Litigation Lookout

PE Industry Guide to Legal Developments

October 2024

ROPES & GRAY

With summer now in the rearview mirror, we are pleased to share another update on recent court decisions and litigation developments with particular relevance to our private equity clients. We hope that this will serve not only as a refresher on several notable developments but also as a guide to the issues that may materialize in the coming months. We welcome your thoughts on topics of particular interest for future issues.

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Developments in Delaware Law

Court of Chancery Imposes Sanctions for Failure to Preserve Text Messages

The Background: In a recent decision, Vice Chancellor Laster of the Delaware Court of Chancery imposed severe pre-trial sanctions in light of the defendants' failure to preserve relevant text messages. In the underlying lawsuit, stockholders of Bioverativ, Inc. claim that Sarissa Capital—with the help of its controlling principal, Alex Denner, who also served as a Bioverativ director—used inside information to octuple its stake in Bioverativ before the company was sold to Sanofi at a substantial premium.

Litigation holds were issued to Mr. Denner and other relevant Sarissa custodians—including its general counsel and head trader—as soon as plaintiffs filed lawsuits challenging the sale of Bioverativ. At the time, Sarissa's outside counsel determined not to collect those custodians' text messages based on the general counsel's representations that (i) neither he nor Mr. Denner texted for business; (ii) Sarissa had a policy against texting for business; and (iii) he had personally looked through Mr. Denner's phone and had found no responsive texts. Outside counsel asked that Sarissa personnel preserve their texts and check in with outside counsel before replacing their phones.

Ultimately, texts were not preserved. Sarissa's head trader never turned off the 30-day auto-delete function that was enabled on his phone. Mr. Denner upgraded his phone to a new model without consulting outside counsel and claimed that the upgrade caused the loss of all of his data. And the general counsel took his phone to be repaired after it fell into a pool and claimed that the repair caused the loss of all of his data.

> Failure to take adequate preservation steps could cause the court to infer that messages that were deleted—even inadvertently—would have supported the plaintiffs' claims.

Vice Chancellor Laster ultimately held that Sarissa failed to take adequate steps to preserve potentially relevant text messages. Importantly, the vice chancellor held that circulating a litigation hold was not enough—Sarissa should have "take[n] steps to ensure that the recipients of the hold" understood what it meant and abided by it, including by having outside counsel (i) conduct custodian interviews as soon as the duty to preserve arises in order to determine where sources of potentially relevant data are located; and (ii) backing up or imaging the relevant devices around the same time.

To remedy the prejudice caused to the plaintiffs, the court imposed severe sanctions, including a presumption at trial that (i) Sarissa purchased Bioverativ stock based on inside information; and (ii) the lost texts would have supported the plaintiff's position. The court also raised the defendants' "standard of proof by one level," from a preponderance of the evidence to "clear and convincing evidence." Six days before trial was scheduled to begin, the parties filed a letter informing the court that they had agreed to settle the case and requesting that the trial be removed from the court's calendar.

The Takeaway: This decision is the latest development in a growing trend whereby courts and regulators second-guess defendants' preservation efforts and impose substantial merits-based penalties for failures to preserve potentially relevant documents. It also shows that the Court of Chancery expects defendants and their counsel to actively preserve potentially relevant documents, including text messages, and that simply sending a litigation hold and presuming compliance may no longer be sufficient. Failure to take adequate preservation steps could cause the court to infer that messages that were deleted—even inadvertently—would have supported the plaintiffs' claims. At a minimum, document preservation issues may cause the court to disregard witness testimony about the nature of the deleted messages, which can similarly undermine defendants' ability to present an effective case at trial.

Potential Consequences of Omitting Legal and Financial Advisor Fees From Transactional Disclosures

The Background: In two decisions issued in March and May of 2024, the Delaware Supreme Court reinforced that the favorable standard of review for conflicted controller transactions under *Kahn v. M&F Worldwide Corp.* (which offers business judgment rule protection where the transaction is approved by a fully empowered, independent special committee and a fully informed majority of the minority stockholders) provides no protection for issuers who do not disclose material advisor conflicts. And, in a third decision issued in May of 2024, the Delaware Court of Chancery held that disclosures made to stockholders who have not been asked to vote (and whose only decision is whether to tender their shares for appraisal) must similarly disclose all material advisor conflicts.

In the first of the three decisions *(Brookfield),* the Delaware Supreme Court reversed the Court of Chancery's dismissal of claims challenging a squeeze-out merger pursuant to which Brookfield Asset Management acquired the remaining 38% of shares in Terraform Power, Inc. that it did not already own. The court found that the minority stockholder vote was not fully informed, and that *MFW*'s requirements were therefore not met, because the proxy statement did not disclose that Morgan Stanley, one of the special committee's two financial advisors, had invested $470 million in Brookfield-affiliated entities. The court also held that the proxy was misleading because it stated that Morgan

Stanley "may have committed and may commit in the future to" invest in funds managed by Brookfield, despite the fact that it had already invested in those funds. In so holding, the court accepted the plaintiffs' allegation that the $470 million was held for Morgan Stanley's own benefit.

The *Brookfield* decision also addressed disclosures concerning legal advisors, as the court held that the proxy statement improperly failed to disclose that the special committee counsel was concurrently representing Brookfield in other matters at the time of the transaction. The court concluded that an advisor's "concurrent engagement with a transaction counterparty can present legitimate concerns" warranting disclosure.

These decisions underscore the Delaware courts' continuing focus on advisor conflicts and related disclosures and the corresponding importance of ensuring that transactional disclosures regarding advisors' potential conflicts of interest are fully and fairly disclosed in a common sense and plain English way.

In the second of the three decisions *(Inovalon)*, the Delaware Supreme Court reversed the Court of Chancery's dismissal of claims challenging the acquisition of Inovalon Holdings, Inc. by a consortium led by Nordic Capital. The transaction involved a significant equity rollover from Inovalon's founder and CEO, who controlled approximately 86% of the company's voting power. The court found that the minority stockholder vote was not fully informed, and that *MFW*'s requirements were not satisfied, because the proxy statement (i) did not disclose that affiliates of Evercore—one of the special committee's advisors—were concurrently representing members of the buyer consortium in unrelated transactions; (ii) disclosed that J.P. Morgan—another advisor to the special committee—received $15.2 million in fees for past work from Nordic, but did not disclose that J.P. Morgan had received between $34 million and $383 million in fees for past work from other members of the buyer consortium in the same period; and (iii) did not disclose the fees that J.P. Morgan anticipated earning for concurrent services it was providing to members of the buyer consortium. The court also noted that the proxy statement overstated Evercore's role in the deal process.

In the final of the three decisions *(Foundation Building Materials)*, the Delaware Court of Chancery sustained claims challenging the sale of Foundation Building Materials, Inc., which was controlled by a private equity sponsor, to a third party. The plaintiffs alleged that Foundation Building Materials' sponsor was uniquely incentivized to support a sale transaction because it stood to receive a significant early termination payment under a Tax Receivable Agreement upon a change in control. The transaction was approved by written consent, but the court held that the public stockholders were still entitled to the level of disclosure they would have received had they been asked to vote on the transaction, as the stockholders needed such information to make a fully informed decision as to whether to exercise their appraisal rights. The court ultimately sustained fiduciary duty claims against the company's directors because the information statement did not disclose, among other things, (i) that the special committee's advisors—RBC and Evercore—would receive contingent success fees based in part on the consideration that Foundation Building Materials' private equity sponsor would receive under the Tax Receivable Agreement in connection with the deal; and (ii) RBC's deep relationship with the sponsor, including the more than $70 million in fees that it had received from the sponsor over a 2.5-year period. The decision also reached the novel holding that, at least in the Vice Chancellor's view, special committee advisors should not receive contingent compensation.

The Takeaway: These decisions underscore the Delaware courts' continuing focus on advisor conflicts and related disclosures and the corresponding importance of ensuring that transactional disclosures regarding advisors' potential conflicts of interest are fully and fairly disclosed in a common sense and plain English way.

Delaware State Legislature Amends the Delaware General Corporation Law to Address Common Law Developments

The Background: Recently, the Delaware state legislature amended the Delaware General Corporation Law (DGCL) to address a recent series of surprising decisions by the Chancery Court: (i) *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, which limited the enforceability of numerous provisions found in a typical agreement between a company and major stockholders; (ii) *Crespo v. Musk*, which foreclosed target companies in failed mergers from pursuing lost stockholder premia as damages; and (iii) *Sjunde AP-fonden v. Activision Blizzard, Inc.*, which held that for a board to approve a merger agreement, that merger agreement presented to the board for approval must be "essentially complete."

Stockholder Agreements. The *Moelis* decision's impact on stockholder agreements drove many of the amendments, including the creation of subsection (18) to Section 122 of the DGCL. The new subsection provides that a corporation can enter into contracts allocating governance rights to current or prospective stockholders, although such contracts cannot include provisions that violate the corporation's charter or Delaware law more generally.

The scope of delegable authority is limited by both the corporation's charter and Delaware law more broadly, such that the board cannot contract away powers it does not have. As with other contracts, the corporation must receive consideration, although the consideration need not be monetary. Consideration for consent rights can include inducing or refraining from certain actions, such as facilitating an IPO or refraining from pursuing an activist proxy campaign. Notably, the amendments do not alter the fiduciary duties of directors or existing standards of review, and the revised statute specifically exempted ongoing litigations. So there are some number of cases in which the Delaware courts will continue to apply the prior statute and case law to determine whether the challenged stockholder agreement violates the DGCL. With the exception of those legacy litigations, this new DGCL provision applies to all Delaware corporations—including those with existing stockholder agreements that included the types of provisions later questioned by the *Moelis* decision.

Merger Agreement Remedies. The amendments also address the Court of Chancery's holding in *Crespo v. Musk*, which stated in dicta that a target company in a failed merger cannot directly recover lost stockholder premium damages. Specifically, the amendments clarify the ability of parties to a merger to agree to lost stockholder premia as a remedy available in the event of a failed merger.

The amendments address this issue with subsection (a)(1) to Section 261 of the DGCL to clarify that parties to a merger agreement may contract for penalties or consequences for a breach of the merger agreement that occurs prior to the effective time, and that these penalties and consequences are enforceable regardless of any otherwise applicable provisions of contract law (such as those addressing liquidated damages and unenforceable penalties). So long as the parties contract for it, a target corporation has the right to enforce and retain the benefit of such lost premia agreements. The amendments also add subsection (a)(2) to Section 261 to clarify that parties to an agreement may provide for the appointment of one or more persons to act as a representative to enforce stockholders' rights under the agreement.

Corporate Approval Process. Finally, the amendments address the corporate process to approve a merger agreement. The DGCL contemplates that the board will first adopt a resolution approving the agreement, which will then be executed and submitted to stockholders. In its recent decision in *Sjunde AP-fonden v. Activision Blizzard, Inc.*, the Court of Chancery held that a merger agreement approved by the board must be "essentially complete." The amendments address this holding by adding Section 147 to the DGCL. Under this new section, the agreement approved by the board must be in final form or "substantially" final form. The amendments do not define "substantial," but the synopsis provided to the Delaware General Assembly in connection with the amendments contemplated that the agreement will be in substantially final form if all of the material terms are set forth therein or determinable through other information or materials presented to or known by the board.

Delaware Supreme Court Affirms Use of *MFW* Cleansing Outside of Squeeze-Out Transactions

The Background: In April, the Delaware Supreme Court ruled that both of *MFW*'s protections (approval of the transaction by an independent and fully empowered special committee and the company's non-controlling stockholders) are required for transactions involving interested controlling stockholders to receive business judgment review. Absent both of *MFW*'s protections, Delaware's harshest standard of review, entire fairness, will apply. Further, the court held that *all* members of a special committee must be independent of the controller for the transaction to receive *MFW*'s cleansing effect.

The ruling comes in the context of a reverse spinoff of Match.com by IAC. Through ownership of Match.com's super voting class B shares, prior to the spin IAC controlled 98.2% of Match.com's voting power despite only controlling 24.9% of its outstanding common stock. IAC announced an intent to separate from Match.com and conditioned any transaction on the approval of an independent special committee and a fully informed stockholder vote. After negotiation, Match.com's special committee, which included Thomas McInerney (a former IAC executive), approved the transaction. Match.com's stockholders voted on the transaction, which included Match.com paying a pre-separation dividend (primarily to IAC), Match.com guaranteeing IAC's debt, and IAC's near-term governance control of Match.com despite the reclassification of Match.com's structure into a single class of common stock with no controlling stockholder.

Plaintiffs challenged the reverse spinoff as an unfair controlled transaction given that IAC, as controller, stood on both sides. The Court of Chancery granted the defendants' motion to dismiss, finding that the transaction satisfied *MFW* and was therefore subject to deferential business judgment review. Although the Court of Chancery found that McInerney lacked independence from IAC, it concluded that a majority of the special committee was independent and that McInerney failed to infect or dominate the special committee's consideration of the transaction.

On appeal, plaintiffs challenged the trial court's ruling that an *MFW* special committee may include non-independent

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members and that the stockholder vote was fully informed. In addition to defending the trial court's decision, the defendants argued that because the reverse spin-off was not a squeeze-out transaction, they only needed to satisfy one of *MFW*'s safeguards in order to trigger business judgment review.

In determining that both *MFW* protections are required to "cleanse" non-squeeze-out transactions and avoid entire fairness review, the Delaware Supreme Court held that transactions involving conflicted controlling stockholders are inherently subject to entire fairness and that application of a single *MFW* protection shifts the burden of proof but does not alter the standard of review.

In addition to requiring the presence of both *MFW* procedural protections for a transaction to receive business judgment review, the Court held that the special committee must be entirely, and not just majority, independent. The court reasoned that the inclusion of a non-independent special committee member fails to disable a controller's inherent coercion. Accordingly, because the Court of Chancery found that McInerney lacked independence from IAC, the Match.com special committee was not wholly independent, and the transaction did not comply with the *MFW* protections.

The Takeaway: This decision highlights the importance of selecting independent directors for special committees, particularly in the context of controller transactions. This includes thorough diligence for actual and potential conflicts, and an open dialogue among committee members regarding any conflicts that might arise during the process. In addition, the decision highlights the Delaware courts' continuing suspicion of controlling stockholder transactions in which the controller is receiving some non-ratable economic benefit. The decision clearly evidences the court's view that both *MFW* protections are necessary to simulate arm's-length bargaining with the controller and ensure that the transaction is not coercive.

Delaware Plaintiffs Attack Net Operating Loss Poison Pills

The Background: Following the rash of litigation challenging "acting in concert" provisions within advance notice bylaws, stockholder plaintiffs' firms have begun challenging net operating loss (NOL) poison pills that use similar language. In these cases, plaintiffs have alleged that agreement, arrangement, and understanding clauses (AAUs) in advance notice bylaws that require a nominating stockholder to disclose coordination with other stockholders, as well as related "daisy chain" provisions imputing agreements between third parties to the nominating stockholder, infringe on the stockholder franchise, are facially unreasonable, and cause a board to breach its duty of loyalty when it enacts or fails to repeal such bylaws. Such provisions are common within NOL poison pills, which are implemented to dissuade stockholders from triggering ownership changes that result in the loss of valuable NOLs. Given the tax code's complex aggregation principles, unforgiving nature, and harsh punishment for an ownership change, relatively broad poison pills may be situationally appropriate to avoid adverse outcomes.

Plaintiffs have primarily targeted companies that are in the process of renewing their NOL poison pills in connection with an upcoming proxy. Usually, these renewed poison pills are unchanged from the poison pills that were previously in place. Nonetheless, plaintiffs' complaints allege that, in service of entrenching incumbent directors, AAUs and "daisy chains" in these NOL poison pills are facially invalid, go beyond what is required by the tax code's aggregation principles, and chill the stockholder franchise.

Rather than litigate plaintiffs' claims, most companies faced with such a challenge to their NOL poison pills have chosen to moot plaintiffs' complaints. They have done so with simple revisions to the language of their poison pills, making clear that the tax code and relevant regulations limit stockholder aggregation by the terms of their pills.

The Takeaway: We expect complaints challenging NOL poison pills will continue to be filed until the law around this issue becomes better developed. However, at present, the cost of litigating these provisions is likely higher than the cost of simply amending the pill, which incentivizes further complaints and reduces the likelihood of new decisional law addressing the merits of these claims. Accordingly, companies with NOL poison pills should closely examine the pill's language, consider targeted revisions of the pill where appropriate, and ensure that the board implements best practices on the process of implementing or renewing the pill.

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Delaware Supreme Court Clarifies the Standard Required to Challenge Bylaws

The Background: In July, the Delaware Supreme Court clarified the appropriate standard for evaluating facial challenges to corporate bylaws. The decision addressed a long-running activist battle between AIM ImmunoTech and certain of its stockholders. In connection with that dispute, AIM adopted a set of advance notice bylaws and applied those bylaws to reject the dissident stockholders' submission in support of their board nominations. Although the Court of Chancery upheld the corporation's decision

to reject the notice, it struck down several of the bylaws as disproportionate to the threat faced by the corporation.

On appeal, the Delaware Supreme Court held that bylaws are presumed to be valid, and a "facially valid bylaw is one that is authorized by the Delaware General Corporation Law (DGCL), consistent with the corporation's certificate of incorporation, and not otherwise prohibited." As such, a bylaw is only facially invalid when it is invalid in all circumstances. The Supreme Court therefore reversed the Court of Chancery's holding that a number of provisions in AIM's advance notice bylaws were deficient, but affirmed that one provision was invalid because it was simply "incomprehensible."

Turning to the as applied challenge, the court held that bylaws adopted, amended, or enforced in response to a threat, or looming threat, are still reviewed under an enhanced scrutiny standard. This requires a court to review both the board's intent in implementing the bylaws and whether the bylaws were proportional to the threat they were intended to address. If the bylaws fail either one of these tests, they are presumed to be unenforceable. The court held that a number of the bylaws were unenforceable because they were adopted for an improper motive, but refused to take further action because the dissident stockholders' notice contained false and misleading information.

The Takeaway: The Delaware Supreme Court's clarification of the standard for facial review of bylaws should pare back the number of complaints filed in Chancery challenging bylaws absent a true case or controversy. Corporations should nonetheless consider whether their bylaws are intelligible and clarify any that are overly unwieldy. Similarly, when adopting, amending, or enforcing bylaws that could be viewed as defensive, boards will need to consider the enhanced scrutiny that will be applied to those bylaws and ensure that the board record concerning those bylaws is sufficiently developed to support a strong defense in any eventual litigation.

Developments in Antitrust

Recent Trends in Antitrust Enforcement

The Background: In recent years, antitrust has been a hot topic in government enforcement, with particular focus on private equity investment. Recent events and trends suggest this scrutiny is unlikely to abate soon.

> Private equity is an increasingly high-priority enforcement area for the current administration, and recent trends suggest this is unlikely to slow down.

On March 5, 2024, the FTC hosted *Private Capital, Public Impact: An FTC Workshop on Private Equity in Healthcare*. This panel featured speakers including government regulators and enforcers from the FTC, DOJ, HHS and CMS, and representatives from academia, research institutions, and clinical practice. The workshop further amplified prior statements and positions of FTC Chair Lina Kahn, who has indicated increased scrutiny by the FTC of the "roll-up" strategy employed by financial sponsors to purchase and then merge several businesses in the same sector, enabling consolidation of power and (allegedly) reducing incentives to compete. She also expressed concern about interlocking directorates (more on this later).

The panelists presented a uniformly negative view of sponsors' investments in the health care industry, opining that consolidation will result in higher costs and worse outcomes for patients. The presenters claimed that sponsors invest to realize short-term returns following quick exits, which clashes with the longer-term interests of providers and patients. Broadly, the panelists suggested increasing transparency of ownership to show the extent of a sponsor's investment, allowing the government and the public to hold sponsors accountable more easily. The participating regulators and enforcers identified several potential pathways for future action with respect to private equity investment in health care, including: (1) increased inter-agency collaboration on enforcement of fraud and abuse laws and data sharing regarding ownership, costs, and quality of care; (2) heightened enforcement of antitrust laws at the federal and state level; (3) enhanced scrutiny of non-reportable transactions at the state and federal level; (4) expansion and enforcement of CPOM (Corporate Practice of Medicine) laws; and (5) identification and closure of reimbursement "loopholes." Coincident with the March 5 workshop, the agencies opened a 60-day Request for Information period and are seeking public comments on the impact of private equity acquisitions of health care providers.

Separately, recent trends in the DOJ Antitrust Division's enforcement efforts under Section 8 of the Clayton Act (Clayton 8) indicate another avenue for DOJ and FTC's heightened interest in private equity crackdowns. Clayton 8 prohibits directors and officers from simultaneously serving on the boards of competing companies, with the goal of preventing coordination and exchange of competitively sensitive information. Section 8 prohibits a "person" from serving as a director or officer of two competing corporations if each has capital, surplus, and undivided profits of more than $48,559,000 (increased from $45,257,000) unless one of the following de minimis exemptions is met: the competitive sales of either corporation are less than $4,855,900 (increased from $4,525,700); the competitive sales of either corporation are less than 2% of its total sales; or the competitive sales of each corporation are less than 4% of its total sales. Companies cannot avoid the issue by placing different individuals on competing boards—DOJ interprets Clayton 8

broadly, to cover any individuals under the direction of the same entity.

Until recently, Clayton 8 violations were handled without fanfare: enforcement was uncommon and an interlocking director, once identified, would simply resign. In 2022, the Justice Department declared that Clayton 8 was underenforced, and announced that the Antitrust Division was "undertaking an extensive review of interlocking directorates across the entire economy and will enforce the law." On April 1, 2024, the DOJ reported that it had unwound or prevented interlocks in over two dozen companies. Most recently, two Warner Bros. Discovery directors resigned from the WBD board following DOJ concerns about their simultaneous memberships on the board of WBD and a telecommunications company. Shortly thereafter, John Malone, chairman of Liberty Media Corporation, preemptively resigned from his director role at the telecommunications company, citing the uptick in Clayton 8 enforcement and the WBD resignations specifically. And the DOJ has not stopped at expressing concern: in recent public filings, a large private equity sponsor disclosed that it is subject to a Clayton 8 DOJ investigation.

The Takeaway: Private equity is an increasingly high-priority enforcement area for the current administration, and recent trends suggest this is unlikely to slow down. Financial sponsors should be mindful of this increased government oversight and ever-changing laws and regulations when pursuing expansion opportunities, and continually assess their portfolios to identify risks of interlocking directorates. For public companies, the recent Clayton 8 disclosure raises the specter of potential liability for failing to disclose these investigations. Firms should proactively review their disclosure requirements to determine if any pending investigations meet those thresholds.

Texas Federal Court Dismisses FTC Case against Private Equity Firm

The Background: A recent decision from a federal court in Texas pushes back on the FTC and DOJ's attempts to hold private equity sponsors liable for the actions of their portfolio companies. On May 14, a Texas judge dismissed an action against private equity sponsor Welsh, Carson, Anderson and Stowe (WCAS) for the alleged anticompetitive practices of its portfolio company U.S. Anesthesia Partners, Inc. (USAP). WCAS is a minority investor in USAP; since 2017, only a single WCAS fund has held a 23% ownership interest in USAP with a right to appoint two of USAP's 14 board members.

In the action, the FTC alleged that WCAS and USAP engaged in a "multi-year anticompetitive scheme to consolidate anesthesiology practices in Texas, drive up the price of anesthesia services provided to Texas patients, and boost their own profits." Specifically, the complaint alleged that WCAS created USAP in 2012 to execute a "roll-up strategy" by which USAP would acquire large anesthesiology practices and then enter into or maintain price-setting and market allocation arrangements with its competitors. The FTC argued that receiving profits from an entity that may be violating antitrust laws and continuing to hold stock in USAP constituted ongoing antitrust violations. In its motion to dismiss, WCAS argued, among other things, that the FTC ignored well-established principles of corporate separateness in seeking to hold a private equity sponsor liable for the conduct of its portfolio company.

Sponsors, particularly those engaged in roll-up or serial acquisition strategies, should continue to exercise caution.

On May 14, U.S. District Judge Kenneth Hoyt granted WCAS's motion to dismiss the suit, but denied the motion to dismiss as to USAP. With respect to WCAS, the court found that the FTC had not adequately alleged that WCAS "is violating" antitrust law, because the FTC did not cite "any authority for the proposition that receiving profits from an entity that may be violating antitrust laws is itself a violation of antitrust laws." Further, the FTC "[did] not cite[] a case in which a minority, noncontrolling investor—however hands-on—is liable under Section 13(b) [of the FTC Act] because the company it partially owned made anticompetitive acquisitions." The court refused to adopt this "novel interpretation" of the FTC Act, which would "expand the FTC's reach further than any court has yet seen fit; it would also expand liability to minority investors whose subsidiaries reduce competition."

The Takeaway: This case is a significant victory for WCAS and the private equity industry, and provides guidance on potential antitrust liability by sponsors involved in roll-up acquisition strategies. This decision indicates that private equity firms may be shielded from liability for the alleged anticompetitive actions of their portfolio companies if they hold a minority share; the court's decision emphasized WCAS's position as a minority owner of USAP, and thus would not protect majority owners in similar cases. While this is good news for sponsors, the FTC continues to pursue novel, aggressive enforcement strategies. Sponsors, particularly those engaged in roll-up or serial acquisition strategies, should continue to exercise caution.

Developments in Restructuring

Texas Federal Court Weighs in on Liability Management Transaction

The Background: In our previous round-up, we noted our expectation that there would be more decisions likely to impact the calculus of borrowers and creditors when entering credit facilities or weighing unique financing options, such as "uptier" transactions. Recent rulings from Judge Isgur of the U.S. Bankruptcy Court for the Southern District of Texas do just that. This includes Judge Isgur's summary judgment opinions and judgment following trial in *In re Wesco Aircraft Holdings, Inc.*, which addressed the effects of uptier transactions on nonparticipating creditors. Judge Isgur denied, in part, the debtor's motion for summary judgment on the nonparticipating creditors' breach of contract and tortious interference claims, as well as their good faith and fair dealing claims. Following trial, he held that the transactions at issue violated Wesco's indentures and ordered the parties to unwind the transaction. These decisions follow a line of decisions, at odds with Judge Jones's decisions in *Serta*, that bolster the position of nonparticipating creditors who challenge unique liability management transactions.

Liability management transactions have increasingly been challenged by lenders excluded from newly created credit facilities that give new debt priority over existing debt. Disputes over the permissibility of such transactions under the applicable credit documents often focus on a few key provisions addressing the quantum of lender approval necessary for potential modifications or amendments to the intra-creditor relationship. Minority lender claims have sometimes been permitted to progress into discovery over concern that such terms are ambiguous and capable of multiple interpretations. The implied covenant of good faith and fair dealing has also been invoked by minority lenders in several actions. As a result, even transactions that strictly comply with credit agreement terms may still be vulnerable to the argument that they comply with the letter but not the spirit of the intra-creditor relationship.

Judge Isgur's decisions in *Wesco* dealt with both types of claims mentioned above. Wesco, a provider of supply management services to the global aerospace business, undertook a series of liability management transactions in 2022 to address approximately $2 billion in outstanding debt (the "2022 Transactions"). Wesco subsequently filed for bankruptcy in 2023 and sought a declaratory judgment from the bankruptcy court that the 2022 Transactions complied with the indentures in its credit document and applicable law. The nonparticipating noteholders asserted various counterclaims against Wesco and the participating creditors.

Judge Isgur found that reasonable, factual disputes existed as to whether the 2022 Transactions constituted a "single, integrated transaction," which under the indentures would require a two-thirds vote from pre-transaction noteholders. The court also found that additional fact-finding and adjudication were necessary to determine whether the transaction was subject to the indentures' pro rata redemption requirement—or was instead authorized under the indentures as an open market or privately negotiated transaction. The court then denied summary judgment on the nonparticipating creditors' tortious interference claims, similarly finding that such a determination would ultimately require a broader factual analysis as to whether the 2022 Transactions were contractually permitted in the first instance.

In January, the parties began a months-long trial before Judge Isgur that concluded in June. Following the trial, Judge Isgur issued an oral opinion holding that the 2022 Transactions breached the indentures and ordered Wesco to unwind the 2022 Transactions. Judge Isgur made clear that his decision was not based on a finding that the 2022 Transactions were a single, integrated agreement for analysis of their effect on third parties. Rather, the decision rested on the text of the indenture, which required a two-thirds majority for any transaction that "had the effect" of stripping the liens of the minority noteholders.

The Takeaway: Nonparticipating noteholders who challenge uptier transactions will look to *Wesco* to defeat such transactions and inflict litigation costs on borrowers and counterparties that seek priority among competing creditors. Judge Isgur's decisions largely follow the New York Supreme Court's decision in *Boardriders* and other decisions in which the court has upheld challenges to liability management transactions by nonparticipating noteholders. Those decisions cut against the favorable decision for participating creditors in *Serta* and open the door at summary judgment for nonparticipating creditors to argue that the debt documents used by participating creditors in uptier transactions are "ambiguous and require extrinsic evidence at trial." Stay tuned for further guidance from the courts as parties continue to litigate these controversial transactions.

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Third Circuit Lends Support to Mandatory Appointment of Independent Examiner

The Background: The Third Circuit recently weighed in on a split among courts as to whether Chapter 11 of the Bankruptcy Code mandates the appointment of an examiner

during the bankruptcy process. Some courts, including the Sixth Circuit and many district and bankruptcy courts, have found that section 1104(c) of Chapter 11 mandates the appointment of an examiner when certain conditions are met. Others have found that it merely provides courts with discretion to appoint an examiner. The court in *In re FTX Trading Ltd.*, 91 F.4th 148 (3d Cir. 2024) *("FTX Trading")* took the former approach, finding that the plain text of section 1104(c) mandates the appointment of an examiner.

Section 1104(c) of the Bankruptcy Code provides that courts *shall* order the appointment of an examiner when (1) a plan has not been confirmed; (2) the court does not find cause to appoint a trustee; and (3) the Office of the U.S. Trustee (UST) or any party in interest has requested the appointment. The section further limits the appointment of an examiner to cases in which (a) the court determines that the appointment is in the best interests of creditors, interest holders, or the estate; or (b) the debtor's qualifying unsecured debt exceeds $5 million. The UST moved the bankruptcy court in *FTX Trading* for the appointment of an examiner to investigate FTX's management. The UST argued that appointment of an examiner is mandatory under section 1104(c)(2) if requested by the UST and if "the debtor's total fixed, liquidated, unsecured debts" exceed $5 million—one of the conditions set forth in section 1104(c). The bankruptcy court disagreed with the UST, finding persuasive the arguments made in a joint opposition by the official unsecured creditors' committee, the debtors, and the joint liquidators of a non-U.S. affiliate that section 1104(c) should be read as giving the court discretion to appoint an examiner, but not mandating such appointment.

The UST appealed the bankruptcy court's decision to the Third Circuit, which found that appointment is mandatory under section 1104(c). The Third Circuit explained that the issue was one of statutory interpretation and the bankruptcy court should not have read "shall" to mean "may" by construing other language in the statute as modifying the section's obligatory command. The Third Circuit also looked to the legislative history of the provision and found that it supported the conclusion that appointment is mandatory. In January 2024, the debtors declined to seek U.S. Supreme Court review of the decision.

The Takeaway: Large and medium-sized debtors in bankruptcy proceedings should know about the potential impacts the *FTX Trading* decision will have on future bankruptcy cases. The Third Circuit has bolstered the majority view, now held by two circuit courts, that the appointment of an examiner in such cases is mandatory, which may be followed by other jurisdictions going forward. The decision may be particularly impactful given the number of corporate bankruptcies that are filed in bankruptcy court in Delaware. Stay tuned for future updates as other circuits address the examiner appointment provisions of Chapter 11 considering the Third Circuit's decision.

Developments in Administrative Law

The Supreme Court's Decisions in *Jarkesy* and *Loper Bright*

The Background: The Supreme Court's most recent term featured a series of decisions that reshaped longstanding tenets of administrative law and signaled its willingness to take a robust and skeptical approach to judicial review of agency actions.

In *SEC v. Jarkesy* *("Jarkesy")*, the Supreme Court held that the SEC violated the Seventh Amendment in using administrative tribunals to adjudicate securities fraud claims seeking civil penalties. Writing for the Court, Chief Justice Roberts established that the SEC's action against George Jarkesy Jr.—an investment adviser to private funds—implicates the Seventh Amendment's right to a jury trial because the relevant SEC antifraud provisions "replicate common law fraud." The Court acknowledged some differences between federal securities fraud and common law fraud but reasoned that the two were sufficiently similar for the Seventh Amendment's jury trial protections to apply. Roberts's opinion emphasized that the key consideration for determining whether a claim implicates the Seventh Amendment is the remedy sought. Roberts noted that, while monetary relief can be legal or equitable, "money damages are the prototypical common law remedy." Moreover, Roberts stated that the civil penalties (i.e., monetary fines) sought in *Jarkesy* were legal in nature because they were designed to punish or deter the defendant, rather than solely to "restore the status quo." The Court also held that the public rights exception—under which Congress can assign a matter for decision to an agency without a jury—did not apply, quoting its decision in *Granfinanciera, S. A. v. Nordberg,* 492 U. S. 33, 52 (1989); Congress cannot "conjure away the Seventh Amendment by mandating that traditional legal claims be . . . taken to an administrative tribunal."

Arguably the Supreme Court's most prominent administrative law decision was the 6-3 ruling in *Loper Bright Enterprises v. Raimondo* *("Loper Bright")*, in which the Court overruled *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* (1984) *("Chevron")*. *Chevron* held that, where statutory ambiguities exist, federal judges must generally defer to the interpretation of regulating agencies. Writing for the majority, Chief Justice Roberts reasoned that *Chevron* deference was inconsistent with both the federal judiciary's constitutional

The Supreme Court's decisions from this most recent term represent a meaningful shift in the judiciary's approach to agency action.

duty to say what the law is, as well as Section 10(c) of the Administrative Procedure Act (APA), which states that courts "shall decide all relevant questions of law." Roberts noted that courts routinely confront statutory ambiguities without deferring to external parties, whereas agencies possess "no special competence in resolving statutory ambiguities." Roberts also explicitly stated that the decision "do[es] not call into question prior cases that relied on the Chevron framework," though Justice Kagan's dissent (joined by Justices Sotomayor and Jackson) argued that *Loper Bright*'s mandate is likely to lead to increased challenges to regulatory actions and "large-scale disruption." *Loper Bright* represents a significant change in the Court's administrative law jurisprudence though not necessarily a surprising one; even before the decision in *Loper Bright,* legal commentators had observed that the Supreme Court has not cited *Chevron* since 2016.

It remains to be seen how lower courts will react to *Loper Bright*. *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944) offers a lower form of deference that could apply to cases involving agency interpretations of statutes. Moreover, *Loper Bright* recognized that "when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it." Some legal commentators have observed that this leaves the door open for lower courts to simply determine that a particular statute delegates discretionary authority to the agency.

The Takeaway: Beyond the specific effects of *Jarkesy* and *Loper Bright* themselves, the Supreme Court's decisions from this most recent term represent a meaningful shift in the judiciary's approach to agency action. Although the full impact of these decisions will play out in lower-court litigation in the coming years, the decisions at a minimum suggest that some courts are increasingly open to challenges to agency authority. For additional insights regarding these decisions and their implications for regulated entities please refer to Ropes & Gray's podcast on SCOTUS and the Future of the Administrative State.

For more information on any of these developments, or if you would like to speak with someone with particular expertise in any of these areas, please contact your regular Ropes & Gray advisor or any member of the Ropes & Gray litigation department.

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