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Potential Impact of Sen. Warren's "Stop Wall Street Looting Act of 2021

Celesq® AttorneysEd Center
www.celesq.com

5301 North Federal Highway, Suite 150, Boca Raton, FL 33487
Phone 561-241-1919

Stop Wall Street Looting Act of 2021

ROPES & GRAY

Summary

- On October 20, 2021, Senator Elizabeth Warren, joined by Bernie Sanders among others, introduced the Stop Wall Street Looting Act of 2021 (S. 3022; H.R. 5648) (the "SWSLA"), which proposes significant changes to fundamental principles of corporate and bankruptcy law

  - The full text of the SWSLA can be found at https://www.govinfo.gov/content/pkg/BILLS-117s3022is/pdf/BILLS-117s3022is.pdf.

- The SWSLA is a re-worked version of legislation previously proposed in 2019 and has prompted responses from various academics, practitioners and other commentators:

  - *See* Gregg M. Galardi, Ryan Preston Dahl & Mark Maciuch, *Stop Looting the Bankruptcy Code: Stop Wall Street Looting Act Proposes Substantial Changes to the Bankruptcy and Key Principles of Corporate Law*, ROPES & GRAY LLP, https://www.ropesgray.com/en/newsroom/alerts/2021/November/Stop-Looting-the-Bankruptcy-Code-Stop-Wall-Street-Looting-Act-Proposes-Substantial-Changes.

  - *See In Financial Times, Ryan Preston Dahl Discusses Potential Impact of Proposed Bankruptcy Legislation*, ROPES & GRAY LLP, https://www.ropesgray.com/en/newsroom/news/2021/December/In-Financial-Times-Ryan-Preston-Dahl-Discusses-Potential-Impact-of-Proposed-Bankruptcy-Legislation.

  - *See* Sujeet Indap, *Warren's anti-'looting' crusade is about fundamental accountability*, FINANCIAL TIMES, file:///C:/Users/mmaciuch/Downloads/LNFT245finallocked.pdf.

Summary

- The SWSLA seeks to, among other things:
  - ❑ make financial sponsors (i.e., private equity firms) jointly and severally liable for all liabilities of their portfolio companies;
  - ❑ create a presumption under the Bankruptcy Code that certain “change in control transactions” are fraudulent transfers;
  - ❑ address so-called “sham” independent directors by vesting the official committee of unsecured creditors with the exclusive right to bring certain avoidance actions, or actions against insiders; and
  - ❑ increase protections for employees in bankruptcy cases by increasing the amount and priority status of certain wage claims, limiting executive compensation in bankruptcy cases, and directing bankruptcy courts to favor “employee-friendly” asset sales
- If passed in its current form, the SWSLA would completely reform the private equity industry and American corporate and bankruptcy law

SWSLA Title I

- Title I, Section 101 provides that:

> *"Notwithstanding any other provision of law, or the terms of any contract or agreement, a **controlling private fund**, and any holder of an active interest with respect to a controlling private fund, shall be **jointly and severally liable for all liabilities** of each target firm for which the controlling private fund is a **control person**, and for all liabilities of any affiliate of each such target firm"*

- A "controlling private fund" is any private fund that becomes a "control person" through a "change in control transaction" in that it (i) holds with power to vote 20% or more of the target firm (i.e., portfolio company), (ii) operates the target firm under an operating or management agreement; or (iii) otherwise has the ability to direct the actions of the target firm

- A "change in control transaction" is a change in the economic interest of the target firm with respect to the power to vote more than 50% of any class of voting securities or any lesser percentage that gives the acquirer the ability to direct the action of the corporation

SWSLA Title I

- Section 101 would make controlling private funds liable for virtually all debts of their portfolio companies, including:
  - ❑ any financial debt of the portfolio company;
  - ❑ any federal or state civil monetary penalties, or obligations under settlement agreements with government authorities;
  - ❑ any liability arising from violations of Section 3 of the Worker Adjustment and Retraining Notification Act (WARN Act) by the portfolio company, or an affiliate of the portfolio company;
  - ❑ any withdrawal liability determined under part 1 of subtitle E of the title IV of the Employee Retirement Income Security Act of 1974 (ERISA) that is incurred by the portfolio company, or an affiliate of the portfolio company; and
  - ❑ any claim for unfunded benefit liabilities owed to the Pension Benefit Guaranty Corporation under subtitle D of title IV of ERISA with respect to the termination of a pension plan by the portfolio company, or an affiliate of the portfolio company
- Further, SWSLA Title I, Section 102 voids as a against public policy any obligation of a portfolio company, or any of its affiliates, to indemnify a controlling private fund for any such liabilities

SWSLA Title I

- Limited liability and corporate separation are core principles of American corporate law and capital markets generally

- Causing equityholders to become de facto (and de jure) guarantors for substantially all the liabilities of a wholly separate corporate entity run contrary to such principles

SWSLA Title II

- SWSLA Title II, Sections 202(a) and (b) seek to:
  - ❑ carve out transfers made in connection with "change in control transactions" from the safe harbor protections of Section 546(e) of the Bankruptcy Code; and
  - ❑ create the presumption under section 548(a)(1)(A) of the Bankruptcy Code that actual and constructive fraud occurred with respect to:
    - any transfer made to or obligation incurred by the debtor or an affiliate in connection with a "change in control transaction" in the 8 years prior to a bankruptcy filing; or
    - any transfer made or obligation incurred by the debtor to or from a "control person," an affiliate or an insider during a "protected period" (i.e., the shorter of the 8 years prior to a bankruptcy filing, or a public offering of the portfolio company)

SWSLA Title II

- The SWSLA proposes to amend Section 546(e) of the Bankruptcy Code as follows:

"Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, ***and except in the case of a transfer made in connection with a change in control transaction, as defined in section 3 of the Stop Wall Street Looting Act, or during the protected period, as defined in section 548(f) of this title****, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title."*

SWSLA Title II

- The SWSLA proposes to add a new Section 548(f) and (g) to the Bankruptcy Code:

Section 548(f) - "For purposes of this section [548], if the debtor is a target firm, the debtor is presumed to have made a transfer or incurred an obligation described in subparagraphs (A) and (B) of subsection (a)(1) [of section 548] if:

(A) the transfer was made to or obligation was incurred by the debtor or an affiliate in connection with a change in control transaction; or

(B) during a protected period—

(i) the transfer was made by the debtor or an affiliate to a control person, an affiliate, or an insider; or

(ii) the obligation was incurred by the debtor or an affiliate from a control person, an affiliate, or an insider."

Section 548(g) - "The trustee may avoid under subsection (a) a transfer of an interest of the debtor in property or any obligation incurred by the debtor on or within—

(1) 8 years before the date of the filing of the petition if the transfer was made or obligation incurred in connection with a change in control transaction, as defined in section 3 of the Stop Wall Street Looting Act; or

(2) 2 years before the date of the filing of the petition for all other transfers and obligations."

SWSLA Title II

- Again, these proposed changes seem to contradict traditional legal concepts of what is (or is not) "fraud"

  - *See* Fed. R. Civ. P. 9(b). – "Fraud or Mistake; Conditions of Mind. In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

- Additionally, it is unclear how investors and the capital markets will react when required to fund transactions that are deemed to be fraudulent

SWSLA Title II

- SWSLA Title II, Section 202(e) seeks to eliminate so-called "sham" independent directors by giving the official committee of unsecured creditors the exclusive right to bring avoidance actions, or actions against insiders
- The SWSLA proposes to amend Section 1107 of the Bankruptcy Code to adding a new subsection (c):

"[I]f a debtor in possession is serving in a case under this title, a committee of creditors appointed under section 1102 of this title shall have the exclusive right of a trustee serving in a case under this chapter to bring or settle on behalf of the estate—

(1) an action under section 544, 547, 548, or 553 to avoid a transfer made or obligation incurred by the debtor in connection with a change of control transaction, as defined in section 3 of the Stop Wall Street Looting Act; or

(2) an action against an insider, a former insider, or an agent or aider and abettor of an insider or former insider"

SWSLA Title II

- A baseline proposition of American bankruptcy law is that the debtor in possession stands as a fiduciary for all stakeholders
- The bankruptcy process involves the balancing of a number of stakeholder interests – i.e., secured creditors, administrative creditors, priority creditors, general unsecured creditors, etc.
- The prosecution of estate causes of action such as the avoidance actions or claims against insiders are not viewed through the narrow lens of how such prosecution benefits any one stakeholder constituency

SWSLA Title II

- Granting an exclusive right to this particular estate asset to a single stakeholder constituency is hard to be seen as anything other than an attempt to create a favored creditor class at the expense of other stakeholders
  - ❑ The official committee of unsecured creditors is not a fiduciary for all stakeholders; it serves as a fiduciary for unsecured creditors alone
  - ❑ The official committee of unsecured creditors has no fiduciary obligation to maximize value for other stakeholders and may be incentivized to use litigation or the threat of litigation to extract a recovery where unencumbered value is scarce
  - ❑ Nowhere else does the Bankruptcy Code vest a particular stakeholder class with control over any particular asset in this fashion
- This proposal also disregards the Bankruptcy Code's priority scheme by giving this estate asset to unsecured creditors who stand junior to administrative and priority creditors (in terms of unencumbered value)

SWSLA Title III

- SWSLA Title III seeks to increase protections for employees in bankruptcy cases by:
  - ❑ increasing the priority claim amount for unpaid wages, severance, and employee benefit plan contributions from $13,650 to $20,000, and eliminating the 180-day prepetition cut of date;
  - ❑ elevating the priority of claims arising from unpaid severance or employee benefit plan contributions, or WARN act violations to administrative expense status;
  - ❑ eliminating any compensation, bonus, or severance payments to senior executives of the debtor, and the next 20 highly compensated employees;
  - ❑ prohibiting the approval of any payments to insiders, senior executives, highly compensated employees or consultants if the debtor has not paid severance or has reduced employee benefits in the year prior to filing for bankruptcy;
  - ❑ blocking plan confirmation if any insider, senior executive, etc. receives any payments not generally applicable to employees or are excessively disproportionate to non-management workforce;
  - ❑ granting a surcharge on collateral for all unpaid wages and benefits for services rendered during the bankruptcy cases;
  - ❑ giving the United States Trustee power to avoid payments to executives in violation of the aforementioned provisions; and
  - ❑ directing bankruptcy courts, when assessing multiple bids for a debtor's assets under Section 363 of the Bankruptcy Code, to give substantial weight to the bid that best preserves the jobs of the debtor's workforce

Other SWSLA Provisions

- Other notable SWSLA provisions include:
  - ❑ granting priority treatment under the Bankruptcy Code to gift card claims;
  - ❑ eliminating the time limit imposed under Section 365(d)(4) of the Bankruptcy Code for retail debtors to decide to assume or reject commercial real estate leases;
  - ❑ eliminating “carried interest” under the Tax Code;
  - ❑ enhancing SEC reporting/disclosure requirements for private equity funds; and
  - ❑ limiting risk sharing through loan syndications

Conclusion

- The SWSLA has drawn support and criticism:
  - ❑ The U.S. Chamber of Commerce issued a full report in 2019, and published another letter in 2021, criticizing the SWSLA and the potential for enormous loss of market capital and jobs
    - https://www.uschamber.com/improving-government/us-chamber-letter-the-stop-wall-street-looting-act
    - https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/11/Swenson-Chamber-Economic-Impact-Analysis-Report-Stop-Wall-Street-Looting-Act-FINAL-002.pdf
  - ❑ The Center for Economic and Policy Research published a letter and research in support of the SWSLA, casting doubt on the purported benefits of private equity firms and their ability to outperform the market
    - https://cepr.net/letter-to-sen-warren-on-stop-wall-street-looting-act/
- The House and Senate versions of the bill remain in the introductory legislative phases and have not yet been referred for committee review