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Contents

Private Equity and Public-Private Partnerships: Potential Roles in Solving the U.S. Infrastructure Crisis

By Chuck Wall and Christine Byrnes

Against the backdrop of the White House's February 2018 release of its 53-page "Legislative Outline for Rebuilding Infrastructure in America," the prospects for public-private partnerships ("P3s") and private equity's role in U.S. infrastructure upgrades appeared on the rise. The Legislative Outline (a self-described roadmap for Congress to "draft and pass the most comprehensive infrastructure bill in our Nation's history") proposed allocating $200 billion of federal spending to new infrastructure projects over a 10-year period and recommended certain changes to streamline project permitting, consolidate required governmental approvals, and shorten project timelines, all with the goal of incentivizing private investment to help close the infrastructure investment gap. But with Congressional action appearing to be postponed until after the 2018 mid-term elections (though this is subject to change at any moment), one might expect interest on the part of PE firms in infrastructure to wane. Layer on a reliance in the White House's proposal on significant state and local contributions, and the prospects for excitement become even more dim. Or so it might seem.

PE Interest in Infrastructure

Perhaps surprising to some, investor appetite in the infrastructure sector continues to be strong. According to Prequin, private-equity firms raised a record $33.7 billion in 2017 for infrastructure funds focused on investments in North America, resulting in infrastructure-focused capital amassed at roughly $70 billion. Among the fund managers surveyed by Prequin, 74 percent plan to invest more infrastructure capital in 2018 than was invested in the prior

12 months, and 94 percent of those surveyed expect industry assets under management to increase in 2018. Notably, none of the fund managers surveyed expected the number of assets to decrease.

This strong investor appetite is evidenced by recent fund raises. For example, KKR's third dedicated infrastructure fund reportedly exceeded its $5 billion target in this year's first quarter, Brookfield Asset Management was able to close its inaugural infrastructure fund at the beginning of 2018 with an aggregate equity commitment of approximately $885 million (well in excess of its $700 million target), and Stonepeak Infrastructure Partners' latest fund surpassed its $7 billion hard cap in May after receiving $7.2 billion in commitments. These raises will serve to enlarge the hundreds of billions of dry powder already marked for infrastructure investment. And what will these resources be targeting? To the White House's dismay, it is anticipated that a very small percentage of infrastructure fund monies will be directed to public assets, such as toll roads and bridges, as Wall Street has typically shied away from this asset class because of the long project timelines and political hurdles that must be faced to complete the transactions. Rather, most of these funds are expected to be targeted to infrastructure projects that are already privately-owned, thereby increasing competition for these private assets. So where does that leave prospects for an infusion of private capital to save our crumbling and overcrowded highways and bridges?

Transportation Infrastructure: Public Highways, Transit and Airports

In the U.S., unlike many other countries that have centralized control over public infrastructure, states and local governments are largely responsible for decisions on infrastructure financing. The limited federal control – when combined with the robustness of the municipal bond market (a relatively cheap funding alternative), the uncertainties of state and local processes and the threat of shifting political tides – may steer PE funds away from competing for highway, transit and airport investment opportunities. These obstacles are troubling, but not catastrophic. Enactment of policies and legislation that incentivize private investment in public assets, through P3s or otherwise, could quickly overcome much of the existing reluctance. Legislative reform could trigger serious interest among PE firms and a commensurate boost in P3 procurements initiated by state agencies and local governments desperate for new transportation projects.

Perhaps most intriguing to PE funds in the short term are the administration's proposals in the Legislative Outline relating to brownfield assets. Among the more notable are the potential for sizeable brownfield federal assets to be candidates for privatization (*e.g.*, Reagan National Airport and Dulles International Airport). Proposed modification of the Federal Aviation Administration's airport privatization program applicable to state- and locally-owned airports and the proposed streamlining of the environmental review process could ease regulatory and financing hurdles, making these assets more attractive to PE firms.

On the greenfield side, a sizable chunk of recent PE interest in new public infrastructure comes from firms with some ability to manage construction risks. Even so, state agencies and local governments are sometimes highly prescriptive in their project requirements, limiting the value the private sector may bring to P3 greenfield projects. Relaxation of regimented procurement processes and encouragement of "alternative technical concepts" and other private-sector innovations set the stage for a win-win: the public stands to benefit from higherquality, life-cycle oriented projects, and procurements become more attractive to a larger segment of the P3 community and its massive amounts of capital earmarked for infrastructure investment.

The merits, risks and consequences of these brownfield and greenfield initiatives continue to be highly debated, on both financial and policy grounds. Opponents to the measures claim that privatization will result in higher costs for the traveling public through a combination of taxes and user fees and that the proposed streamlining of the permit and approval processes will allow projects to move forward without the necessary protections for clean air, clean water, and other environmental elements.

Conclusion

The need for major improvements in public infrastructure is real and will only accelerate as legislative action continues to be deferred. With its Legislative Outline, the administration made clear that attracting private investment should be a key focus of the government's infrastructure plan. While private equity stands poised for deployment through P3s in both the brownfield and greenfield contexts, absent the adoption of necessary incentives and the injection of a meaningful stream of federal money, states and localities will remain hamstrung in unleashing the full potential P3s offer as viable and useful tools in solving the infrastructure crisis.

Reverse Piercing of the Corporate Veil: New Implications in Light of a Fourth Circuit Decision

By Alan Wingfield and Massie Cooper

Traditional Piercing of the Corporate Veil

Typically, owners or shareholders of a corporation have limited liability over the corporation's actions. In other words, there is a corporate veil that can protect owners and shareholders from liability over a corporation's actions. In some circumstances, an owner or shareholder may be made liable for the corporation's actions. Piercing the corporate veil allows a plaintiff to breach this veil of protection and implicate owners or shareholders for a corporation's actions.

When the veil is pierced, an owner of a corporation is liable on the basis that the corporation is only the "alter ego" or "instrumentality" of the owner. There are two basic requirements for piercing the corporate veil. First, the owners must have exercised domination or control over the corporation. Secondly, the actions taken must have wronged the plaintiff. Additionally, some states require further proof that the domination caused the harm.

Reverse Piercing of the Corporate Veil

Reverse piercing exists when a third party seeks to impose liability on a corporation for the actions of an individual shareholder or owner. Establishing a reverse piercing involves the same requirements as traditional piercing: domination over the corporation and harm caused to an aggrieved party. A reverse piercing typically arises when a third-party plaintiff seeks to collect on a debt or payment owed to the third party. Unlike traditional veil piercing, reverse piercing is not universally nor uniformly imposed. Some states have even rejected a reverse piercing of the corporate veil.

When a party seeks to pierce the corporate veil in reverse, the law where the corporation is incorporated typically determines whether a reverse piercing is permissible. A recent case decided in the United States Court of Appeals for the Fourth Circuit, *Sky Cable, LLC v. DIRECTV, Inc.*, 886 F.3d 375 (4th Cir. 2018), has brought into question whether Delaware law would permit a reverse piercing. Delaware courts have not yet addressed whether a reverse piercing is permissible, but those courts have not expressly prohibited it, either. However, this Fourth Circuit decision authorized a reverse piercing of the corporate veil, and in doing so, it sets the tone for how Delaware courts may act in future reverse piercings.

Sky Cable v. DIRECTV

Randy Coley was the sole owner of three Limited Liability Companies (LLCs). Coley created the LLCs to hold title to real estate properties, and the LLCs managed and controlled Coley's finances in his investments. Coley contracted with DIRECTV, by using one of his LLCs, to provide cable programming to nearly 2,500 rooms in a Virginia resort. Coley paid for services for 168 of the rooms, but he fraudulently retained the excess revenue for over 2,300 units. Each of the three LLCs and Coley engaged in a co-mingling of funds, and Coley disregarded corporate formalities in managing his finances through the LLCs. DIRECTV investigated the matter and discovered the fraud. Sky Cable, a dealer of DIRECTV's services, sued Coley for the scheme.

Until *Sky Cable*, no case interpreting Delaware law had adopted the reverse piercing remedy. However, the district court held that under Delaware law, the three LLCs were “alter egos” of Coley and that Delaware would recognize reverse veil piercing under such circumstances. In context, Coley’s fraudulent actions reversed the presumption of limited liability for his LLCs, which is a reverse piercing of the corporate veil; the now defunct LLCs shared liability for Coley’s actions as the sole owner of the LLCs.

The Fourth Circuit affirmed the district court’s holding. They did so on the basis that many courts have allowed outsider reverse piercing for creditors. Also, Delaware law does not expressly oppose a reverse piercing. However, the court acknowledged that some states have barred it because of potential harm to innocent shareholders. Before this case, Delaware courts cautioned that a traditional piercing of the corporate veil is appropriate only in exceptional circumstances. In response, the Fourth Circuit noted that reverse veil piercing is particularly appropriate when an LLC has a single member, because it alleviates the concern that reverse veil piercing may affect innocent shareholders. Thus, when an entity and its sole member are alter egos, as was the case with Coley, the argument for reverse veil piercing is strong.

In making its decision, the court was mindful that Delaware has a special interest in assuring that companies incorporated in the state are not conduits for fraudulent activity for shareholders. Piercing the corporate veil is done to promote equity and limit injustice. Coley was the sole member of each of the LLCs, he was the only person paid by the LLCs, and he did not keep complete accounting records for himself or for the LLCs. In Delaware, if legally separate entities do not follow corporate formalities with one another, there may be an inference that the owner and the corporation are alter egos. To the court, a reverse piercing in this case would not compromise Delaware’s corporate form nor harm any innocent shareholders.

Implications

The Fourth Circuit acknowledged that even a traditional piercing of the corporate veil is only done in exceptional circumstances. It involves looking past a legal fiction, even though the corporation as a legal fiction with limited liability is a well-established presumption. Veil piercing is an equitable remedy extended in the interest of justice. Still, reverse piercing is not a universal practice, and in practice its application is largely a factual determination. In *Sky Cable*, the court analyzed the facts and law to determine whether Delaware law would permit a reverse piercing. Ultimately, the court determined that a reverse piercing of the corporate veil is permissible under Delaware law. Given Delaware’s traditional and ongoing role as the site of incorporation for many companies, the Fourth Circuit’s ruling in this case may have ongoing implications.

Debt Previously Contracted ("DPC") Investments: Equity by Accident or Safe and Sound M&A for Lenders?

By Gerald Francese and Zayne Tweed

Banks have several weapons in their arsenal to prevent corporate loan defaults, including foreclosure and acting on collateral. As a potentially less draconian step, which could serve to augment rather than strain relations with the borrower, when loans become distressed (or are expected to become distressed), bank lenders and their affiliates have the authority to restructure loans to include an equity "kicker" for the lender under the authority to resolve debts previously contracted ("DPC Authority").[1]

Pursuant to DPC Authority, national banks may accept equity securities in lieu of (or in addition to) existing or restructured loans with a view to a subsequent sale or conversion of the equity into money to make good or reduce anticipated losses. Such transactions are not considered dealing in securities, but as compromises in good faith to resolve a debt.[2] Typically, the lender would reduce either or both of the loan payment stream and/or principal balance to amounts that the borrower can demonstrate are serviceable, and then make up the difference in value with equity valued at the then-current fair market value of the borrower entity. This way, the borrower can continue to service the loan, the lender can remove the debt from its default status, and both borrower and lender will enjoy upside if the restructured debt provides the borrower with a path to growth and financial stability. Under this structure, the interests of the lender and borrower are aligned for the success of the borrower. As described in greater detail below, under DPC Authority, lenders are permitted to provide substantial assistance to borrowers to manage and operate the business back to health and profitability.

DPC Authority

A national bank's authority to take property under DPC Authority emanates from two sources. First, banks have express statutory authority to take real property in satisfaction of DPC.[3] Second, the powers incidental to carrying on the business of banking include the power to acquire and manage personal property taken in satisfaction of DPC.[4] Under these combined statutory authorities, a bank may acquire DPC securities and, in good faith, hold, manage, and ready those assets for sale as would any other prudent owner.[5]

DPC Authority is premised on the bank's good faith business judgment and is implied whenever a bank is faced with a loss. It is not necessary that the borrower be in default.[6]

[1] *See generally* 12 C.F.R. § 1.7 (securities held in satisfaction of DPC) and OCC Interpretive Letter No. 517 (Aug. 16, 1990) (as activity incidental to business of banking, national banks permitted to accept stock and stock warrants in addition to or in lieu of interest on loans).

[2] Pursuant to Federal Deposit Insurance Corporation ("FDIC") guidance and state parity statutes, state banks may take advantage of DPC Authority to the same extent. Generally, equity investments acquired by an insured state bank pursuant to DPC Authority are not covered by the activities restrictions under 12 C.F.R. Part 362 so long as the bank does not hold the DPC asset for speculation, takes only such actions as would be permissible for a national bank, and disposes of the property within the statutory holding period. See 12 C.F.R. § 362.1(b)(3) (purpose and scope) and § 362.2(g) (definition of equity investment). *See also* FDIC FIL54-2014 (Nov. 19, 2014) (filing and documentation procedures for state banks engaging, directly or indirectly, in activities or investments permissible for national banks).

[3] 12 U.S.C. § 29(Third). *See also* OCC Interpretive Letter No. 1123 at n.5 (Sept. 18, 2009) (noting that DPC Authority is a "necessary power" of banks "recognized since the earliest days of our country").

[4] 12 U.S.C. § 24(Seventh).

[5] *See* OCC Interpretive Letter No. 1007 (Sept. 7, 2004) (national bank may negotiate with borrower to extinguish poor credit in exchange for form of property bank otherwise unable to hold).

[6] A bank may exercise DPC Authority when an extension of credit is in default, is nonperforming, or the borrower establishes a history of poor performance. *See id.* at *3 ("When a national bank exercises its lending authority, regardless of the legal form that the extension of credit takes, the bank should be able to use its DPC Authority when a credit event warrants.").

Likewise, the property taken in satisfaction of DPC need not be the borrower's original collateral. The Office of the Comptroller of the Currency (the "OCC") and the federal courts have recognized that banks may acquire and hold various types of real and personal DPC property – including equity securities – not given as collateral for the original loan.[7]

Banks may also engage in activities that, absent underlying DPC Authority, are generally beyond the implied powers of a national bank. For example, banks have been permitted to operate chemical production facilities, complete the construction of residential properties, and fund new development within existing properties to mitigate losses on loans pursuant to DPC Authority.[8] More importantly, where a bank takes corporate stock as part of its DPC Authority, it has the implied power to operate the corporation's business and perform other necessary and reasonable acts to preserve the value of the business when its resale value depends on uninterrupted operation. The bank may also advance additional funds to improve the business and increase its ultimate recovery.[9] By contrast, under the merchant banking powers granted by the Bank Holding Company Act, such acts are generally prohibited absent extreme distress circumstances.[10]

Even so, there are two key limits to DPC Authority. First, DPC Authority must be exercised in good faith. It cannot be used as a cloak to cover unauthorized practices, including speculation on the future value of the DPC asset. When done in good faith, such activity is not *ultra vires*, but is deemed incidental to the business of banking.[11]

Second, a bank can only hold DPC assets (including securities) for five years, subject to one additional five-year extension.[12] Regulatory authorities will only grant an extension upon a clearly convincing demonstration of need, and subject to a substantial charge to the bank's Tier 1 capital. For this reason, banks should balance their extension needs against an additional hit to Tier 1 capital for the extension period, as well as the loss of a favor from regulators that may be better used elsewhere.

It is important to keep in mind that DPC Authority is not exclusive of other bank powers. In some cases, it may not be the best fit for the bank. Accordingly, DPC Authority should be weighed against other bank powers – such as merchant banking authority or Sections 4(c)(6) and 4(c)(7) of the Bank Holding Company Act – to manage regulatory requirements, supervisory expectations, and transaction needs.

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[7] *See* OCC Non-Objection Letter No. 89-01 (Jan. 25, 1989) and OCC Interpretive Letter N. 892 (Sept. 13, 2000) (permitting bank to hold equity securities to hedge derivatives transaction by analogy to DPC Authority). *See also* First Nat'l Bank of Charlotte v. Nat'l Exch. Bank of Baltimore, 92 U.S. 122, 127 (1875) and Atherton v. Anderson, 86 F.2d 518, 525 (6th Cir. 1936), rev'd on other grounds, 302 U.S. 643 (1937).

[8] *See e.g.* OCC Interpretive Letter No. 12 (Dec. 7, 1977) (bank permitted to operate anhydrous ammonia plant); OCC No-Objection Letter No. 86-6 (Apr. 22. 1986) (bank permitted to continue construction on DPC property to realize full satisfaction of debt); and OCC No-Objection Letter No. 87-2 (bank permitted to develop DPC property to preserve zoning plan and avoid substantial decrease in property value).

[9] These additional funds are not subject to the bank's legal lending limit. However, the advances are subject to certain restrictions. *See* 12 C.F.R. § 34.86(a). In addition, if the estimated sum of the additional funds plus the bank's current recorded investment exceed 10% of the bank's capital and surplus, the bank must notify its supervisory office at least 30 days prior to action. *Id.* at § 34.86(b).

[10] *See generally* 12 C.F.R. Part 225 Subpart J (Merchant Banking Investments).

[11] *See* Atherton at 525 ("[A bank] may clean [DPC property], make reasonable repairs upon it, and put it in presentable condition to attract purchasers in the same way that an individual of sound judgment and prudence would do if he desired to make a sale…."). *See also* OCC Conditional Approval No. 895 (March 31, 2009) (permitting bank to create multiple operating subsidiaries in connection with restructuring of DPC property) (quoting Morris v. Third Nat'l Bank, 142 F. 25, 31 (8th Cir. 1905), cert. denied, 201 U.S. 649 (1906) ("A [bank] may lawfully do many things in securing and collecting its loans, in the enforcement of its rights and conservation of its [DPC property], which it is not authorized to engage in as a primary business.").

[12] *See* 12 U.S.C. § 29 and 12 C.F.R. § 1.7 (imposing limitations with respect to holding period, accounting treatment, and non-speculative purpose for DPC securities).

Acquisition of a Non-Controlling Interest in an Entity to Hold DPC Assets

Banks in a syndicate often acquire DPC interests via an entity – usually a limited liability company (an "LLC") – that holds DPC assets (including equity securities).[13] No prior regulatory notice is required for such an investment, but the bank must document the satisfaction of four criteria: (1) the activities of the LLC are limited to those that are part of, or incidental to, the business of banking; (2) despite not having control of the LLC, the bank is in a position to prevent the LLC from engaging in activities that do not meet this standard; (3) the bank's loss exposure is limited, as a legal and accounting matter, and it does not have open-ended liability for the LLC's obligations; and (4) the investment is convenient and useful to the bank's business.[14] Criteria 1 and 4 are satisfied where the investment is made pursuant to a good faith exercise of DPC Authority. Criteria 2 and 3 are addressed in the transaction documents. The bank must document satisfaction of these criteria for its examiner to review.

Formation of a Subsidiary to Hold DPC Assets

When a bank acquires corporate stock pursuant to DPC Authority, the corporation does not become the bank's operating subsidiary.[15] However, where a bank establishes a separate subsidiary to hold its DPC assets (including equity securities), the entity will be considered an operating subsidiary subject to the OCC's prior notice requirements if any of the following apply:

- The bank has the ability to control the management and operations of the entity, and no other person exercises effective control over the entity or has the ability to influence its operations to an extent equal to or greater than the bank.
- The bank holds 50 percent or more of the voting or controlling interests in the entity.
- The entity is consolidated with the bank under generally accepted accounting principles ("GAAP").[16]

The bank may be eligible for after-the-fact notice with respect to formation of the operating subsidiary if the bank: (1) is "well capitalized" and "well managed"; (2) is commencing new activity in the entity; (3) controls the entity; (4) holds more than 50 percent of the voting interests in the entity; and (5) consolidates its financial statements with the entity under GAAP. In many cases, forming an operating subsidiary to hold DPC assets is tempting. But there are drawbacks, chief among them that the bank will be subjected to additional reporting, corporate governance, and regulatory burdens.

Conclusion

Consistent with the powers and limitations imposed on national banks under federal laws and OCC guidance, banks may acquire, hold, and manage many forms of real and personal property – including equity securities – to recover investments on a doubtful loan pursuant to DPC Authority. Of course, the exercise of DPC Authority is not without obstacles and risks. Regulatory authorities, including the OCC and the FDIC, may take different positions based on the same, or similar, facts and circumstances cited in prior interpretive guidance or based on supervisory purposes irrespective of established legal precedent. Prior to engaging in DPC activities, contact Troutman Sanders LLP to discuss how acquiring DPC assets can benefit your bank.

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[13] Investments of this type are permitted pursuant to the powers granted to banks under 12 U.S.C. § 24(Seventh) and 12 C.F.R. § 5.36(g).

[14] *See* OCC Interpretive Letter No. 735 (July 15, 1996) (bank permitted to establish operating subsidiary through which it would become minority member of limited liability company).

[15] 12 C.F.R. § 5.34(e)(2)(B).

[16] *See generally*, OCC, Comptroller's Licensing Manual, "Subsidiaries and Equity Investments," p.2 (Oct. 2017). *See also* 12 C.F.R. § 5.34.