CADWALADER

The End of Chevron: Considerations for Private Equity, Banks and Investors

July 12, 2024

By **Chris Montgomery**
Partner | Fund Finance

It's been less than two full weeks since the U.S. Supreme Court issued its *Chevron* decision, yet the myriad impacts of the ruling have caused many of us to feel like it's been much longer, as we've stretched each day weighing the implications in virtually every area of business. Fund finance is no different, and we want to share with you our early impressions and analysis for the near future.

The story begins in 1984, when the Supreme Court set the rules for challenging a federal agency's interpretation of ambiguous statutory provisions and this became a landmark case: *Chevron USA v. National Resources Defense Council* ("*Chevron*"). (For an overview, please see Mercedes Tunstall's excellent write-up **here**.)

The doctrine has long been the subject of curiosity, discussion and spirited debate over the role of administrative agencies in American life. Courts could not look over the shoulder of an administrative agency, so long as that agency was interpreting an ambiguous provision. The doctrine was generally considered welcome by those who liked stable rulemaking of administrative law, and less welcome by those who felt one should be able to sue the government when they acted upon an ambiguous statute.

The Supreme Court's 6-3 overruling of *Chevron* on June 28th will not lead to sudden and sweeping change, but it could open the door to legal challenges over time and a more complex regulatory environment, at least initially. Here are six key regulatory areas where we might observe substantial changes and potential legal actions:

1. **ESG Regulation**

The first issue is a live one—as in the oral arguments for trial started this week in the Fifth Circuit Court of Appeals. In 2022, the Department of Labor created a rule that allowed pension managers to consider ESG factors as a "tiebreaker" when considering two or more investments that equally serve the financial interest of the pension fund. Various state attorneys general sued the Department of Labor arguing that the ESG rule violated fiduciary duties owed to the beneficiaries of the plan to maximize investment gains. The case was dismissed in district court, but the district court judge relied heavily on *Chevron* deference in deciding for the Department of Labor. The parties to the suit have amended their filings in light of overruling *Chevron*, and it is highly uncertain who will prevail, as the Department of Labor maintains that the rule can stand even without *Chevron* deference.

2. **Securities Regulation**

The Securities and Exchange Commission ("SEC") often interprets and enforces complex securities laws that govern the private equity industry. Without *Chevron* deference, private equity funds might face more challenges in assessing the regulatory compliance and stability of their funds and structure. Conversely, private equity funds could challenge the SEC's interpretations of certain rules, such as disclosure requirements under the Investment Advisers Act of 1940. For example, by arguing that certain disclosure mandates are overly burdensome and not clearly supported by statutory language, funds have sought to reduce compliance costs and streamline their operations—we have already seen litigation to this effect before the demise of *Chevron.* Please see Leah Edelboim's recent analysis **here**.

3. **Taxation**

The Internal Revenue Service ("IRS") plays a crucial role in interpreting tax laws that affect private equity funds, particularly concerning carried interest and capital gains treatments, but also the tax liabilities of investors. Without *Chevron* deference, IRS interpretations could be more frequently contested. If there are divergent judicial rulings on tax matters, this could increase the complexity of tax analysis for private funds and their investors.

4. **Environmental Regulation**

The Environmental Protection Agency ("EPA") issues regulations that impact a wide range of industries in which private equity funds invest. Overruling *Chevron* could lead to more frequent legal challenges to EPA rules, creating uncertainty around the compliance and valuation of portfolio companies within private equity funds with environmental exposure. However, funds could challenge EPA interpretations that impose stringent environmental regulations on portfolio companies, which could unlock additional value for such companies. By arguing that certain regulations exceed statutory authority or lack clear legislative backing, funds could aim to lower compliance costs for their investments in sectors like energy, manufacturing and real estate.

5. **Labor and Employment Law Liability**

The National Labor Relations Board ("NLRB") is responsible for interpreting and enforcing labor laws that affect many private equity-owned companies. Without *Chevron* deference, NLRB decisions might face more legal challenges, impacting labor rules for portfolio companies. Private equity funds might challenge NLRB interpretations that broaden the definition of joint employers, which could hold funds liable for labor practices at portfolio companies. By arguing that the statutory language does not support such broad interpretations, funds could seek to limit their liability.

6. **Antitrust Regulations**

The Federal Trade Commission ("FTC") and the Department of Justice ("DOJ") oversee antitrust laws that govern mergers and acquisitions, including those involving many portfolio companies. If courts no longer defer to these agencies' interpretations, it is possible some parties could challenge the FTC or DOJ's interpretations of antitrust laws that apply stringent scrutiny to mergers and acquisitions. To the extent that certain interpretations are overly restrictive and not clearly supported by the statutory text, funds could seek to facilitate smoother approval processes for their transactions.

Conclusion

In addition to the foregoing, there are many other potential changes that will affect funds, banks and investors—for example, we have not even mentioned the impact of overruling *Chevron* on the Consumer Financial Protection Bureau or the Basel III endgame, which merit their own articles for discussion. In the end, sometimes you may like a rule protected by *Chevron* deference, other times not. There are therefore no clear winners or losers in overruling *Chevron*, just that the rules of the game have changed. Funds, banks and investors now have a greater opportunity to challenge certain agency decisions—but also other parties may bring suit who may have divergent interests, such as environmental groups, unions or state attorneys general of various political persuasions. In any case, courts are likely to give great weight to long-standing rules, with or without *Chevron* deference, so the pace of any change is likely to be gradual.