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Transaction ID 44439750
Case No. 5109-CS

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

FLETCHER INTERNATIONAL, LTD.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil Action No. 5109-CS
	)	
ION GEOPHYSICAL CORPORATION, f/k/a INPUT/OUTPUT, INC., and ION INTERNATIONAL S.àr.1.,	)	
	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: February 27, 2012
Date Decided: May 23, 2012

Paul J. Lockwood, Esquire, Ronald N. Brown, III, Esquire, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, Wilmington, Delaware; Bruce E. Fader, Esquire, Margaret A. Dale, Esquire, Brian L. Friedman, Esquire, PROSKAUER ROSE LLP, New York, New York, *Attorneys for Plaintiff.*

Kenneth J. Nachbar, Esquire, Leslie A. Polizoti, Esquire, Albert J. Carroll, Esquire, Angela C. Whitesell, Esquire, MORRIS, NICHOLS, ARSHT & Tunnell LLP, Wilmington, Delaware, *Attorneys for Defendants.*

STRINE, Chancellor.

I. Introduction

These cross-motions for partial summary judgment ask me to determine whether ION Geophysical Corporation violated the rights of its preferred stockholder Fletcher International Ltd. by causing a wholly-owned ION subsidiary to issue certain promissory notes without Fletcher's approval in connection with ION's purchase of a business. The promissory notes were issued to the seller of the business. Under the Certificates of Rights and Preferences (the "Certificates") governing the terms of Fletcher's preferred stock, Fletcher has consent rights over the issuance of "any security" by any of ION's subsidiaries.[1] Fletcher claims that the three promissory notes in dispute each constituted a "security" within the meaning of the Certificates, and that ION therefore breached the Certificates by issuing the notes through a subsidiary without first obtaining Fletcher's consent.

A similar question – whether a particular promissory note issued by an ION subsidiary was a "security" under the Certificates requiring Fletcher's consent – was addressed by this court in a prior decision in this case ("*Fletcher I*").[2] The court in *Fletcher I* ruled that ION violated Fletcher's rights under the Certificates by causing a different ION subsidiary to issue a promissory note without Fletcher's consent. In reaching this conclusion, the court found that the term "any security" in the Certificates referred to "instruments generally recognized to be securities under federal and state

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[1] Whitesell Aff. Ex. 2 (the Certificates) § 5(B)(ii).

[2] *Fletcher Int'l, Ltd. v. ION Geophysical Corp.*, 2010 WL 2173838 (Del. Ch. May 28, 2010) (Parsons, V.C.) ("*Fletcher I*").

securities statutes and regulations,"[3] and that whether any note issued by an ION subsidiary was a "security" was to be determined by applying the four-factor formula set forth by the United States Supreme Court in *Reves v. Ernst & Young*.[4] That ruling is the law of the case.[5]

Fletcher argues that when the analytical approach adopted in *Fletcher I* is applied to the undisputed facts regarding the issuance of the three promissory notes at issue here, the notes emerge as securities under the *Reves* test. For its part, ION contends that because the three notes were issued as part of the purchase price for a business, they are not securities for purposes of federal and state securities laws under the *Reves* framework, and thus not securities within the meaning of the Certificates as established by this court in *Fletcher I*.

As an initial matter, I agree with the parties that to determine whether the notes are securities is an issue appropriate for summary judgment, because the determinative, undisputed facts are the objective terms of the notes and the related deal documents. To serve their intended purpose, the securities laws and provisions like Fletcher's consent rights in the Certificates must turn on the discernable characteristics of the instrument in question, as revealed by the instrument's own terms and the terms of the other transactional documents with which it operates and to which it relates.

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[3] *Id.* at *5.
[4] *See id.* (citing *Reves v. Ernst & Young*, 494 U.S. 56, 66-67 (1990)).
[5] *See Zirn v. VLI Corp.*, 1994 WL 548938, at *2 (Del. Ch. Sept. 23, 1994), *aff'd*, 681 A.2d 1050 (Del. 1996).

On the merits, however, I do not agree with ION's argument that all notes issued as compensation to a seller of a business by the buyer of that business are not securities. Under *Reves*, the determinative question is not whether the note was received as consideration for the seller's sale of its business to the note issuer; rather, the question is what is the nature of the note that the seller received. If what the seller received was a note that constituted a long-term investment in the buyer, then the note would be a security under *Reves*. By contrast, if the note was, for example, a short-term commercial bridge loan issued to help the sale close, it is less likely to be a security under the *Reves* test. In other words, the relevant analysis must focus on the specific characteristics of the note at issue.

Accordingly, in this opinion, I first discuss the background of the transaction that led to the issuance of the notes. In keeping with *Fletcher I*, I then apply the *Reves* test to each note to determine whether it is a security. I conclude that, under *Reves*, two of the promissory notes issued to the business seller by the ION subsidiary are not securities, because they are most sensibly characterized as short-term commercial bridge financing to facilitate the closing of the acquisition transaction. But, I conclude that the third note is a security. This security was issued only because ION could not obtain the funding that it had hoped to use to pay the seller. The seller therefore took as part of its consideration for selling the business a long-term, transferable note that had a possible duration of four years and nine months at a high rate of return. Along with $50 million in

stock in ION that the seller received,[6] this third note constituted a substantial investment in ION – the buyer – not unlike other high-yield instruments like a junk bond. Because *Reves* creates a strong presumption in favor of finding that a note is a security, these factors showing that the third note resembles the kind of investments that are typically considered securities, rather than short-term financing transactions that look more like specialized loans, require that summary judgment be entered for Fletcher on this aspect of its claim.

Therefore, I find that Fletcher's consent rights under the Certificates were not breached by the issuance of the first two notes, but were breached when ION caused its subsidiary to issue the third note.

II. Factual Background

A. An Overview Of Fletcher's Consent Rights And This Court's Prior Ruling In *Fletcher I*

ION is a publicly-traded seismic solutions company that provides equipment and services to the global oil and gas industry. When it purchased preferred stock in ION, Fletcher obtained the right to consent to issuances or sales of securities by an ION subsidiary to any third party. Section 5(B)(ii) of each of the Certificates provides, in relevant part:

> The consent of [Fletcher] shall be necessary to … permit any Subsidiary of [ION] to issue or sell, or obligate itself to issue or sell, except to [ION] or any wholly owned Subsidiary, any security of such Subsidiaries …[7]

[6] Dollar value measured as of the date of closing.
[7] Certificates § 5(B)(ii).

In *Fletcher I*, this court considered the meaning of "any security" under the Certificates and whether the Certificates were breached by ION causing a subsidiary to issue a note. In holding that the convertible promissory note then at issue was a security that could not be issued without Fletcher's consent, *Fletcher I* found that the term "security" is "not ambiguous and must be afforded its ordinary meaning as it has developed under federal and state law."[8] In particular, *Fletcher I* applied the approach to analyzing whether notes are securities that was adopted by the United States Supreme Court in *Reves v. Ernst & Young*,[9] and which has been embraced by our own Supreme Court in *Boo'ze v. State*.[10] In *Reves*, the Court held that all "notes" are presumed to be securities, but this presumption may be rebutted by objective indicators that show that the note in question is, or bears a "strong resemblance" to, an item on a judicially-created list of instruments that are commonly denominated as "notes," but are not securities.[11]

The law of the case doctrine requires adherence to the prior ruling in *Fletcher I*.[12] Therefore, my analysis here is grounded in the reasoning of the *Fletcher I* decision and its call to analyze each of the notes at issue under the *Reves* test. To determine whether the notes at issue here were securities under *Reves* and therefore subject to Fletcher's consent

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[8] *Fletcher I* at *5.
[9] 494 U.S. 56 (1990).
[10] 2004 WL 691903, at *2 (Del. Mar. 25. 2004) (TABLE) (adopting the *Reves* "family resemblance" test to determine whether a note was a security under the Delaware Securities Act).
[11] *Reves*, 494 U.S. at 65-67.
[12] *See Zirn v. VLI Corp.*, 1994 WL 548938, at *2 (Del. Ch. Sept. 23, 1994), *aff'd*, 681 A.2d 1050 (Del. 1996) ("Once a matter has been addressed in a procedurally appropriate way by a court, it is generally held to be the law of that case and will not be disturbed by that court unless compelling reason to do so appears."); *Frank G.W. v. Carol M.W.*, 457 A.2d 715, 719 (Del. 1983) ("When a successor judge enters onto the scene … additional considerations for adherence to prior rulings come into play," because "[p]arties must not be entrapped by varying philosophies of different judges of the same Court in the case.").

rights under the Certificates, the essential characteristics of the notes as reflected by the transactional documents giving rise to their issuance must be understood.

B. ION Agrees To Acquire ARAM

The three promissory notes in dispute were issued in connection with ION's 2008 acquisition of ARAM Systems Ltd. and its affiliate company Canadian Seismic Rentals Inc. (collectively, "ARAM"). For the sake of clarity, I refer to the three notes in dispute as the "Escrow Note," the "Tax Receivable Note," and the "Final Note" (collectively, the "ARAM Notes"). ARAM, which was wholly owned by its founder Don Chamberlain and his family,[13] manufactured, sold, and leased cable-based land seismic recording systems to data contractors.[14] ION agreed to purchase all of ARAM's shares for $350 million (Canadian), or approximately $343 million (US),[15] subject to certain adjustments. For tax reasons, ION formed a wholly-owned Canadian subsidiary named 3226509 Nova Scotia Company (the "Acquisition Sub") to serve as the acquisition vehicle for the transaction.[16] On July 8, 2008, ION and ARAM entered into a "Purchase Agreement," and ION assigned its rights and obligations under that Agreement to the Acquisition Sub.

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[13] *See* Whitesell Aff. Ex. 12 (Evercore Partners Presentation to the ION Board of Directors (July 2, 2008)) at IONBGP00065587.
[14] *See* Whitesell Aff. Ex. 39 (ION 8-K (Sept. 23, 2008)) at 2.
[15] *See* Whitesell Aff. Ex. 25 (Email from Cindy Du to Brian Hanson (July 9, 2008)); Whitesell Aff. Ex. 26 (Email from Joe Agular to Brian Hanson (July 9, 2008)) (both emails containing announcements of transaction at approximately $343 million (US)).
[16] Whitesell Aff. Ex. 16 (Hanson Dep.) at 222-24.

C. ION Finances The Cash Portion Of The ARAM Acquisition With Commercial Loans And Temporary Funds Supplied By The Escrow Note And The Tax Receivable Note

Of the $343 million purchase price, $275 million was to be paid in cash, and the rest in ION common stock. Thus, the transaction was one in which the Chamberlains would receive a substantial new equity investment interest in ION. In addition to the Chamberlains becoming major stockholders in ION, Don Chamberlain's son was expected to serve in a senior role in the combined company.[17] The Purchase Agreement also required that $35 million of the cash portion of the consideration be placed in escrow for the benefit of ION in the event of any post-closing purchase price adjustments or indemnification claims (the "Escrow").[18]

ION initially planned to finance the $275 million cash portion of the purchase price through a $110 million term loan from its senior credit facility and a $175 million high-yield bond offering.[19] But, ION could not proceed with its bond offering until ARAM produced audited financials in accordance with US GAAP standards, as is necessary for a public offering, and doing so would take several months.[20] Because both parties wanted a speedier closing, ION developed a plan to finance the purchase price

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[17] *See* Whitesell Aff. Ex. 12 at IONBGP00065577; Whitesell Aff. Ex. 8 (Email from Bob Peebler to Chuck Ledet et. al. (May 28, 2008)) at IONBGP00058557.
[18] Whitesell Aff. Ex. 17 (Purchase Agreement) § 1.5(a)(i).
[19] Whitesell Aff. Ex. 12 at IONBGP00065563.
[20] *See* Whitesell Aff. Ex. 16 at 365-66; Whitesell Aff. Ex. 32 (Email chain between Brian Hanson and David Maxey (July 23-26, 2008)) at IONBGP00009514-16.

with short-term bridge financing.[21] Specifically, to fund the cash portion of its purchase price, ION arranged with its commercial lenders to do the following:

- Borrow $125 million of term loans and $72 million of revolving loans from its bank syndicate, for a total of $197 million, under its $235 million Senior Secured Credit Facility (the "Senior Credit Facility");[22] and

- Borrow $40 million under a short-term, senior increasing rate note payable to Jeffries Finance CP Funding LLC (the "Jeffries Bridge Note"), which would be due in approximately three months.[23]

To make up the remaining cash shortfall, ION suggested that ARAM accept a $35 million promissory note to fund the Escrow (the "Escrow Note").[24] The thought was that once ION completed its bond offering, it would then pay down the Escrow Note by funding the Escrow with the newly-raised cash.[25]

Don Chamberlain was amenable to this suggestion, but wanted the Escrow Note secured.[26] ION's commercial lenders would not allow the Escrow Note to be secured, "especially as big as [the Escrow Note] [was]," and considered it "a deal breaker."[27] In the interest of an early closing, Chamberlain accepted that he would "have to live with an

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[21] *See* Whitesell Aff. Ex. 32 at IONBGP00009516 ("The more I think about the slippage in dates to produce the audited financials at ARAM, I think we need a contingency plan to bridge the bond [raise].").
[22] Whitesell Aff. Ex. 51 (Funds Flow Memorandum (Sept. 18, 2008)) at 1-2.
[23] *Id.* (net of original issue discount); *see also* Whitesell Aff. Ex. 50 (Jeffries Bridge Note).
[24] Whitesell Aff. Ex. 33 (Email from Brian Hanson to Bob Peebler (July 28, 2008)) at IONBGP00009525.
[25] *E.g.*, *id.* at IONBGP00009525 ("Perhaps we agree with ARAM that we don't fund the escrow at closing … but they take a promissory note for it, which is due and payable to escrow 21 days after they provide the audited financials. That gives us time to market and close the bond, then we'd fund the escrow.").
[26] *See* Whitesell Aff. Ex. 34 (Email from David Whelan to Marc Folladori (Aug. 5, 2008)) at IONBGP00009882.
[27] Whitesell Aff. Ex. 35 (Email from Thomas Perich to Tristan Propst (Aug. 11, 2008)) at IONBGP00120967.

unsecured debt on the $35 million of escrow funding," but insisted that the unsecured debt reflect "market terms for the increased risk."[28] The Acquisition Sub, rather than ION itself, issued the Escrow Note, made payable to a wholly-owned ARAM subsidiary.

The Escrow Note was not convertible into equity. It had a one-year term that corresponded to the one-year term of the original Escrow contemplated by the Purchase Agreement.[29] But, the Escrow Note could be taken out early by ION's funding the Escrow before the expiration of the Escrow Note's one-year term (more on this in a moment). Although it was issued by the Acquisition Sub, the Escrow Note was guaranteed by ION.[30]

The Note had escalating rates of interest to coincide with certain milestones in connection with repayment expectations. Specifically, the interest rate was set initially at 9%. If the Note had not been paid in full (*i.e.*, if the Escrow had not been funded) by the later of (1) December 17, 2008 and (2) the "Interest Change Date," meaning the date that was 45 days following the date that ARAM completed its preparation of the qualified financial statements for the planned bond offering (the "Financial Statements Delivery Date"), then "commencing on (and including) the date [immediately following] the Interest Change Date," the interest rate would increase to 12%.[31] If the sums were still due under the Note by March 18, 2009, then the interest rate would increase once more to

[28] Whitesell Aff. Ex. 36 (Email from Greg Burrows to Brian Hanson et. al. (Aug. 12, 2008)) at IONBGP00011410.
[29] *See* Whitesell Aff. Ex. 37 (Escrow Note) § 3; Purchase Agreement at 68 (Definitions) (defining the "Escrow Period" as the closing date to the first anniversary of the closing date).
[30] Escrow Note § 7; Whitesell Aff. Ex. 46 (ION Geophysical Corp. Guarantee of the Escrow Note (Sept. 18, 2008)).
[31] Escrow Note § 2(a).

15%.[32] By way of comparison, the interest rate on the three-month Jeffries Bridge Note started at 13.5% and increased to 14% if the note had not been repaid in two months.[33]

The relationship between the Escrow Note and the Escrow was governed by the terms of both the Escrow Note and the Amended and Restated Share Purchase Agreement (the "Revised Purchase Agreement"), an agreement into which ION and ARAM entered on September 17, 2008 in order to document these new changes to the financing structure.[34] First, the Revised Purchase Agreement provided that "as soon as reasonably possible" after the Financial Statements Delivery Date, ION was to fund the Escrow with cash equal to the principal of the note ($35 million) plus a portion of the accrued interest that represented the rate of interest that would typically accrue under an escrow agreement (here, 3%).[35] These "Escrow Funds" would then accrue interest at the rate set by the terms of the Escrow Agreement.[36] On this "Deposit Date,"[37] ION was required to deliver to ARAM the remaining portion of the interest due under the Note. The interest was split in such a way so that the "Incremental Interest" (above 3% and up to 9%, 12%, or 15%) would be paid directly to ARAM. That excess interest was for ARAM's benefit because ARAM would be "bearing the risk of the unsecured loan in the interim" before the Deposit Date.[38]

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[32] *Id.* § 2(b).
[33] Jeffries Bridge Note § 2.
[34] *See* Whitesell Aff. 38 (Revised Purchase Agreement) at 73 (Definitions).
[35] Whitesell Aff. 52 (Email from Maria S. Doerksen to Marc Folladori et. al. (Aug. 28, 2008)) at IONBGP00013702 ("Our [ARAM's] desire is to have the regular [Guaranteed Investment Contract] rate (approx. 3-4[%]) be included in the escrow amount.").
[36] Revised Purchase Agreement at 73 (Definitions).
[37] *Id.* § 1.5(a).
[38] Whitesell Aff. 52 at IONBGP00013702.

The Escrow Note mimicked the original Escrow in another key way: as long as the Escrow Note was outstanding, ION had the right to "withhold and set off against any amount due" under the Escrow Note any amounts due to ION by virtue of indemnification claims or post-closing purchase price adjustments in accordance with the terms of the Revised Purchase Agreement.[39] In the event that the parties disputed what amounts were owed to ION, the Revised Purchase Agreement required that they go to arbitration.[40] And, not only would the amounts due under the Escrow Note be reduced dollar-for-dollar by indemnification or post-closing claims, but ION could also voluntarily pay down the Note "in whole or in part" without prepayment penalty, "with each such prepayment being applied first to accrued and unpaid interest, and then to outstanding principal."[41] Once ION deposited in full the Escrow Funds and paid the Incremental Interest to ARAM, then the Escrow Note would be deemed to be repaid in full, and it would be cancelled.[42] Of course, upon cancellation of the Note, no more interest would be due.

But, in repaying the Escrow Note, ION had to comply with the terms of its other credit agreements. Specifically, ION could not repay the Escrow Note without having already (or at the same time) repaid both the Jeffries Bridge Note and the revolving credit

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[39] Escrow Note § 4.
[40] *See* Revised Purchase Agreement §§ 1.5(a)(v), 1.6 (post-closing adjustments); *see also id.* §§ 8.11(a), 10.17 (indemnification).
[41] Escrow Note § 3.
[42] Revised Purchase Agreement § 1.5(a)(iii).

loan indebtedness under the Senior Credit Facility.[43] Furthermore, the Escrow Note obligated ION, when it repaid the Jeffries Bridge Note and the revolving credit loan indebtedness with the proceeds of either the planned bond offering or a separate backstop funding commitment by Jeffries, to "at such time … repay in full" the remaining principal and interest on the Escrow Note.[44] In this way, the Escrow Note was in a sense *pari passu* with the Jeffries Bridge Note and ION's revolving credit loan indebtedness.

The Escrow Note bore a legend stating that the note was not registered under the securities laws and that it could only be sold or transferred in accordance with the securities laws.[45] By its terms, the Escrow Note was transferable with ION's "express written consent, which consent shall not be unreasonably withheld."[46] But, if the Escrow Note was in default, or if other specified events of default occurred and remained uncured, then the Note was "freely assignable" by ARAM "so long as [it] and its assignee compl[ied] with all applicable securities laws in relation to such assignment."[47] By contrast, the Jeffries Bridge Note did not have any legend regarding the securities laws; nor did it require Jeffries to comply with the securities laws before any assignment.

In addition to the Escrow Note, the Acquisition Sub issued a subordinated $10 million promissory note to ARAM's wholly-owned subsidiary, dated September 18, 2008, to reflect a $10 million increase in ARAM's working capital and, therefore, its

[43] *See* Jeffries Bridge Note § 6(i)(iii); Whitesell Aff. Ex. 53 (First Amendment To The Amended and Restated Credit Agreement and Domestic Security Agreement (Sept. 17, 2008)).
[44] Escrow Note § 8(b).
[45] *Id.* at 1.
[46] *Id.* § 10.
[47] *Id.*

purchase price, due to a tax receivable to be issued by the Canadian tax authorities that was anticipated but not yet received (the "Tax Receivable Note").[48] The parties only realized that the purchase price would have to be increased by this amount days before closing.[49] Because the tax receivable had not yet been received, ION offered, and ARAM agreed, to take the Tax Receivable Note in its place as part of the purchase price for the acquisition.[50]

Like the Escrow Note, the Tax Receivable Note was unsecured but guaranteed by ION, and did not have any convertibility feature.[51] The maturity of the Tax Receivable Note was pegged to the maturity of the Escrow Note such that the outstanding principal and interest would be due one day after the Maturity Date set forth in the Escrow Note (which, as an unusually retentive reader will recall, provided for a one-year term that could be shortened by ION's full funding of the Escrow).[52] Interest rates on the Tax Receivable Note were one percent above the interest rates on the Escrow Note, and increased over time in the same manner as the Escrow Note.[53] Also, the Tax Receivable Note bore a similar legend disclaiming registration under the securities laws.

Unlike the Escrow Note, however, there was no right of set off against the Tax Receivable Note in case the actual tax receivable was lower than expected. Rather, according to the Revised Purchase Agreement, any portion of the income tax receivable

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[48] Whitesell Aff. Ex. 45 (Tax Receivable Note).
[49] Whitesell Aff. 21 (Roland Dep.) at 104-105.
[50] Whitsell Aff. Ex. 44 (Email chain between ARAM and ION representatives (Sept. 16-17, 2008)), at IONBGP00016732.
[51] Tax Receivable Note § 8; Whitesell Aff. Ex. 47 (ION Geophysical Corp. Guaranty of the Tax Receivable Note (Sept. 18, 2008)).
[52] Tax Receivable Note § 3.
[53] *Id.* § 2.

that was not realized would be owed to ION from the Escrow Funds, or would be set off against amounts owed under the Escrow Note if that Note was outstanding.[54] By way of illustration, if the Canadian tax authorities determined that ARAM was only entitled to $6 million instead of the $10 million that ION and ARAM were expecting, then that $4 million difference would be considered a post-closing purchase price adjustment in favor of ION and would be applied against the Escrow Note. Thus, a lower-than-expected income tax receivable would not affect the principal and interest balance under the Tax Receivable Note. Accordingly, if ARAM were to transfer its Tax Receivable Note, something which ARAM was entitled to do under the same transferability terms as set forth in the Escrow Note, then the Note's transferee would be entitled to payment of the full $10 million obligation plus interest regardless of the outcome of the Canadian tax authority's decision, subject to ION's right to prepay the Note "at any time" without penalty.[55]

D. ION Amends Its Senior Credit Facility To Account For The Escrow Note And Tax Receivable Note In A Way That Shortens The Life Of Each Note To Three Months, And The ARAM Acquisition Closes

On September 17, 2008, the same day that ION and ARAM entered into the Revised Purchase Agreement, ION and its bank syndicate entered into the First Amendment to the Senior Credit Facility to account for the new Notes. Importantly, the Senior Credit Facility was amended to require that ION "make any remaining payments

[54] Revised Purchase Agreement § 1.5(l). Such a determination was to be made "on or before the six [] month anniversary of the Closing Date." *Id.*
[55] Tax Receivable Note § 3.

to the sellers of ARAM" by December 31, 2008, at the latest.[56] This amendment was important. Although the terms of the Escrow Note and the Tax Receivable Note contemplated a one-year maturity date, the amended Senior Credit Facility imposed a separate, independent requirement that both Notes be paid back in three months. In plain terms, this amendment effectively shortened the life of both the Escrow Note and the Tax Receivable Note from one year to three months.

ION also amended the Senior Credit Facility to add a cross-default provision for the Escrow Note.[57] That is, if the Acquisition Sub defaulted on the Escrow Note, then that default would also be an Event of Default under the Senior Credit Facility and would trigger the bank syndicate's right to accelerate the payment of the amounts outstanding under the Senior Credit Facility.[58]

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[56] Whitesell Aff. Ex. 53 § 2(q).

[57] *See id.* § 2(y) (adding as an Event of Default if "[ION or any ION subsidiary] shall fail to make any payment (whether of principal or interest and regardless of amount) in respect of any Material Indebtedness, including without limitation the … [Escrow Note], when and as the same shall become due and payable after giving effect to any applicable grace period," to the Event of Default provision in the Amended and Restated Credit Agreement, which provides the bank syndicate the right to "declare the Loans then outstanding to be due and payable in whole or in part … and thereupon the principal of the Loans so declared to be due and payable, together with accrued interest thereon …."); Whitesell Aff. Ex. 77 (Amended and Restated Credit Agreement (July 3, 2008)) § 7.01)). I refer to this Amended and Restated Credit Agreement, as amended, as ION's Senior Credit Facility.

[58] Although counsel for ION indicated at oral argument that the cross-default provisions in the Senior Credit Facility also applied to the Tax Receivable Note, upon close review of the Senior Credit Facility that does not clearly appear to be the case, and ION's briefs contain no citation to contractual text supporting that conclusion. The Senior Credit Facility was amended specifically to include the Escrow Note in its cross-default provisions, but not the Tax Receivable Note. Arguably, a failure to pay the Tax Receivable Note could trigger an Event of Default under the provision considering an Event of Default to include the circumstance when "[ION] or any of [ION's subsidiaries] shall become unable, admit in writing its inability, or fail generally to pay its debts as they become due." Whitesell Aff. Ex. 77 § 7.01(k). But, this provision seems to speak more generally to ION's insolvency, rather than its failure to pay any specific "debt" in accordance with that debt's terms.

Ultimately, to close the ARAM acquisition, ION used financing that consisted of: (1) $125 million in term loans under the Senior Credit Facility; (2) $72 million in revolving credit indebtedness under that Senior Credit Facility; (3) the $40 million Jeffries Bridge Note; (4) the $35 million Escrow Note; (5) the $10 million Tax Receivable Note; (6) $619,000 in cash; (7) and 3,629,211 in ION common stock, which had a market value on the date of closing of approximately $51 million.[59]

E. With Credit Markets Frozen In The Midst Of The Financial Crisis, ION Looks For Replacement Long-Term Financing And Amends The Terms Of The Notes

In the days before ION and ARAM signed the Revised Purchase Agreement and issued the Escrow Note and Tax Receivable Note, Lehman Brothers collapsed and the credit markets froze. Because of this, in the ensuing months, ION was unable to proceed with the bond offering that it had expected would provide the cash to pay down the $45 million aggregate indebtedness to ARAM by December 31, 2008, as was required by ION's Senior Credit Facility. To remedy this, ION and ARAM, along with ION's bank syndicate, came to the following agreement.

First, on December 30, 2008, ION assigned to ARAM the income tax receivable in consideration for extinguishing the Tax Receivable Note.[60] Second, on that same day, ION caused the Acquisition Sub to issue a new $35 million note (the "Final Note"), with an extended term of nearly five years (until September 2013). The Final Note carried a

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[59] *See* Whitesell Aff. Ex. 39 at 2; *see also* Whitesell Aff. Ex. 61 (ION 10-Q (Nov. 7, 2008)) at 6. On September 18, 2008, which was the closing date, ION's closing stock price was $14.10. *See* Yahoo Finance, ION Geophysical Corp. Historical Stock Prices, http://finance.yahoo.com/q/hp?s=IO+Historical+Prices (last visited May 21, 2012). 3,629,211 shares of stock * $14.10 per share = $51,171,875.

[60] Whitesell Aff. Ex. 64 (Assignment Agreement (Dec. 30, 2008)).

15% interest rate from the outset, payable quarterly,[61] and was transferable with ION's express written consent, which could not be unreasonably withheld.[62] Like the other Notes, if there was an event of default that remained uncured, the Final Note would become freely assignable.[63] And, although the Final Note contained the same rights of set off for amounts owed to ION due to post-closing purchase price adjustments or indemnification claims as the Escrow Note, the Escrow Period was set to expire on September 18, 2009. Thus, the balance that the Acquisition Sub would be obligated to pay under the Final Note would be fixed nine months into a nearly five-year term.[64] This contrasted with the original Escrow Note, under which the right of set off was always a possibility throughout the entire life of the Note. Consistent with the longer term of the Final Note, the Senior Credit Facility was amended to delete the language requiring ION to pay down the aggregate indebtedness owed to ARAM by December 31, 2008.[65] Additionally, the Senior Credit Facility was amended to make the cross-default provisions applicable to "any default under … the [Final Note]."[66]

The Final Note also bore a legend disclaiming registration under the securities laws like the other two Notes at issue. Although the Final Note was subordinated to ION's entire Senior Credit Facility and the Jeffries Bridge Note (which at this point had been extended), the terms of the Final Note also provided that if ION completed the

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[61] Whitesell Aff. Ex. 66 (Final Note) §§ 2, 3.
[62] Final Note § 12.
[63] *Id.* § 12.
[64] *Id.* § 4.
[65] Whitesell Aff. Ex. 67 (Fourth Amendment to the Amended and Restated Credit Agreement and Foreign Security Agreement, Limited Waiver and Release (Dec. 30, 2008)) § 2(f).
[66] *Id.* § 2(m).

public bond offering, or incurred certain other specified indebtedness, then the Acquisition Sub was obligated to "repay in full" the Final Note, as long as that is done concurrent with, or immediately following, repayment of the extended Jeffries Bridge Note.[67] Like the other Notes issued to ARAM, the Final Note was guaranteed by ION.[68]

ION did not seek Fletcher's consent before causing the Acquisition Sub to issue the Escrow Note, the Tax Receivable Note, or the Final Note. On January 23, 2009, Fletcher informed ION that it believed that the Acquisition Sub's issuance of the ARAM Notes violated Fletcher's consent rights. In response, and although disagreeing with Fletcher's legal conclusion, ION caused the Acquisition Sub's successor by amalgamation to assign the Final Note – the only ARAM Note then outstanding – to ION under a Transfer, Assumption, Consent and Release Agreement dated April 9, 2009.[69] As consideration for ION's assumption of its obligations, the successor to the Acquisition Sub issued shares of its capital stock to ION.[70]

III. Legal Analysis

A. Standard Of Review

Both parties have moved for summary judgment, arguing that no genuine issue of material fact exists and the matter can be resolved as a matter of law.[71] In the context of determining whether a particular note is a security, summary judgment is particularly

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[67] Final Note § 9(b).
[68] *Id.* § 8.
[69] Whitesell Aff. Ex. 71 (Transfer, Assumption, Consent and Release Agreement (April 9, 2009)).
[70] *Id.* § 4.
[71] *Emmons v. Hartford Underwriters Ins. Co.*, 697 A.2d 742, 745 (Del. 1997).

appropriate. This is a determination that, to be useful, must be made by reference to manifest information that investors can evaluate, namely the terms of the instruments themselves and the other transactional documents to which they relate.[72] As befits that, the parties have for the most part hewed closely to the evidence of that which is most critical.[73] In my analysis, the plain terms of those documents supply the undisputed evidence that drives the legal outcome.

The sole question presented by these motions is whether the three ARAM Notes – the Escrow Note, the Tax Receivable Note, and the Final Note – are securities under the meaning of that term as adopted by this court in *Fletcher I*. If any of these Notes are securities, then Fletcher's consent rights over those securities' issuance were violated.

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[72] To this point, the parties have cited to a slew of federal decisions applying the *Reves* test. To this reader's eye, all seem to be decisions issued in response to a motion to dismiss or motion for summary judgment. None appear to be post-trial decisions. *E.g.*, *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808 (2d Cir. 1994) (motion to dismiss); *Robyn Meredith, Inc. v. Levy*, 440 F. Supp. 2d 378 (D.N.J. 2006) (motion to dismiss); *Leemon v. Burns*, 175 F. Supp. 2d 551 (S.D.N.Y. 2001) (motion to dismiss); *Premier Microwave Corp. v. Comtech Telecommunications Corp.*, 1991 WL 12430 (S.D.N.Y. Jan. 28, 1991) (motion for summary judgment); *but see McNabb v. S.E.C.*, 298 F.3d 1126 (9th Cir. 2002) (review from administrative proceeding); *Boo'ze v. State*, 2004 WL 691903 (Del. Mar. 25. 2004) (TABLE) (appeal from criminal conviction).

[73] In response to ION's recitation of facts set forth in its opening brief, Fletcher argued that ION's brief raised issues of material fact, and requested that if the court were to find factual issues precluding summary judgment, the court resolve those issues at trial instead of on a motion for summary judgment under Court of Chancery Rule 56(h). *See* P. Ans. Br. at 3 n.4. But, the factual dispute that Fletcher raises is not relevant to the question of whether the Notes in issue are securities. Rather, that dispute concerns ION's decision to cause the Acquisition Sub to issue the ARAM Notes rather than ION itself. Basically, ION contends that the transaction was economically identical to one in which ION issued the notes, rather than the Acquisition Sub. Although this question might bear on the remedial calculus, it has no bearing on whether Fletcher's consent rights have been breached because those rights apply to securities issued by ION subsidiaries, and it is undisputed that the ARAM Notes were all issued by an ION subsidiary.

B. <u>When Is A Note A Security Under *Reves*?</u>

Under the *Reves* test embraced in *Fletcher I* and by our Supreme Court in *Boo'ze v. State*, all notes are presumptively securities.[74] That presumption may be rebutted in two ways worth noting here. First, the presumption may be rebutted if the note in question fits within one of the specific categories of notes listed in *Reves* that are explicitly excluded from the definition of a security. These notes include, among others, (1) a short-term note secured by a lien on a small business or some of its assets; (2) short-term notes secured by an assignment of accounts receivable; (3) notes evidencing loans by commercial banks for current operations; (4) a note evidencing a "character" loan to a bank customer; and (5) a note that formalizes an open-account debt incurred in the ordinary course of business.[75] None of the Notes at issue here are on that list.

Thus, an alternative test that *Reves* articulates must be applied here. Under that "family resemblance" test, the presumption may be rebutted if the note bears a strong resemblance to one of those specifically enumerated types of notes.[76] To aid this determination, the *Reves* court identified four relevant factors for courts to consider: (1) the motivations that would prompt a reasonable buyer and seller to enter into the transaction; (2) the plan of distribution of the note; (3) the reasonable expectations of the investing public; and (4) whether some factor, such as the existence of another regulatory

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[74] *Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990); *Boo'ze*, 2004 WL 691903, at *2.
[75] *Reves*, 494 U.S. at 65 (citing *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976) and *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 939 (2d Cir. 1984)). The following notes issued in the consumer context are included in that list as well: (1) a note delivered in consumer financing; and (2) a note secured by a mortgage on a home. *Reves*, 494 U.S. at 65.
[76] *Id.* at 64-65.

scheme, significantly reduces the risk of the instrument, thereby rendering the application of the securities laws unnecessary.[77] No one factor is dispositive as they are considered as a whole.[78] Finally, a court may decide to add another category to the list by examining the same four factors.[79] When undertaking this analysis, courts are instructed to look to the "economic realities" of the transaction, rather than focus solely on a note's label or moniker.[80] As such, "[t]he test … necessarily becomes highly individualized to the facts of the particular case."[81]

Multi-factor tests can sometimes make the mind glaze over, and obscure their own fundamental purposes. Some of the less-than-logically-compelling case law under *Reves* illustrates that danger. To avoid that risk, it is useful to focus on the essence of what *Reves* is getting at, which is the question of whether the note in question is an investment, or whether the note represents a commercial or consumer loan transaction.[82] That is because, as *Fletcher I* was careful to point out, the "fundamental essence of a 'security' [is] its character as an 'investment.'"[83] To that end, when examining whether a particular note is a security, a pattern that emerges from the list of notes set forth in *Reves* as part of

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[77] *Id.* at 66-67.
[78] *See McNabb v. SEC*, 298 F.3d 1126, 1132-33 (9th Cir. 2002). Under *Reves*, a court may also decide to add another category to the list by examining the same four factors. *See Reves*, 494 U.S. at 67. The invitation to do this is not one that any party to this case asks me to accept, and it is not necessary to deciding this case. Therefore, I do not.
[79] *Reves*, 494 U.S. at 67.
[80] *See id* at 62; *see also S.E.C. v. Wallenbrock*, 313 F.3d 532, 538 (9th Cir. 2002) ("It is not the moniker or label that is dispositive, but the economic characteristics of the notes.").
[81] Thomas Lee Hazan, *The Law of Securities Regulation* §1.6(14), at 66 (4th ed. 2002).
[82] As *Reves* pointed out, the "family resemblance test" is another way of "formulating the same general approach" as the "investment versus commercial test" that had been adopted by a majority of the Court of Appeals that had considered the issue of whether a note is a security before *Reves*. *Reves*, 494 U.S. at 64.
[83] *Id*. at 68-69, *cited in Fletcher I* at *5.

its "family resemblance" focus provides guidance. Specifically, several of the commercial financing arrangements identified in *Reves* are short-term notes that are situational to the particular lender and borrower, and not the types of instruments that are easily traded.[84] They are all examples of transactions more readily characterized as short-term commercial loans than the sale of a "security." Accordingly, if a note in dispute shares these objective characteristics, then the presumption that the note is a security will be rebutted because the *Reves* family resemblance test will have been satisfied. On the other hand, if the note in question looks more like a corporate bond, debenture, or other instrument the value of which rises and falls with the success of the issuer's business, has a term of several years, and is easily traded, then that presumption will not be rebutted, because the note will not bear a strong resemblance to any of the notes listed in *Reves* for the basic reason that such a note is easily characterized as an investment, and thus a security.[85]

C. The Escrow Note And The Tax Receivable Note Are Not Securities, But The Final Note Is A Security

With these considerations in mind, I conclude that the Escrow Note and Tax Receivable Note are not securities under *Reves*, and therefore, under the Certificates for

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[84] *E.g.*, *Reves*, 494 U.S. at 65 (short-term note secured by a mortgage on a home; short-term note secured by a lien on a small business or some of its assets; short-term notes secured by an assignment of accounts receivable; notes evidencing loans by commercial banks for current operations).

[85] *E.g.*, *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 813 (2d Cir. 1994) (noting that investment grade commercial bonds are regulated as securities); *Exch. Nat. Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1133 (2d Cir. 1976) (noting the functional equivalent of corporate debentures are securities); *Banco Nacional De Costa Rica v. Bremar Holdings Corp.*, 492 F. Supp. 364, 369 (S.D.N.Y. 1980) (finding notes to be securities where the "debt obligations [in question] have much more in common with corporate debentures than with a consumer credit agreement.").

purposes of Fletcher's consent rights. Both of the Escrow Note and the Tax Receivable Note were short-term lending transactions entered into to facilitate the early closing of the ARAM acquisition, rather than to supply permanent financing for it.[86] In this way, these Notes are sensibly characterized as bridge loans designed to provide interim financing until ION could proceed with its planned bond offering.[87] The bridge loan nature of the Notes is borne out by their short term; not only were the Notes fully due and payable by their own terms in twelve months, but the legal reality was that the Notes were actually shorter-term than a year. The separate, binding terms of the Senior Credit Facility required that both Notes be repaid in three months, not a year.

Further, the Escrow Note and the Tax Receivable Note were enmeshed in an intricate, short-term relationship with ION as they related to the settling of the Escrow and the receipt of the income tax receivable. Taken together, these factors are important. For the entire one-year life of the Escrow Note and the Tax Receivable Note, a third party would not know if there were going to be claims against the Escrow, and the Acquisition Sub was obligated to pay off both Notes at the expiration of that same one-year period.[88]

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[86] *Cf. Banco Espanol de Credito v. Sec. Pac. Nat. Bank*, 973 F.2d 51, 55 (2d Cir. 1992) (holding that notes entered into by highly sophisticated commercial entities engaging in short-term commercial financing arrangements for current operations were not securities).

[87] *See Bass v. Janney Montgomery Scott, Inc.*, 201 F.3d 577, 585 (6th Cir. 2000) (finding that note that was the equivalent of a bridge loan was driven by commercial rather than investment motivations and not a security); *see also Singer v. Livoti*, 741 F. Supp. 1040, 1050 (S.D.N.Y.1990) (finding that short-term note issued as a temporary loan rather than a semi-permanent source of capital to fund a venture was driven by commercial motivations and not a security).

[88] I note that this applies with lesser force to the Tax Receivable Note, because any right of set off due to a lesser than expected income tax receivable would be applied against the Escrow Note rather than the Tax Receivable Note, and so the principal due under the Tax Receivable Note was a fixed amount. But, this reality is offset by the fact that the Tax Receivable Note

But, as noted, even this exaggerates the window any successor "investor" had because the Senior Credit Facility required that the Notes be taken out in three months. Thus, as a practical matter, it would be very difficult to price or sell either Note, even in today's short-term market, and this cuts against a finding that the Notes are securities.[89] Thus, under the first two *Reves* factors, which look to the objective motivations of the parties entering into the note transaction and to the likelihood of "common trading for speculation or investment,"[90] respectively, the Escrow Note and the Tax Receivable Note do not look like securities, but rather short-term commercial financing arrangements. The fact that the Notes carried securities act legends and contained references to the securities laws – although a point in Fletcher's favor under the third *Reves* factor[91] – does not require a different outcome when the overall weight of the analysis tilts heavily in favor of the conclusion that the Escrow Note and Tax Receivable Note are not securities.

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separately bears a strong resemblance to the enumerated item described in *Reves* as a "short-term note secured by an assignment of accounts receivable," *Reves*, 494 U.S. at 65, because the Tax Receivable Note was a cash advance in anticipation of the receipt of a future stream of income that would provide the funds necessary for repayment. *See Asset Prot. Plans, Inc. v. Oppenheimer & Co., Inc.*, 2011 WL 2533839, at *3 (M.D. Fla. June 27, 2011) ("Finally, the two largest notes are secured both by a prospect's anticipated income and by Willis & Woy's future accounts, in which respect the two largest notes are akin to a 'short-term note secured by an assignment of accounts receivable.'").

[89] *See Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982) (holding that a "unique agreement, negotiated one-on-one by the parties, is not a security" for similar reasons); *Asset Prot. Plans*, 2011 WL 2533839, at *4 ("A negotiated loan is unique and thus typically a poor vehicle for speculative trading."). Importantly, the investing public would be able to glean these characteristics from the objective terms of the Notes as well as the related documents referenced by the Notes.

[90] *Reves v. Ernst & Young*, 494 U.S. 56, 66 (1990).

[91] *See Fletcher I* at *6 n.45 ("While it may be true, as [ION] suggest[s], that the legend was added by the lawyers … simply out of 'an abundance of caution,' ... its inclusion nevertheless evidences [ION's] own recognition that the [n]ote could be viewed by investors and regulators as a security subject to the Securities Act.").

Similarly, the lack of risk-reducing factors of the sort contemplated by *Reves*, such as the existence of an alternate regulatory scheme or collateral,[92] does not change the fundamental nature of the Escrow Note and the Tax Receivable Note as short-term commercial loans rather than investments. The fourth factor focuses ultimately on whether the protection of the securities laws is needed.[93] Because of the factors discussed, the Escrow Note and Tax Receivable Note would not trade like a security, but more like a short-term loan provided by a sophisticated party, and thus the protection of the securities laws is not required.

By contrast, the Final Note cannot be described as a short-term bridge loan awaiting a more permanent source of funds, for the simple reason that the Final Note was the permanent source of funds. The economic context of the Final Note differs from that of the first two Notes in that critical respect: ION issued the Final Note because it did not have the cash to meet its short term obligations under the Escrow Note.[94] Thus, the Final Note is most naturally understood as a long-term investment in ION, the proceeds of which ION would use to compensate the Chamberlains in part for selling ARAM to it. In exchange, the Chamberlains received a transferable, long-term debt instrument that offered a high rate of interest payable every three months. The reality that emerges from these objective facts is that the Chamberlains accepted the Final Note with an eye

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[92] *See Reves*, 494 U.S. at 67.

[93] *See id.* (focusing on 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.").

[94] As the reader will recall, ION resolved its obligations relating to the Tax Receivable Note by assigning the Chamberlains the income tax receivable and extinguishing the Tax Receivable Note.

towards the profit that they would make from that high rate of interest and from their ability to resell the Final Note,[95] and that ION used the Final Note to "finance substantial investments."[96] *Reves* describes each of these as investment motives.[97]

Moreover, that the Final Note constituted an investment makes sense in light of the Chamberlains' substantial, post-ARAM acquisition equity position in ION, which suggests that the Chamberlains agreed to the Final Note in part to protect their equity investment rather than as commercial lenders with no stake in the success of the borrower.[98] That is, the Chamberlains were seeking to facilitate the sale of ARAM to ION, in exchange for which they received a substantial equity stake in ION shares. The credit market collapse endangered this transaction with ION, leading the Chamberlains to exchange the Escrow Note and Tax Receivable Note – which were essentially a short-term loan deferring ION's duty to pay the full cash consideration due – for the Final Note, which exposed the Chamberlains to long-term investment risk in ION.[99] Essentially, the Chamberlains exchanged a very short-term loan for a long-term security, thus justifying the much higher rate of interest they demanded to accept the Final Note.

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[95] *See Reves*, 494 U.S. at 68 n.4 (explaining that profit in the context of notes means "a valuable return on investment, which undoubtedly includes interest") (internal citations omitted); *see also Stoiber v. S.E.C.*, 161 F.3d 745, 750 (D.C. Cir. 1998) (favorable interest rates suggest that a note is a security); *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 813 (2d Cir. 1994) (noting that bonds with a fixed rate of return may be regarded as securities).

[96] *See McNabb v. S.E.C.*, 298 F.3d 1126, 1132 (9th Cir. 2002) (the inquiry related to the motivations of the parties is an objective one).

[97] *See Reves*, 494 U.S. at 66 ("If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'").

[98] *See Fox v. Dream Trust*, 743 F. Supp. 2d 389, 401 (D.N.J. 2010) (fact that a note was issued as a way to protect the noteholder's pre-existing investment in the issuer counseled in favor of determining that the note was a security).

[99] *See Fletcher I* at *6.

Respected courts examining notes issued in similar economic contexts have held such notes to represent securities, and I adhere to their reasoning.[100]

This conclusion makes sense and is grounded in reality, because the Final Note is precisely the sort of instrument that investors regularly buy and sell in the secondary markets. Here, the length of the Final Note becomes important. Nine months into the life of the Final Note, the Escrow Period would close and the Chamberlains could market the Final Note as an instrument free of any set off rights, with a capacious four years remaining of promised high yields payable every three months.[101] And, similar to a high-yield corporate bond or debenture, the value at which the Final Note would trade would

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[100] *See Movielab, Inc. v. Berkey Photo, Inc.*, 452 F.2d 662, 663 (2d Cir. 1971) (per curiam), *cited with approval in Exch. Nat. Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1133 (2d Cir. 1976) (Friendly, J.) (long term promissory notes issued in exchange for the assets of a business were securities); *S.E.C. v. Global Telecom Services, L.L.C.*, 325 F. Supp. 2d 94, 114 (D. Conn. 2004); *Private Corporate Advisors, Inc. v. Heard*, 1995 WL 66647, at *8 (S.D.N.Y. Feb. 17, 1995) (notes issued in connection with an acquisition of a company's securities were securities); *Leemon v. Burns*, 175 F. Supp. 2d 551, 559 (S.D.N.Y. 2001) (where noteholder invested $150,000 in a company in return for promissory notes, stock, an appointment to a position of authority in the company, and operational control of the company, the court held the promissory notes were securities); *see also S.E.C. v. Wallenbrock*, 313 F.3d 532, 538 (9th Cir. 2002) ("The notes can hardly be categorized as stop-gap measures to correct for cash-flow difficulties, loans to facilitate the purchase of minor assets, or notes grounded in a traditional commercial purpose. Particularly in light of revelations that the cash infusions kept afloat Wallenbrock's purchases of high-risk start-up companies, it is evident that the notes were used to finance substantial investments.").

[101] The marketability of the Final Note bears importantly on the question of whether it is a security, because it speaks to the likelihood of "common trading for speculation or investment" under *Reves*, 494 U.S. at 66. *See also Banco Nacional De Costa Rica v. Bremar Holdings Corp.*, 492 F. Supp. 364, 369, 369 n.3 (S.D.N.Y. 1980) (where the noteholder "intend[ed] to recover at least some of its expenditure immediately by selling or hypothecating the notes in the secondary market," the court held that "the fact that [the noteholder] sought the advantages of the market place increases its burden of proving that the notes it marketed are not securities."); *compare Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982) (holding that the note in question was not a security in part because the "unique agreement [the parties had] negotiated was not designed to be traded publicly."); *Asset Prot. Plans, Inc. v. Oppenheimer & Co., Inc.*, 2011 WL 2533839, at *4 (M.D. Fla. June 27, 2011) (same).

depend materially on the success of ION's business and its ability to meet its payment obligations under the Final Note.[102] Instruments with characteristics like the Final Note are regularly purchased in today's securities markets, where certain investors specialize in buying and selling debt securities.[103] In that respect, the fact that the Final Note bore a securities legend and contained references to the securities laws lends additional support to my finding that the Final Note is a security. The lengthy term of the Note, its transferability, and its substantial size makes the legend important because transferability of the Note after the Escrow closed to buyers of securities like bonds and debentures was so feasible. The legend represents an acknowledgement that potential investors could

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[102] *Compare Intelligent Digital Sys., LLC v. Visual Mgmt. Sys., Inc.*, 683 F. Supp. 2d 278, 284 (E.D.N.Y. 2010) ("The motivation of the seller is not to invest in the future success of the buyer, where the price to be paid might vary along with the success, or lack thereof, of the buyer's business.").

[103] *E.g.*, Riva D. Atlas, *Company in Trouble? They're Waiting*, N.Y. Times, Jan. 21, 2001, *available at* http://www.nytimes.com/2001/01/21/business/21VULT.html?pagewanted=all (last visited May 23, 2012) (describing investors who specialize in buying and selling debt securities of distressed companies); *The Securities Industry and Financial Markets Association*, *Research Quarterly 2Q* 10 (2011) (noting that "[o]verall demand for [high yield corporate] bonds continued to be exceptionally high due to moderate economic improvement and near-zero benchmark interest rates. As a result, the last three quarters: 4Q'10, 1Q'11, and 2Q'11 were the three largest [high yield] issuance quarters on record at $85.4, $81.5, and $80.3 billion respectively."); *id.* at 11 (indicating that the average daily trading volume for high yield corporate bonds increased between June 2008 and June 2011). As of May 21, 2012, the dollar volume for high yield corporate bond trades exceeded $4 billion. *See* FINRA TRACE Market Aggregate Information, FINRA TRADE Bond Market Activity, *available at* http://cxa.gtm.idmanagedsolutions.com/finra/BondCenter/TRACEMarketAggregateStats.aspx (last visited May 22, 2012) [hereinafter FINRA Market Information]. According to FINRA's data, the ten most active high yield bonds (ranked by par value traded) as of May 21, 2012 are not that dissimilar from the Final Note, with coupon rates ranging from 5.4% to 12.625% and maturity dates ranging from May 2015 to June 2021. *See* FINRA Market Information, Most Active High Yield Bonds. The Final Note bears a higher interest rate than these notes, but matures a few years earlier on September 2013. Although one should not strain the comparison, the reality is that the Final Note does have attributes similar to instruments that trade regularly and this factor makes it impossible to find that the Final Note's presumptive status as a security has been rebutted by strong evidence as is required by *Reves*.

view the Final Note as a security.[104] By contrast, no such legend or references appear on the face of the Jeffries Bridge Note, which is more clearly seen as a commercial loan, despite its transferability.

ION argues that the fact that the Final Note was issued to the Chamberlains as consideration for their sale of ARAM to ION makes it not a security. But that cannot be the test. The Chamberlains received equity as part of the consideration, and surely shares of ION stock are securities.[105] The critical distinction between the Escrow Note and the Tax Receivable Note, on the one hand, and the Final Note, on the other, is that the former Notes were a very short-term form of bridge loan financing that did not represent any long-term investment in ION, whereas the Final Note represented a long-term investment, the value of which was dependent on ION's fate. The reality is that many sellers of businesses receive consideration that in part consists of an investment interest in the buyer, such as equities or junk bonds. The Final Note closely resembles that type of investment, and not a short-term loan arrangement. Nor does any attribute of the Final Note eliminate the need for the protection of the securities laws,[106] the focus of the final factor of the *Reves* analysis.

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[104] *Fletcher I* at *6 n.45 (finding the note's inclusion of a securities legend relevant under the third *Reves* factor, which considers the reasonable expectations of the investing public).

[105] *See Landreth Timber Co. v. Landreth*, 471 U.S. 681, 687 (1985).

[106] Although the Final Note was guaranteed by ION, the Acquisition Sub's parent, which reduces the risk of the Final Note somewhat by "mak[ing] recovery more likely after injury" due to the existence of an alternate source of payment upon default, *Stoiber v. S.E.C.*, 161 F.3d 745, 752 (D.C. Cir. 1998), that guarantee alone, absent any other collateral or insurance, is not the type of risk-reducing factor that courts applying *Reves* have held to rebut the strong presumption that a note is a security. *See Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577 (6th Cir. 2000) (fourth *Reves* factor met when note was heavily collateralized, and the fact that it was guaranteed by the issuer's subsidiary provided an additional point of support); *see also Robyn Meredith, Inc.*

For all these reasons, the undisputed facts demonstrate that the strong presumption that the Final Note is a security under *Reves* has not been rebutted. Thus, under *Fletcher I*, the Final Note is a security as that term is used in the Certificates, and the Acquisition Sub's issuance of the Final Note without obtaining Fletcher's consent violated Fletcher's consent rights under the Certificates.

IV. Conclusion

For the foregoing reasons, Fletcher's motion for partial summary judgment is GRANTED in part and DENIED in part, and ION's motion for partial summary judgment is GRANTED in part and DENIED in part in accordance with this opinion.

IT IS SO ORDERED.

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v. Levy, 440 F. Supp. 2d 378, 386 (D.N.J. 2006) (fourth *Reves* factor not met when note was "uncollateralized, uninsured, and not regulated by any statute or agency," with no mention of whether there was a guarantee). Indeed, courts typically do not mention the presence or absence of a guarantee when examining the fourth *Reves* factor, which suggests that it does not bear importantly on that question. *E.g.*, *Robyn Meredith, Inc.*, 440 F. Supp. 2d at 386. Moreover, bonds and debentures may often be guaranteed by a parent of an issuer; that does not render them not a security as the investor still looks to the health of the issuer and the issuer's parent as the only source of its recovery of value. A parent guarantee is unlike a governmental or third party guarantee that provides a source of protection independent from the health of the issuer and its parent, which are the types of risk-reducing factors that *Reves* identifies as cutting against the need for the application of the securities laws. The ION guarantee is "significantly less valuable than collateral or insurance and not … an adequate substitute for the protection of federal law." *Stoiber*, 161 F.3d at 751. Similarly, courts have rejected attempts to characterize acceleration provisions, such as the cross-default provisions added to the Senior Credit Facility applicable to the Final Note, as an adequate risk-reducing factor for similar reasons. *Id.* at 751-52; *see also Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 813 (2d Cir. 1994) ("[T]he degree of safety of an investment does not call into doubt the applicability of the securities laws.").