webex Events" and "Connected". The main content area shows a webinar slide titled "Pepper Hamilton Webinar" with the logo for "Pepper Hamilton LLP Attorneys at Law". A red text overlay in the center of the slide reads "Audio should stream automatically on entry through your computer speakers". An arrow points from this text to an "Audio Broadcast" control window. This window shows a status of "24.7 Kbps" and includes "Pause" and "Stop" buttons. The bottom of the interface features a control bar with icons for mute, video, chat, and other functions. On the right side, a participants list shows "Panelist 1" (Brian Dolan (Host)) and "Attendee: Brian Dolan (me)".

File Edit View Communicate Participant Event Help

Cisco Webex Events

Connected

BD Brian Dolan (Host)

Viewing Pepper Hamilto...

Audio should stream automatically on entry through your computer speakers

Pepper Hamilton Webinar

Pepper Hamilton LLP Attorneys at Law

Audio Broadcast

24.7 Kbps

Pause Stop

BD Brian Dol... (Host)

BD Brian Dolan (me)

Q&A

Attorneys at Law

Audio

The screenshot displays the Cisco Webex Events interface. At the top, the title bar reads "Cisco Webex Events" and includes a menu with "File", "Edit", "View", "Communicate", "Participant", "Event", and "Help". The main content area shows a video player with a large red text overlay: "If you cannot stream audio, click phone icon and a phone number will be sent to you". Below this, the text "Pepper Hamilton Webinar" is visible. At the bottom of the video player, there is a logo for "Pepper Hamilton LLP Attorneys at Law".

An "Audio Broadcast" control window is open, showing a rate of "24.7 Kbps" and buttons for "Pause" and "Stop". At the bottom of the interface, a row of icons includes a phone icon, a microphone icon, a screen share icon, a participant icon, a chat icon, a settings icon, and a close icon.

On the right side, a "Participants" panel is visible, showing a list of participants under "Panelist: 1" and "Attendee:". The host, Brian Dolan, is listed as "Brian Dol... (Host)" and the attendee is listed as "Brian Dolan (me)".

An arrow points from the text overlay to the phone icon in the bottom control bar.

Q&A

Cisco Webex Events

File Edit View Communicate Participant Event Help

Connected

BD Brian Dolan (Host)

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Click here to send questions to us

Pepper Hamilton Webinar

Audio Broadcast 24.7 Kbps

Pause Stop

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Participants

- Panelist 1
- BD Brian Dol... (Host)
- Attendee: BD Brian Dolan (me)

Q&A

Attorneys at Law

Global Reach

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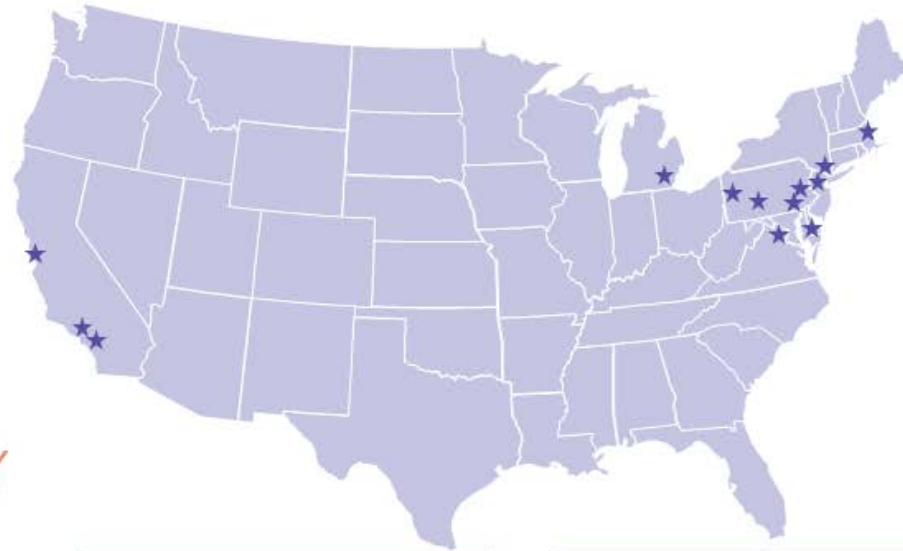
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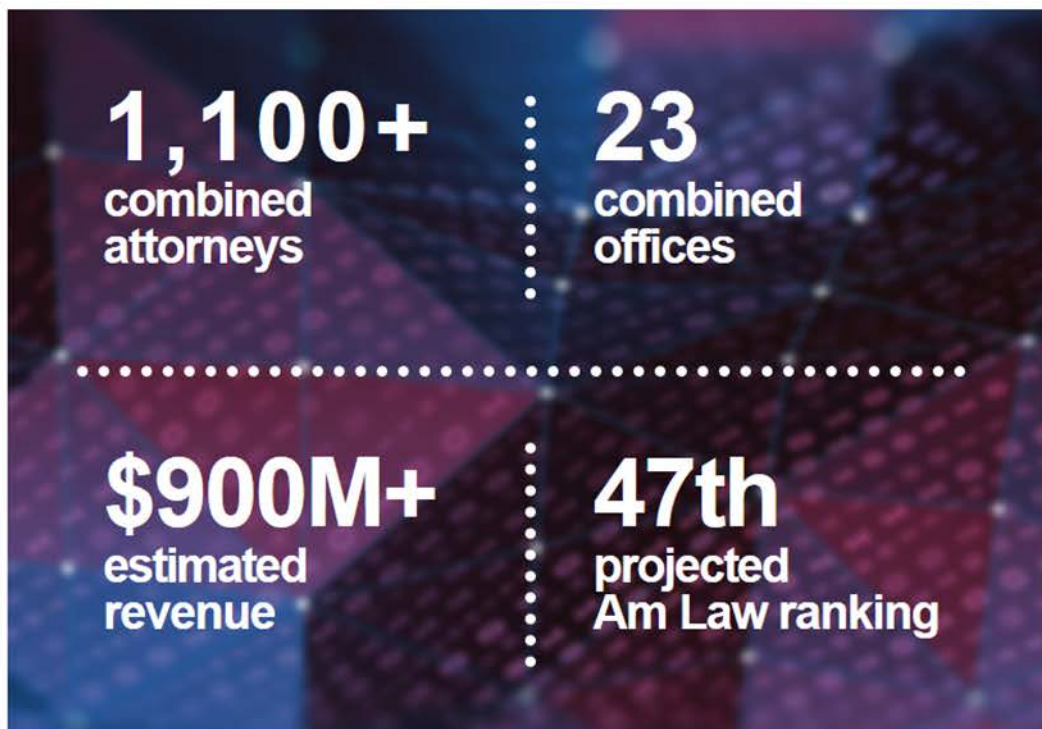
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Troutman Sanders and Pepper Hamilton Announce Plans to Combine

Troutman Sanders and Pepper Hamilton LLP have agreed to merge effective July 1, 2020. Troutman Pepper will offer expanded capabilities and practice strengths, with a hallmark focus on client care.



Gregory J. Nowak

Partner, Financial Services & Technology

212.808.2723

nowakg@pepperlaw.com

- ▶ Concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940
- ▶ Represents hedge funds and other alternative investment funds in fund formation and investment and compliance matters, including compliance audits and preparation work
- ▶ Writes and speaks frequently on issues involving investment management, health care and other matters, and is the author of five books on hedge funds, the most recent published in February of 2018. Hosts the monthly Investment Management and Private Funds roundtable in New York City.



Mark T. Dabertin

Special Counsel, Financial Services

610.640.7841

dabertinm@pepperlaw.com

- ▶ Has over 25 years of broad-based experience in financial services law, including lending and merchant cash advance transactions.
- ▶ Career includes extensive experience in banking law, lending, safety and soundness, and anti-money laundering.
- ▶ Began his career in financial services working as a senior attorney at the Office of the Comptroller of the Currency (OCC) and went on to work in various in-house capacities at major financial institutions for nearly two decades.



What Is Merchant Cash Advance?

- Short-term commercial financing vehicle involving the purchase and sale of future receivables at a discount.
- “Purchases and sales of future receivables and sales proceeds are common commercial transactions expressly contemplated by the Uniform Commercial Code.” *IBIS Capital Group, LLC v Four Paws Orlando LLC*, 2017 N.Y. Misc. LEXIS 884, 2017 NY Slip Op 30477(U), *6 (N.Y. Sup. Ct. Mar. 10, 2017).
- “Factoring is a financial transaction and a type of debtor finance in which a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount. A business will sometimes factor its receivable assets to meet its present and immediate cash needs.” *Wikipedia*.
- But see: *Fleetwood Servs., LLC v. Complete Bus. Sols. Grp.*, 374 F. Supp. 3d 361 (E.D. Pa. 2019).

What Is Merchant Cash Advance?

“If [a] Factoring Agreement is in substance a factoring agreement, i.e., a purchase of accounts receivable below their face value, then there can be no usury. . . .”

Fleetwood.

‘The rudimentary element of usury is the existence of a loan or forbearance of money’ [cites omitted]. . . . ‘When determining whether a transaction constitutes a usurious loan it must be ‘considered in its totality and judged by its real character, rather than by the name, color, or form which the parties have seen fit to give it.’ [cites omitted]. ‘Whether a transaction constitutes a cover for usury is a question of fact.’ [cite omitted]. . . .

‘Further, there can be no usury unless the principal sum advanced is repayable absolutely.’

Colonial Funding Network, Inc. v. Epazz, Inc., 2017 U.S. Dist. LEXIS 70747, *7.

NY Courts Have Adopted Rules For Sorting MCATs From Loans

Three key factors are considered decisive in determining whether an MCA agreement creates a loan:

- (1) whether principal is “put in hazard” versus “in some way secured;”
- (2) the existence of a reconciliation provision; and
- (3) an indefinite versus a fixed repayment term.

LG Funding, LLC v Snowstar, Inc., 2017 N.Y. Misc. LEXIS 5190, 2017 NY Slip Op 32741(U) (N.Y. Sup. Ct. Dec. 7, 2017) (citing *K9 Bytes, Inc. v. Arch Capital Group*).

MCAT Participation Interests – Are They Securities?

- Why is this important?
- You represent whom?
- You must respect (fear?) Section 29 of the Securities Exchange Act of 1934, as amended.

What Is A Participation?

“Participations are not loans; they are contractual arrangements between a lender and a third party, in which the third party, or participant, provides funds to the lender. The lender in turn uses the funds from the participant to make loans to the borrower.” If the agreements are “true participations,” [citations omitted] and thus sales rather than loans, then the funds are effectively removed from the res. of the estate.”

Rothenberg v. Oak Rock Fin., LLC, 14-cv-3700, USDC, EDNY (March 31, 2015).

Elements of A Participation

1. Money is advanced by participant to a lead lender;
2. A participant's right to repayment only arises when a lead lender is paid;
3. Only the lead lender can seek legal recourse against the borrower; and
4. The document is evidence of the parties' true intentions.

Rothenberg.

True Participation

- Sale of an ownership interest in an underlying asset that is a “true sale” in the sense that the participant will not be deemed to have made a loan to the lead participant/originator of the asset.
- In a true participation the participant receives all of their rights from the lead and has no privity of contract with the underlying obligor or merchant .

Elements of A Participation

1. Money is advanced by participant to a lead lender;
2. A participant's right to repayment only arises when a lead lender is paid;
3. Only the lead lender can seek legal recourse against the borrower; and
4. The document is evidence of the parties' true intentions.

Rothenberg.

Participation or Loan?

“The most determinative factor of all of these is the risk allocation involved in the transaction. If the participant does not bear the same risk of loss as the seller, or if the seller has made a guarantee of payment to the participant, the transaction [*28] is generally considered a loan and not a sale.” *In re Corporate Financing, Inc.*, 221 B.R. 671 (Bankr. E.D.N. Y. 1998). “In a typical participation agreement, the lead lender makes no warranties or guarantees about the borrower's ability to repay the underlying loan. Thus, an indicium of a loan is the guarantee of repayment by the lead lender to a participant.” *In re Sackman Mortgage Com.*, 158 B.R. at 933.

Participation or Loan?

Where an investor receives “no contractual guarantee of repayment or compensation” in the case of the borrower’s default, “[s]uch assumption [*39] of risk strongly suggests that the [investors [are] not in a creditor-debtor relationship with [Lender].”

In re Golden Plan of California, Inc., 829 F.2d at 709-10.

Factors That Signify A Debtor Creditor Relationship

1. Guarantee of repayment by the lead lender to a participant;
2. Participation that lasts for a shorter or longer term than the underlying obligation;
3. Different payment arrangements between borrower and lead lender and lead lender and participant; and
4. Discrepancy between the interest rate due on the underlying note and interest rate specified in the participation.

What Is A Syndication?

- ▶ Debts issued by a consortium of lenders to a sole borrower.
- ▶ There is a “lead lender” or arranger for each consortium.
 - Lead is responsible for facilitation of the loan and allocating cash flows to the other consortium members.
 1. Underwritten deal
 2. Club deal
 3. Best-Efforts Syndication Deal

Partnership?

- ▶ '40 Act issues and Advisers Act Issues??
- ▶ Tax Issues
- ▶ Does holder have debt or equity?
- ▶ Who has custody of the assets? Do they have legal competence?

What Is A Security?

▶ Howey test

- investment of money
- in a common enterprise
- with the expectation of profit
- from the efforts of others

▶ Reves test

- a note is presumed to be a security unless it is of a type specifically identified as a non-security
- An instrument not among the list of non-security notes identified in *Reves* is deemed a security unless it bears a “strong family resemblance” to the non-security notes identified in the opinion

What Is A Security?

Reves established a four-part family resemblance test for determining whether a note is a security composed of the following factors:

1. motivations of the buyer and seller;
2. plan of distribution;
3. reasonable expectations of the investing public; and
4. existence of an alternate regulatory regime.

What Is FINRA And Why Does It Matter?

- The Financial Industry Regulatory Authority, Inc. (FINRA) is a private corporation that acts as a self-regulatory organization for securities brokers and brokerage firms.
- FINRA issues rules and guidelines ensure a safe and fair market.
- FINRA receives complaints from investors and is authorized along with the SEC to take enforcement actions that may result in financial restitution for investors.
- FINRA Regulatory Notice 16-10 (April 2016) explored whether a financing instrument is a loan, a purchase and sale contract, or a security under the *Reves* factors in the context of private placements in municipal securities.

Recent Cases

Kirschner v. JPMorgan Chase Bank, NA. –on May 22, 2020, the case was dismissed on a motion by the defendants on the grounds that the origination and distribution of a syndicated bank loan did not involve a security. The court applied the family resemblance test of the US Supreme Court as articulated in *Reves v. Ernst and Young*.

1. Motivations of the seller and buyer --inconclusive
2. Plan of distribution – court found that the plan was limited to sophisticated institutions and the transfers required the consent of the Lender, lender affiliate or the “Approved Fund.”
3. Reasonable expectations of the investing public – court focused on the terminology used and concluded that the credit agreement and confidential information memorandum would lead a reasonable investor to believe they were loans and not securities
4. Existence of another regulatory scheme – unlike the unregulated market in *Reves*, in this case the court found that this was a sale to sophisticated purchasers subject to policy guidelines from the Comptroller of the currency.

1 Global Capital LLC

Selling investment contracts to retail investors without the benefit of registration. These were MCA participations.

Turned out to be a ponzi scheme

SEC sued everybody. Outside counsel was charged with issuing false and misleading opinions that the investment were not securities and did not have to be registered with the SEC, knowing that there were facts missing.

Questions & Answers

For more information, visit

www.pepperlaw.com

Gregory J. Nowak
212.808.2723
nowakg@pepperlaw.com