ALERTS

Second Circuit Issues Opinion in *CSX v. TCI*

July 26, 2011

In a long-awaited opinion, the Second Circuit Court of Appeals issued its decision in *CSX v. TCI, et al.*,[1] the hotly-contested litigation arising out of a proxy contest waged in the spring and summer of 2008 in which The Children's Investment Fund ("TCI") and 3G Capital Partners successfully ran a slate of candidates for CSX's board. Schulte Roth & Zabel represented TCI in connection with the proxy contest and ensuing litigation. After trial, the lower court ruled that the shares underlying cash-settled, total-return equity swaps could be deemed "beneficially owned" by the "long party" to the swap transaction, a position seemingly at odds with the custom in the industry, legal commentators and even the Securities and Exchange Commission, which indicated its support for TCI and 3G's position through a submission to the trial court. The trial court also found that communications between TCI and 3G over a period of months in which proposed strategic initiatives had been discussed concerning CSX were sufficient for those entities to be deemed a statutory "group" for Section 13(d) purposes, and ruled that the funds violated Section 13(d) by failing to make timely disclosure of having formed a statutory group. Despite these findings, the lower court refused to enjoin TCI and 3G from voting their shares at the CSX shareholder meeting, and four of the five candidates on the TCI/3G slate were elected to CSX's board of directors. Rather, the lower court issued a permanent injunction against TCI and 3G, prohibiting any further violations of Section 13(d), whether or not involving CSX shares. CSX appealed the lower court's refusal to enjoin the funds from voting their shares, seeking so-called "share sterilization," and TCI and 3G cross-appealed on the issues of

"beneficial ownership," "group" and the imposition of a permanent injunction.

In a majority opinion and separate concurrence by Judge Winter, the Second Circuit vacated the permanent injunction, remanded the case for further findings on whether a group had been formed for the specific purpose of buying or selling CSX shares, and affirmed the lower court's determination that TCI and 3G could vote their shares of CSX stock. The Second Circuit's majority opinion did not resolve the question of whether cash-settled, total-return equity swaps gave TCI and 3G beneficial ownership of the CSX stock underlying the swaps, noting, instead, that there was "disagreement within the panel." Nonetheless, in his 51-page concurrence, Judge Winter carefully and methodically parsed the statutory framework, congressional history and regulatory pronouncements concerning cash-settled, total-return equity swaps, and concluded that TCI and 3G did not have beneficial ownership of the underlying CSX stock. The majority opinion neither criticized nor commented on Judge Winter's analysis.

Thus, the question of whether a fund holding a long position in cash-settled, total-return equity swaps will be deemed to beneficially own the underlying referenced shares of stock remains in flux. In light of the Second Circuit's majority opinion's silence on the question, the lower court's decision that, under the circumstances of that case, the funds would be deemed to have beneficial ownership of CSX stock remains unchanged, regardless of the ultimate disposition of that case. However, given Judge Winter's thoughtful analysis of the beneficial ownership question, it can be expected that, in the absence of guidance from Congress or the SEC, future courts confronted with this issue will take guidance from the Winter concurrence, and consider his analysis in the context of subsequent cases.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1]*CSX Corp. v. The Children's Inv. Fund Mgmt., No. 08-2899-cv, slip op. (2d Cir. July 18, 2011).*

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