Do California Courts Classify Promissory Notes As Securities Based On Their Phenotype?

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A recent decision by U.S. District Judge Paul G. Gardephe has attracted attention among bank finance lawyers by ruling that the sale of promissory notes to "a few hundred" investors did not involve the offer or sale of a security. *Kirschner v. JPMorgan Chase Bank, N.A.*, 2020 U.S. Dist. LEXIS 90797. Judge Gardephe overcame the presumption that the notes were securities after applying the "family resemblance" test set forth in *Reves v. Ernst & Young*, 494 U.S. 56 (1990). Although the plaintiff also brought claims under the securities laws of California and three other states, the plaintiff asserted that these states also applied the *Reves* test.

In fact, *Reves* has been cited in only one California published opinion, *Asplund v. Selected Investments in Financial Equities, Inc.*, 86 Cal. App. 4th 26 (2000). That reference, moreover, could be regarded as *dicta* ("However, even if, as appears the investments were securities under the test articulated by [Reves] . . ."). Despite the tenuous judicial precedent, several administrative decisions of the Commissioner of Corporations (now Commissioner of Business Oversight) refer to *Reves*. See, e.g., *In re Trinity Investment Group et al.*, 2016 Cal. Sec. LEXIS 11; *In re William Benson Peavey, Jr. et al.*, 2013 Cal. Sec. LEXIS 3; and *In re Commissioner v. Fairshare et al.*, 199 Cal. Sec. LEXIS 4. Further, the leading treatise on the Corporate Securities Law notes that "decisions of the California courts involving instruments designated as 'notes' have not always found these instruments to be securities for purposes of the Corporate Securities Law". Marsh & Volk, *Practice Under the California Securities Laws* § 5.19[3] (footnote omitted).
Note to readers - I have served as practice consultant to Practice Under the California Securities Laws since 2009.

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