April 21, 2022

Via E-Filing

Mr. Blake Hawthorne
Supreme Court of Texas

Re: No 22-0227, *In re First Reserve Management, L.P.; First Reserve Corporation, L.L.C.; FR XII Alpha AIV, L.P.; FR XII-A Alpha AIV, L.P.; FR Sawgrass, L.P.;* and *Sawgrass Holdings, L.P.*

Dear Mr. Hawthorne:

The Chamber of Commerce of the United States of America ("Chamber") and the Texas Association of Business ("TAB") submit this letter brief as *amici curiae* in the above matter.[1] In the view of the Chamber and TAB, the petition for a writ of mandamus should be granted.

INTRODUCTION

Limited liability is a foundational principle of corporate law. Investors generally cannot be held liable for the torts of the corporations in which they invest because corporations are distinct legal entities. There are narrow exceptions to this principle for investors who abuse the corporate form to shield their own wrongful and fundamentally unjust actions. But across the country—including in Texas—these exceptions are rare and require truly extraordinary circumstances.

This case presents no extraordinary circumstances that could justify holding petitioners ("First Reserve Investors") liable for torts allegedly committed by the company in which they invested, TPC Group LLC ("TPC"). Rather, what is extraordinary about this case is that the lower court's decision would allow litigation against the First Reserve Investors to proceed based on allegations that the Investors merely: appointed a minority of TPC's board members, had review authority over certain major TPC expenditures, and provided TPC management advice. Each of these three business practices is commonplace among private-equity and venture capital firms seeking to

[1] No entity or person, aside from *amici curiae*, their members, or their counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

protect and support their investments. Indeed, these actions are so common and so well-known that they are openly discussed in treatises about private equity and in industry publications.

Allowing the plaintiffs' veil-piercing and negligent-undertaking claims against the First Reserve Investors to proceed would instantly make Texas a legal outlier. Other states adhere to the well-established rule that veil-piercing and alter-ego determinations are rare and require exceptional circumstances manifesting injustice. But unless this Court intervenes, Texas law would have a new, gaping exception for all private-equity investors who follow their industries' best practices for protecting legitimate investments in legally distinct and functionally independent companies.

Such an exception would inevitably weaken the Texas economy because capital, even more freely than people, can vote with its feet. Texas's business-friendly climate has attracted substantial private-equity investment: Texas is home to 1,061 private-equity-backed companies and private equity directly employs just over 1 million Texans who earn a combined $82 billion in annual wages and benefits. *See infra*. But if private-equity investors face protracted litigation and potential liability based on the actions of the companies in which they invest, they are likely to flee Texas for jurisdictions that do not impose such a significant legal risk, and no public benefit will offset this exodus of capital from the state.

This Court should grant the petition for a writ of mandamus.

ARGUMENT

I. Subjecting private-equity investors to liability for the torts of legally distinct companies contradicts fundamental principles of corporate law.

A. "A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." *Dole Food Co. v. Patrickson*, 538 U.S. 468, 474 (2003). A corollary to this basic tenant is the doctrine of limited liability: A shareholder is generally not liable for the acts of the corporation. *United States v. Bestfoods*, 524 U.S. 51, 61 (1998). *See also Anderson v. Abbott*, 321 U.S. 349, 362 (1944).

Deviating from this foundational rule of corporate law generally requires "fraud or certain other exceptional circumstances." *Dole Food Co.*, 538 U.S. at 475 (internal citations omitted). *See also Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853, 854 (1982) (liability requires "extreme circumstances"). Courts typically require proof that investors abused the corporate form for fundamentally unjust or fraudulent purposes before imposing liability. 1 *Fletcher Cyclopedia of the Law of Corporations Corp.* § 41.10 (hereinafter "*Fletcher*"). "[T]wo general elements [for piercing the corporate veil are] required by most jurisdictions. First, there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist; second, the circumstances must indicate that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice." *Id.* § 41.30. *See, e.g. In re Estate of Wallen*, 633 N.E.2d 1350, 56 (Ill. 1993); *Belvedere Condo. Unit Owners' Assn. v. R.E. Roark Cos., Inc.*, 617 N.E.2d 1075, 1077 (Ohio 1993).

Holding investors personally liable for a corporation's torts is a tall task. *See, e.g.*, *Wallace ex rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A.2d 1175, 1183–1184 (Del. Ch. 1999) ("Persuading a Delaware court to disregard the corporate entity is a difficult task.") (internal quotation marks omitted). Even when a shareholder completely controls a company, liability exists only where there is "direct intervention . . . in the management of the subsidiary to such an extent that 'the subsidiary's paraphernalia of incorporation, directors and officers' are completely ignored." *Billy v. Consol. Mach. Tool Corp.*, 412 N.E.2d 934, 941 (N.Y. 1980). "[I]f those in control of the corporate enterprise have not treated it as a distinct legal entity—have ignored the 'corporateness' of the corporation and have themselves treated it as their 'instrumentality'—courts will be less inclined to regard the corporation as an effective limitation on liability." *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 987 (Del. Ch. 1987). But anything less than extraordinary circumstances will not suffice. *E.g.*, *Simmons v. Clark Equip. Credit Corp.*, 554 So. 2d 398, 400 (Ala. 1989) (reversing veil piercing because "mere domination" is not enough; there must also be the "added elements of misuse of control"); *Chapman v. Field*, 602 P.2d 481, 484 (Ariz. 1979) (declining to pierce the corporate veil despite evidence that shareholders lent money without taking promissory notes and corporation failed to file annual reports).

B. Relying on this case law, private-equity investors across the country have developed common practices to protect their investments while respecting the corporate form.

As the Securities and Exchange Commission explains, "[a] typical investment strategy undertaken by private equity funds is to take a controlling interest in an operating company or business—the *portfolio company*—and engage actively in the management and direction of the company or business in order to increase its value." U.S. SEC, *Private Equity Funds*, Investor.gov, https://tinyurl.com/4yrek3ju (last visited Apr. 21, 2022). Such active management is welcomed by portfolio companies. In a recent survey, portfolio companies explained that they highly value private equity's ability to "deliver[] industry or management expertise"—including by "refining companies' operating models, planning for diverse scenarios, and providing advice through internal and external resources." Patrick Henry et al., *The Growing Private Equity Market*, Deloitte (Nov. 5, 2020), https://bit.ly/3GQJR8q (emphasis removed).

Investors often negotiate for the ability to appoint to the portfolio company's board directors who share their active-management philosophy. Thomas P. Lemke et al., *Overview of Private Equity Funds, Hedge Funds and Other Private Funds: Regulation and Compliance* § 13:1 (2021) (investors negotiate a "minimum number of seats on the board of directors" to "protect [their] investment") (hereinafter "Lemke").[2] Board seats typically go to "one or two 'operators' from the [private-equity] firm, who focus on the details of the [portfolio-company] management's formulation and execution of strategy," and who will "frequently" "engage with the CEO . . . as well as those who report to the CEO." Ronald J. Gilson & Jeffrey N. Gordon, *Board 3.0 - An Introduction*, 74 Bus. Law. 351, 359 (2019). These appointments often include a "lead director" who can "marshal the full analytic capacity of the [private-equity] firm to assess the strategic and operational questions facing the" portfolio company. *Id.*[3] For investor-appointed directors, "oversight of the portfolio company" is their "day job, not just a fiduciary duty." Claudy Jules, et al., *A Playbook for Newly Minted Private Equity Portfolio-Company CEOs*, McKinsey & Company (Sept. 24, 2021), https://tinyurl.com/4m8axce4. They are "actively involved" and, "in many ways, [work] more like a 'super management team.'" *Id.*

Investors also frequently negotiate ways to supervise portfolio companies more directly. Private-equity investors, for example, negotiate "covenants or agreements" as "terms and conditions" of their investment requiring the portfolio company to obtain their "consent to various extraordinary transactions" and their "approval of significant expenditures." Lemke at § 13:1.

C. Aside from boilerplate legal conclusions, plaintiffs in this case allege only that the First Reserve Investors protected their investment in TPC through ordinary private-equity practices—specifically, the ability to appoint board members, to approve major

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[2] *See also* Patricia Lenkov, *Boards of Private Equity Portfolio Companies: Ideas and Suggestions* (Aug. 4, 2020) ("With respect to boards of private equity portfolio companies, the board will be partially comprised of owners (sometimes from more than one PE firm)."), https://tinyurl.com/huyps42a.

[3] *See also* Theresa Boyce, *Why PE Firms Create Boards for Portfolio Companies—Voluntarily*, CEOTrust.org (Feb. 15, 2019) (portfolio company's board is "typically comprised of the CEO, two directors from the private equity firm, and two or three outside directors"), https://tinyurl.com/3rbktu5x; Conor Kehoe & Tim Koller, *Climbing the Private-Equity Learning Curve*, McKinsey & Company (May 26, 2021), https://tinyurl.com/yy3ptph9 (boards typically include the "deal partner" and "one other member of the PE firm").

expenditures, and to provide management guidance and advice. But such commonplace practices are not "exceptional circumstances" and do not justify abrogating limited liability, whether by piercing the corporate veil or by asserting a negligent-undertaking claim.

There is no indication that courts across the country use private equity's standard operating procedures to justify piercing the corporate veil of portfolio companies and holding investors directly liable for the companies' alleged torts. Nor could they do so under established law. As discussed above, jurisdictions across the country generally hold investors liable only when limited liability would perpetuate a fraud or injustice. *See supra* at 2–3 (citing 1 *Fletcher* §§ 41.10, 44.30). But there is nothing fraudulent or unjust about private-equity investors "protect[ing] their investment," Lemke at § 13:1, by appointing portfolio-company directors—even a majority of directors—who will use their knowledge and experience to the company's benefit. Similarly, in many jurisdictions, investors cannot be liable without proof that that they disregarded or abused the corporate form. *Id.* But that is the exact opposite of how private-equity investors operate. Private-equity investors negotiate for seats on a portfolio company's board because they recognize that the portfolio company is a separate legal entity. Far from "completely ignor[ing]" the portfolio company's directors and officers, *Billy*, 412 N.E.2d at 941, private-equity investors actively seek to empower them.

Texas law of corporate veil piercing is consistent with the national consensus. This Court has held that "[t]here must be something more than mere unity of financial interest, ownership and control for a court to treat the subsidiary as the alter ego of the parent and make the parent liable for the subsidiary's tort." *Lucas v. Tex. Indus., Inc.*, 696 S.W.2d 372, 374 (Tex. 1984). "[C]entralized control, mutual purposes, and shared finances" have "never" been sufficient because the "[c]reation of affiliated corporations to limit liability while pursuing common goals lies firmly within the law and is commonplace." *SSP Partners v. Gladstrong Inv. (USA) Corp.*, 275 S.W.3d 444, 455 (Tex. 2008). Yet this precisely describes the First Reserve Investors' ordinary oversight of TPC. The First Reserve Investors' appointment of directors, limited financial controls, and other means of active management are common practices designed to ensure the portfolio company's good corporate governance. They are hardly means of "fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct [or] the like." *Id.*

But under the court of appeals' view, Texas law allows plaintiffs to obtain discovery and potentially hold the First Reserve Investors liable merely because they appointed directors to TPC and engaged in active management. The lower court's decision, if allowed to stand, would render Texas a dangerous outlier. Rather than adhering to the traditional rules limiting veil piercing to exceptional circumstances where the corporate form is abused, Texas would allow plaintiffs to proceed (and possibly succeed) on veil-piercing and alter-ego claims merely by alleging and proving that private-equity investors engaged in commonplace business practices.

II. Subjecting investors to burdensome litigation and liability will cause capital to flee Texas, significantly harming the state's economy.

Private equity contributes significantly to the United States economy and to Texas's economy specifically. "The US private equity sector directly generated $1.4 trillion of gross domestic product (GDP) in the United States in 2020," which amounts to "approximately 6.5% of US GDP in 2020." *Economic Contribution of the US Private Equity Sector in 2020*, American Investment Council (May 2021), https://tinyurl.com/23a7esx3 (hereinafter "*Economic Contribution*").

Private equity's positive impact is felt across the entire economy. "[I]n 2020, the US private equity sector directly employed 11.7 million workers earning $900 billion in wages and benefits," *Economic Contribution*, with over 50% of private equity investment going to businesses with 50 or fewer employees, *Private Equity Delivers the Strongest Returns for Retirees Across America*, America Investment Council (2021), https://tinyurl.com/2p92t8x5. Moreover, suppliers to U.S. private equity and consumer spending related to private equity contributed another 19.4 million jobs and $1.2 trillion in wages and related consumer spending. *Economic Contribution.* As a result of this economic activity, "[t]he US private equity sector generated" $142 billion in federal taxes and $76 billion in state and local taxes in 2020. *Id.*

Texas in particular benefits greatly from private equity and its close cousin, venture capital.[4] Texas receives the second highest amount of private-equity investment in the country, with $60.44 billion invested. *Top States & Districts for Private Equity Investment*, Am. Inv. Council, https://tinyurl.com/2p82n3z3 (last visited Apr. 21, 2022). The American Investment Council reported that in 2020, Texas was home to 1,061 private-equity-backed companies across various industries, including 106 companies in health care, 257 in energy, 188 in manufacturing, and 230 in technology. *Id.* The private-equity sector—again, meaning private-equity firms and their portfolio companies—directly employed just over 1 million Texans who earned a combined $82 billion in wages and benefits.

[4] "Over the past 30 years, venture capital has become a dominant force in the financing of innovative American companies. . . . VC-backed companies play an increasingly important role in the U.S. economy. Over the past 20 years, these companies have been a prime driver of both economic growth and private sector employment." Ilya Strebulaev and Will Gornall, *How Much Does Venture Capital Drive the U.S. Economy? Insights by Stanford Business* (Oct. 21, 2015), https://tinyurl.com/yck8p4cw.

Economic Contribution. And the total economic activity related to private equity in Texas was over 2.5 million jobs and $184 billion in total wages and benefits. *Id.*

These tremendous economic benefits will evaporate if private equity stops investing in, or divests from, Texas companies. If private-equity investors can be held liable for the torts of their portfolio companies simply because they tried to protect their investments through common-sense, ordinary oversight, they will likely look elsewhere to invest. As Judge Easterbrook explained nearly 40 years ago, limited liability is critical to attracting investments because unlimited shareholder liability "will shrink the pool of funds available for investment in projects that would subject investors to risk." Frank Easterbook & Daniel Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 97 (1985).

Even if liability is never actually imposed, merely subjecting investors to expensive litigation and the risk of potential liability will impede Texas's ability to attract future private-equity investments. In a recent survey, a national sample of in-house general counsel, senior litigators, and other senior executives were asked how likely "it is that the litigation environment in a state could affect an important business decision at [his or her] company, such as where to locate or do business." U.S. Chamber Institute for Legal Reform, *2019 Lawsuit Climate Survey: Ranking the States*, 3 (Sept. 2019), https://tinyurl.com/23kebwf3. An overwhelming 89% percent answered that the litigation environment was either somewhat likely or very likely to impact these important decisions. There is no reason for investors to risk burdensome litigation and potential liability by investing in Texas companies when other jurisdictions offer similar business opportunities without this substantial legal risk.

If Texas puts investors like the First Reserve Investors to the choice of risking liability for torts allegedly committed by their portfolio companies or else abandoning customary measures like director appointments to protect their investments, they will be substantially less likely to invest in Texas businesses. This could have devastating and cascading effects throughout the Texas economy given the jobs, spending, and tax revenue that come with private-equity investment.

CONCLUSION

To ensure that Texas corporate law does not become an outlier driving away private-equity investments that provide massive economic benefits to the state and its citizens, this Court should grant the First Reserve Investors' petition for a writ of mandamus.

Respectfully submitted.

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CERTIFICATE OF SERVICE

On April 21, 2022, this document was served electronically on the following: (1) Michal A. Heidler, lead counsel for Relators, via mheidler@velaw.com; and (2) Paul F. "Chip" Ferguson, Jr., lead counsel for the Real Parties in Interest, via cferguson@thefergusonlawfirm.com.

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