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Portfolio Investments: Bad Choices Make for Big Judgments

Any successful private equity investment, whether in a portfolio company or in talent, is preceded by careful collection and analysis of financial and other information. A Delaware vice chancellor's opinion in *Enhabit, Inc. v. Nautic Partners IX, L.P.*^[1] provides a cautionary reminder of limitations on permissible pre-investment sources of such information—and of the potential consequences of ignoring those limitations.

April Anthony was the CEO and, in the words of Vice Chancellor Will, the “wildly successful founder” of Encompass Home Health & Hospice, a provider of home healthcare services. In 2014, Anthony and an investor co-owner sold Encompass to HealthSouth Corporation; Anthony ultimately netted \$370 million from the sale. For seven years she stayed on as CEO of the HealthSouth subsidiary that held the home healthcare operation, but ultimately, “disillusioned with [the parent company], Anthony set out to ‘get [her] baby back,’”^[2] and began working with private equity firms Nautic Partners and Vistria Group to do so. When the parent failed to respond to a bid by Anthony and Nautic and Vistria to acquire controlling interest in the Encompass home health subsidiary, the group began planning for a competing home health and hospice business. Anthony ultimately resigned her position at Encompass and became the CEO of a newly constituted home health and hospice care firm, VitalCaring Group, a subsidiary of a parent company—“Topco”^[3]—funded and owned equally by Anthony and the two private equity firms.

Some of the steps taken toward formation of the competing business could have come from a standard private equity playbook, including the acquisition of “platform” healthcare firms and recruitment of officers and employees for the new company. However, the recruiting began while Anthony was still CEO of Encompass and focused on Encompass officers and employees, including its President Luke James and its CFO Chris Walker; both came on board and were active in the planning process.

Concurrently, information concerning potential target companies identified by the group, and that ultimately formed VitalCaring's platform, were never shared by Anthony with her employer Encompass as acquisition opportunities. As summed up by the vice chancellor,

[Anthony] partnered with Nautic and Vistria and brought along James and Walker. When her plan [to reacquire the business] failed, she turned her focus to creating a competitor. As she told Nautic's investment committee, there was value in getting started while she remained at Encompass and could "access people and relationships."

So they did. Anthony, Walker and James—all senior officers—usurped business opportunities falling within Encompass's line of business. They swayed key Encompass employees to join them using the promise of Topco equity. Their efforts were fortified with Encompass confidential information. Great pains were taken to conceal their actions.

[\[4\]](#)

Anthony, who had earlier been sued by Encompass in state court in Texas, was not a party in the Court of Chancery litigation,[\[5\]](#) but her actions, along with those of Walker and James, were material to two elements of Encompass's claim against the private equity firms for aiding and abetting breach of fiduciary duty: (1) the existence of fiduciary relationships between Encompass and the individuals and (2) the breach of the resulting fiduciary duties. Finding that both had been proven, the vice chancellor proceeded to consider the firms' alleged knowledge[\[6\]](#) of, and culpable participation in the individual officers' breaches of, their fiduciary obligations[\[7\]](#)—and found that Encompass had proved both. Nautic's and Vistria's knowledge that the individuals' conduct was improper was shown in part by each firm's prior involvement in litigation where the firms or individual partners were accused of breaches and/or aiding and abetting same, and by their retention for the Encompass project of counsel who prepared a "roadmap" acknowledging potential claims and suggesting steps to avoid them. Their *participation* in the breaches was evident from (*inter alia*) their efforts to identify and evaluate potential platform acquisitions; their active participation in

Anthony's solicitation of employees; their efforts to obtain confidential Encompass information; steps they took to shield, and later to destroy, communications concerning their efforts; and their disregard of counsel's advice as to the proper course of conduct.

As for remedies, the vice chancellor rejected Encompass's claims for rescissory damages, disgorgement and lost profits because "VitalCaring has no profits to disgorge."^[8] The vice chancellor did provide for a remedy, however, stating:

Still, equity must right a wrong. "[V]iolations of the duty of loyalty" merit "strong medicine." After considering the typical damages measures, I conclude that Encompass is entitled to a share of any future gains VitalCaring realizes. This approach is neither a complete cure for the defendants' blatant misconduct nor punitive. But it maintains incentives for the defendants to grow VitalCaring while recognizing that VitalCaring got a head start at Encompass's expense.^[9]

The chosen remedy was the imposition of a constructive trust, with VitalCaring's profits divided between the two private equity firms on the one hand and Encompass on the other. The allocation formula "compare[d] Nautic's and Vistria's capital contributions to VitalCaring's total projected equity value at exit";^[10] the private equity firms would receive 57% of VitalCaring's profits, to allow them to "recover their initial capital contributions and remain incentivized to grow the business," with the remaining "sizeable 43% portion of the proceeds [to] flow to Encompass due to the willful misconduct that produced VitalCaring."^[11]

The Delaware litigation serves as a cautionary example of the inevitable and inherent tension for portfolio investments pursued with the aid of, and with the expectation of hiring, officers and employees currently employed in the affected industry. On the one hand, the desired personnel will likely be—as were Anthony and James and Walker—the best possible sources of industry expertise, information concerning potential platform and subsequent acquisitions, and knowledge of additional personnel who might join the new firm. On the other hand, such key officers almost certainly will be subject to contractual noncompete, non-solicitation, and

nondisclosure restrictions in addition to common law duties of loyalty. Bringing them into an unfettered planning process while still employed, and thus still under such restrictions and obligations, risks putting the investment firm in the crosshairs of familiar causes of action asserted on behalf of the current employer, such as aiding and abetting breach of fiduciary duty, as in the *Enhabit v. Nautic* litigation,^[12] and tortious interference with contract or with business relationships.

The *remedy* imposed by the Delaware vice chancellor also bespeaks caution for relying, during the due diligence process, on the institutional knowledge possessed by (or access to information gained through) potential key hires who are still subject to employment restrictions. Exit strategies and investment timelines go by the board when a substantial fraction of the new portfolio company's profits is dedicated to a third party by virtue of a court-imposed constructive trust.^[13]

The further problem is that there are simply too many ways in which the inappropriate actions can come to light. In Encompass's case, one of the officers whom Anthony urged to quit and join VitalCaring "had a change of heart"^[14] and revealed the perfidy to a respected superior at Encompass. But even absent a similar revelation by a solicited employee, the simple fact of concurrent or *seriatim* departures of key personnel followed in short order by the establishment of a new competitor frequently triggers litigation accompanied by discovery in which carefully concealed machinations see the light of day.

The temptation is understandable. The potential investment—a startup or a platform acquisition—happens to be heavily dependent on hiring one or more individuals working in the industry. The targeted individual officers or employees possess valuable inside knowledge of other potential hires; existing or potential customers; and price arrangements with key customers, among other things. Why not take advantage of that information in advance of funding the potential investment? The sweeping remedies imposed by the vice chancellor in *Enhabit v. Nautic Partners* provide a graphic example of the reasons to avoid the temptation.

For more information regarding the interplay between portfolio investments, employee recruitment, and fiduciary duty considerations in private equity transactions, please contact the author or any attorney with Frost Brown Todd's [Private Equity and Venture Practice](#). Our deal team can perform due diligence on the target company and help you structure acquisition transactions to avoid the pitfalls highlighted in the *Enhabit v. Nautic Partners* decision.

[1] C.A. No. 2022-0837-LWW, 2024 WL 4929729 (Del. Ch. Dec. 2, 2024).

[2] *Id.* at *24.

[3] Bridgestone Topco, LP.

[4] 2024 WL 4929729 at *24.

[5] Encompass and its parent had previously sued Anthony in state court in Texas and, after a bench trial, obtained a judgment permanently enjoining Anthony from violations of her non-compete and non-solicitation covenants and her employment agreement. Final Judgment and Permanent Injunction, *EHHI Holdings, Inc. et al. v. April K. Anthony*, June 17, 2022 (Cause No. DC-21-15716, 192nd District Court, Dallas County, Texas). Neither the Final Judgment nor the Court's Findings of Fact and Conclusions of Law addressed fiduciary duties, which apparently were not made the subject of the Texas litigation.

[6] And that of the firms' partners who led the investment efforts

[7] *Id.* at *25.

[8][8] 2024 WL 4929729 at *30.

[9] *Id.*, quoting *In re MFW Shareholders' Litg.*, 67 A.3d 496, 532 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

[10] *Id.* at *41.

[11] *Id.* The Court also awarded Encompass the fair value of retention packages granted to ten key employees in the wake of Anthony's departure.

[\[12\]](#) Texas courts have not approved a common-law cause of action for aiding and abetting, see *First United Pentecostal Church v. Parker*, 514 S.W.3d 214, 225 (Tex. 2016), but do recognize a similar claim for knowing participation in breach of fiduciary duty. *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 138 Tex. 565, 160 S.W.2d 509, 514 (Tex. 1942).

[\[13\]](#) Some of the same risks are present when one private equity firm seeks to poach an investment professional from another firm. It would be the unusual firm that failed to contractually restrict its investment professionals with noncompete and non-solicitation clauses. In particular, perhaps the most significant information that an investment firm might seek in its due diligence on a potential hire—his or her past investment successes—is rigidly restricted in the industry. Nondisclosure clauses almost inevitably prohibit a partner or other investment professional from disclosing (whether during or after his or her employment) financial results or other information concerning specific portfolio investments. Likewise, *non-attribution* provisions, preventing one investment professional from claiming credit for the firm's or an individual investment's results, are common; credit for past investment successes is typically retained for the firm as a whole, deemed to have grown out of collaboration, rather than allocated to an individual member, even one given primary responsibility for monitoring a particular portfolio company.

[\[14\]](#) 2024 WL 4929729 at *11.

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