The Rise of Private Equity Sponsors in the Management of Financial Distress: Lessons from the United States, Europe and Asia-Pacific

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Abstract

This article examines the promises, perils and challenges associated with the rise of private equity sponsors in the management of financial distress. Drawing on the legal and finance literature, as well as an analysis of high-profile cases from the United States, Europe and Asia-Pacific, we show that private equity sponsors reshape the management of financial distress in ways that can both enhance efficiency and generate or exacerbate conflicts that may destroy or opportunistically divert value at the expense of creditors or particular classes of creditors. Our comparative analysis reveals important cross-jurisdictional divergences in how private equity sponsors respond to financial distress. We argue that these differences can be explained, at least in part, by variations in legal and institutional environments, which shape sponsor behavior not only in insolvency proceedings but also in the period preceding financial distress. The article concludes by assessing whether existing insolvency and insolvency-related frameworks remain fit for purpose in this new era of capital markets and corporate finance, characterized by the rise of private markets and the growing role of private equity sponsors in the governance of firms, including those in financial distress, and proposes targeted reforms to address some of the distinctive risks posed by private equity-led insolvencies.

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Table of contents

1. Introduction

In recent decades, private equity (PE) has emerged as a central force in global corporate finance, reshaping not only how firms are financed and governed but also how they restructure when they become financially distressed. As the PE industry has expanded, an increasing number of firms are controlled by PE sponsors not only while they are solvent but also when they face financial difficulties and, in some cases, ultimately file for bankruptcy. This development has led to a new paradigm in corporate reorganizations, in which insolvency proceedings are influenced—if not driven—by financially sophisticated equity owners with both the incentives and the capacity to actively shape outcomes.[1]

This shift raises important questions for insolvency law and practice. While insolvency law aims to address similar problems across jurisdictions, particularly various forms of debtor and creditor misconduct that can destroy or opportunistically divert value,[2] some of these issues may be exacerbated or take different forms in a world increasingly shaped by PE firms. Even when PE-backed firms remain solvent, the conduct of PE sponsors and the financing structures of PE-backed firms give rise to a range of challenges, including the use of aggressive financial techniques. As financial distress approaches, these practices are often complemented by increasingly sophisticated forms of legal engineering designed to facilitate out-of-court restructuring.

Additionally, the rise of PE-led firms has introduced new dynamics in the management of financial distress. In countries like the United States, which have traditionally been characterized by

[1] For a seminal work analyzing this new trend in corporate reorganizations, see Vincent Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization*, 90 U. CHI. L. REV. 1 (2023).
[2] For an analysis of the economic problems that insolvency law seeks to solve, see generally THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (Harvard Univ. Press 1986); DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY (6th ed., Foundations Press 2014). For a comprehensive framework conceptualizing the core economic problems of insolvency law as commons, anticommons and agency, and proposing a unifying account of how insolvency law responds to this "bankruptcy trilemma," see Kenneth Ayotte, Jason Roderick Donaldson & Giorgia Piacentino, *Bankruptcy's Trilemma: A Unifying Framework*, 18 J. LEGAL ANALYSIS 51 (2026). Analyzing how changes in financial markets and capital structures are reshaping some of the problems that corporate reorganization law is intended to solve, see SARAH PATERSON, CORPORATE REORGANIZATION LAW AND FORCES OF CHANGE (Oxford Univ. Press 2020). Arguing that insolvency law seeks to solve similar problems across jurisdictions—namely, minimizing value destruction in financially distressed firms and facilitating the efficient allocation of the debtor's assets, both of which are often undermined by various forms of debtor and creditor misconduct—but noting that the optimal design of insolvency law depends on a variety of country-specific and firm-specific factors, see AURELIO GURREA-MARTÍNEZ, REINVENTING INSOLVENCY LAW IN EMERGING ECONOMIES (Cambridge Univ. Press 2024), at 3–22, 111–12.

dispersed shareholdings in the context of public firms, an increasing number of distressed firms now have controlling shareholders. While this is the prevailing pattern in most jurisdictions, it remains a relatively recent development in the United States. However, unlike families or the state, which are the types of controlling shareholders commonly found across jurisdictions, PE sponsors are repeat players in restructuring scenarios.[3] This factor, along with their superior information, expertise, and incentive structures, often makes them behave differently in the management of financial distress. As will be shown, such different behavior can enhance the efficiency of restructurings, but it can also create new risks and challenges.

This paper is structured as follows. Section 2 examines the rise of PE sponsors in insolvency proceedings, explaining the structural drivers behind this trend and highlighting the collapse of several high-profile PE-backed firms across the United States, Europe, and the Asia-Pacific region. Section 3 explores the role of PE sponsors in managing financial distress, emphasizing both the benefits and risks associated with their growing involvement in distressed situations. Section 4 analyzes whether the rise of PE-led insolvencies warrants amendments to existing insolvency and insolvency-related legal frameworks. Section 5 concludes.

2. The Rise of Private Equity Sponsors in Insolvency Proceedings

2.1. Structural Drivers in the Rise of Private Equity-Led Bankruptcies

In recent years, PE firms have emerged as increasingly influential actors in insolvency proceedings. In the United States, PE sponsors were involved in 54% of the largest corporate bankruptcies in 2025, representing 19 of the 35 filings with liabilities exceeding $1 billion at the time of filing.[4] Their involvement was also significant among bankruptcies with liabilities of at least $500 million, accounting for 51% of such cases.[5] Overall, PE-owned companies represented 10% of all U.S. corporate bankruptcies in 2025, underscoring the growing presence of PE firms in

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[3] Certain controlling shareholders observed in other jurisdictions, particularly sovereign wealth funds with large portfolio companies, may also be frequently involved in insolvency proceedings. Therefore, notwithstanding their differences from PE firms in terms of governance, structure, funding models, and fee arrangements, they may, to some extent, also function as repeat players in corporate restructurings.
[4] Matt Parr, *Private Equity behind majority of 2025's largest bankruptcies*, Private Equity Stakeholder Project. (Feb. 24, 2026) https://pestakeholder.org/news/private-equity-behind-majority-of-2025s-largest-bankruptcies/.
[5] *Id.*

distressed markets.[6] While the United States remains the primary arena for PE-led bankruptcies, various high-profile cases of insolvency proceedings led by PE firms have also occurred in Europe, Asia and beyond, suggesting that this phenomenon is gradually extending beyond American borders and is likely to expand further as the PE industry continues to grow.[7]

The growing prominence of PE sponsors in insolvency proceedings is not accidental. Rather, it reflects a combination of broader developments in capital markets, lending practices, and corporate finance. Several structural factors have contributed to this trend. First, over the past decade, global private equity assets under management have more than tripled, rising from approximately $2.5-3 trillion in 2015 to around $9.9 trillion in 2025.[8] Such expansion of PE has also been geographically concentrated. Private equity funds domiciled in North America account for approximately $5.06 trillion, representing around 51% of global private equity assets under management.[9] By comparison, PE funds in Asia account for roughly 31% of the global total,[10] while Europe represents approximately 15%.[11] The predominance of PE in North America, particularly in the United States, helps explain why sponsor-led insolvency proceedings remain largely a U.S. phenomenon. However, the rapid global expansion of private equity and its emergence as a dominant force in corporate finance across other jurisdictions suggest that, as sponsors assume greater control over corporate capital structures, sponsor-led insolvency proceedings are likely to become increasingly prevalent worldwide.

Second, the financial strategies commonly employed by PE firms, particularly leveraged buyouts (LBOs), can increase the risk of insolvency for PE-backed firms.[12] As the core acquisition technique of the PE industry, LBOs finance transactions primarily with debt placed on the target

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[6] *Id.*
[7] See section 2.2
[8] *Analysis reveals record growth in private equity funds*, Ocorian (Oct 29, 2025) https://www.ocorian.com/knowledge-hub/insights/analysis-reveals-record-growth-private-equity-funds.
[9] *Id*.
[10] *Id.*
[11] *Id*.
[12] Brian Ayash & Mahdi Rastad, *Leveraged Buyouts and Financial Distress*, 38 FIN RSCH. LETTERS 101452, 101457 (2021) (finding that LBOs increase the probability of bankruptcy for the target firm by approximately 18%). However, see Tereza Tykvová & Mariela Borell, *Do private equity owners increase risk of financial distress and bankruptcy?* 18(1) J. CORP. FIN. 138, 147–148 (2012) (showing that PE-backed companies do not suffer from higher bankruptcy rates than comparable non-buyout companies). *See also* Shai Bernstein, Josh Lerner, Morten Sorensen & Per Strömberg, *Private Equity and Financial Equity During the Crisis*, 32 REV. FIN. STUD. 1309 (2019) (explaining how PE ownership can enhance firm robustness in economic downturns).

company.[13] When the target company performs as expected, this leverage can facilitate acquisitions while enhancing returns for PE investors and generating efficiency gains also for PE-backed firms.[14] However, by imposing substantial debt burdens on acquired companies, LBOs also increase the risk of financial distress for the target firms.[15] Consequently, whether such companies remain under PE ownership or transition to new owners, the legacy of high leverage often leaves them exposed to a higher risk of insolvency. Thus, the expansion of the PE industry and the growing use of LBOs have led to a larger number of insolvencies involving PE-acquired firms, resulting in the emergence of a significant wave of PE-led insolvency proceedings.[16]

Third, the increasingly borrower-friendly credit environment has further bolstered the role of PE sponsors in bankruptcy.[17] Such favorable conditions are the result of several factors, including a prolonged low interest rate environment,[18] and a significant shift in the leveraged loan market.[19] Money-center banks, which once acted as ongoing financial partners and active monitors of borrower risk, have largely been replaced by collateralized loan obligations (CLOs) as the primary source of leveraged financing.[20] Unlike traditional banks, CLOs are largely passive investors and are not expected to manage the risk of individual loan defaults, thereby weakening routine

[13] Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity,* 23 J. ECON. PERSPS. 121, 121–122 (2009) (explaining the mechanisms and evolution of LBOs).

[14] Such benefits include those generally associated with the use of debt, such as tax benefits and improved corporate governance. *See, e.g.,* Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. FIN. ECON. 147, 148–149 (1977) (explaining that firms determine their capital structure by balancing the tax advantages of debt against the costs of financial distress); Stewart C. Myers & Nicholas S. Majluf, *Corporate financing and investment decisions when firms have information that investors do not have*, 13 J. FIN. ECON, 187, 209 (1984) (highlighting how the use of debt can be preferred in a world of asymmetric information); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, 76 AM. ECON. REV. 323 (1986) (highlighting how debt can improve corporate governance by disciplining managers).

[15] Hanna Sten & Elika Ghiasi Tari, Behind the Buyout: Private Equity and Corporate Default Risk: Evidence from Panel Data on Swedish Firms Using Survival and Difference-in-Differences Models 7 (2025) (Master's thesis, Stockholm Sch. of Econ.), https://arc.hhs.se/download.aspx?MediumId=6449.

[16] Edith S Hotchkiss, David C Smith & Per Strömberg, *Private Equity and the Resolution of Financial Distress*, 10 REV. CORP. FIN. STUD. 694, 696 (2021) (showing that PE-firms default more frequently than non-PE firms, but the PE-backed firms also carry more debt; however, once indebtedness as of the date of the last leverage loan financing is controlled for, differences in probability between the two groups disappear). However, see Tykvová & Borell, *supra* note 12.

[17] Daniel Kamensky, *The Rise of the Sponsor-In-Possession and Implications for Sponsor (Mis)Behaviour*, 171 U. PA. L. REV. ONLINE 19, 22 (2024).

[18] Miriam Gottfried *Buyout Boom Gains Steam in Record Year for Private Equity*. WALL ST. J. (2021 Nov. 28) https://www.wsj.com/business/deals/buyout-boom-gains-steam-in-record-year-for-private-equity-11638095402?msockid=11e39dc11dde67f711278b2c1c9b664e.

[19] Buccola, *supra* note 1; Kamensky, *supra* note 17.

[20] *Id*.

monitoring.[21] This reduction in lender discipline has enabled sponsors to pursue more aggressive, equity-oriented strategies even during times of distress.[22]

In addition, the proliferation of CLOs has contributed to more borrower-friendly loan terms.[23] "Covenant-lite" loans have become increasingly prevalent, initially in the United States, and then in the United Kingdom, Continental Europe and beyond.[24] Unlike traditional bank loans, covenant-lite agreements omit standard financial maintenance covenants and rely primarily on incurrence covenants, which are triggered only when borrowers take on additional debt.[25] As a result, leveraged firms operate under weaker covenant protections and less restrictive collateral packages than in prior decades.[26] For example, carve-outs from standard incurrence covenants limit lenders' ability to block certain transactions, granting borrowers greater flexibility to incur incremental debt while reducing the pool of assets available to creditors.[27] The loosening of covenant protections is often justified by confidence in the monitoring capabilities of PE sponsors, who are perceived as more effective than traditional lenders in overseeing portfolio companies.[28]

Fourth, the repeat-player dynamic between PE sponsors and their lenders in the leveraged loan market, provides incentives for borrower-friendly loan terms and enforcements. Unlike typical corporate borrowers who approach the syndicated loan market episodically, PE sponsors are serial acquirers who return to the same pool of arranging banks.[29] Lenders competing for PE sponsor's future deal flows have a rational basis to offer concessions, such as lower loan spreads and more relaxed covenant thresholds.[30] Similarly, reputable PE groups with an established track record of

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[21] Jeremy McClane, *Reconsidering Creditor Governance in a Time of Financial Alchemy*, COLUM. BUS. L. REV. 192, 228 (2020).
[22] Samir D. Parikh, *Creditors strike back: The return of the cooperation agreement,* 73 DUKE L.J. ONLINE 1, 11–12 (2023).
[23] Sarah Paterson, *The Rise of Covenant-lite Lending and Implications for the UK's Corporate Insolvency Law Toolbox*, 39 OXFORD J. LEGAL STUD. 654, 662–663 (2019); Buccola, supra note 1.
[24] Jared A. Ellias & Narine Lalafaryan, *The Global Law of Debt*, 75 DUKE L.J. (Forthcoming 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5871022.
[25] Paterson, *supra* note 23, at 658.
[26] Buccola, *supra* note 1, at 17.
[27] *Id.*, at 19.
[28] Paterson, *supra* note 23, at 659.
[29] Victoria Ivashina & Anna Kovner, *The Private Equity Advantage: Leveraged Buyout Firms and Relationship Banking*, 24 REV. FIN. STUD. 2462, 2464 (2011).
[30] *Id.*, at 2462–65 (finding that "a one-standard-deviation increase in bank relationship strength is associated with an 8-basis-point (3%) decrease in the spread and a 0.21-basis-point (4%) increase in the maximum debt to EBITDA covenant").

repeat activity pay narrower spreads and secure looser covenant packages than comparable non-sponsored borrowers.[31]

Crucially, lender leniency does not dissipate when a sponsored borrower runs into financial trouble. Private equity-sponsored firms in fact violate loan covenants more frequently than observably comparable non-sponsored firms.[32] Yet the market response to those violations diverges sharply along sponsorship lines: upon a covenant breach, PE-backed borrowers experience significantly smaller reductions in credit commitments than their non-sponsored counterparts, and lenders are more likely to grant waivers and amendments rather than exercise remedies.[33] This asymmetric enforcement reflects two reinforcing mechanisms: the lender's forward-looking interest in preserving the relationship and its attendant deal flow, and the sponsor's superior bargaining power in renegotiation relative to a standalone corporate borrower.

Finally, insolvency proceedings can serve as an opportunity to restructure liabilities and unlock value.[34] While this is true for any company in distress and those controlling them, PE sponsors are particularly well positioned to exploit such opportunities due to their expertise, resources and incentives.[35] It is therefore not surprising that they employ a range of restructuring techniques, including liability management exercises and formal insolvency proceedings, as forms of legal and financial engineering intended to create value.[36]

In sum, the growing presence of PE sponsors in insolvency proceedings reflects a broader trend characterized by the rise of private markets, the increasing size of the PE industry, and a marked shift in corporate financing. The rise of the PE industry and the financial techniques PE firms

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[31] Cem Demiroglu & Christopher M. James, *The Role of Private Equity Group Reputation in LBO Financing*, 96 J. FIN. ECON. 306, 309 (2010).
[32] Sharjil Haque & Anya Kleymenova, *Private Equity and Debt Contract Enforcement*, FED. RESERVE BD. WORKING PAPER NO. 2023–018, 2 (2023) (finding that "PE-backed firms have at least a 4 to 25 % greater probability of violating a covenant relative to non-PE-backed loans").
[33] *Id.*, at 5.
[34] *See, e.g.,* Stuart C. Gilson, CREATING VALUE THROUGH CORPORATE RESTRUCTURING: CASE STUDIES IN BANKRUPTCIES, BUYOUTS, AND BREAKUPS (Wiley 2012).
[35] Kaplan & Strömberg, *supra* note 13, at 130–131 (explaining how private equity firms improve value through financial, governance, and operational engineering). *See also* Viral Acharya, Oliver F. Gottschalg, Moritz Hahn & Conor Kehoe, *Corporate governance and value creation: Evidence from Private Equity*, 26 REV. FIN. STUD. 368, 370–371 (2013) (showing that PE firms create value through operational improvements and skill).
[36] Whether those techniques really create value or simply redistribute value, however, is a separate discussion. For an empirical investigation and a comprehensive analysis of the promises and perils of liability management exercises, see Mark J. Roe & Vasile Rotaru, *Liability Management's Limited Runway: Corporate Restructuring Today* 136 YALE L.J (forthcoming, 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6103369.

employ for their acquisitions—particularly LBOs—and afterwards has increased the number of PE-led insolvency proceedings. At the same time, borrower-friendly financing, driven by a prolonged low-interest rate environment and the widespread adoption of CLOs and covenant-lite loans, has reduced traditional lender oversight, enabling sponsors to pursue more aggressive, equity-focused strategies both before and during periods of financial distress. Collectively, these developments have reinforced the central role of PE sponsors in insolvency proceedings, and more broadly in distressed situations, and suggest that their importance will continue to grow across jurisdictions as private markets and the PE industry expand.

2.2. The Rise and Fall of Private Equity-backed Firms: Evidence from High-Profile Cases in the United States, Europe and Asia-Pacific

2.2.1. United States

Founded in 1948, Toys "R" Us grew into a dominant global toy retailer before losing ground to big-box competitors and e-commerce platforms. In 2005, it was acquired by Bain Capital, KKR & Co. and Vornado in a $6.6 billion leveraged buyout, of which $5.3 billion was financed by debt.[37] While the debt financing the acquisition was initially going to be assumed by the acquirers, it was finally allocated to the company.[38] This left Toys "R" Us saddled with debt payments of about $400 million per year. [39] In the years following the acquisition, the company also engaged in asset monetization strategies, including real estate transactions that increased fixed costs while weakening its long-term financial flexibility.[40]

Despite an attempted IPO exit, that strategy was abandoned due to the insufficient investor demand for the offering.[41] In 2017, constrained by its high levels of debt and declining revenues, Toys "R" Us filed for Chapter 11.[42] Subsequent litigation brought by a creditor trust alleged breaches of

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[37] Shenzhan Li, Xinran Liu & William W. Tan, *The Study of Toys "R" Us' LBO failure*. 215 ADVANCES IN ECON., BUS. AND MGMT. RSCH 1412, 1413 (2022).
[38] *Id. See also* Mark Dunbar, *How Private Equity Killed Toys "R" Us*, IN THESE TIMES (Oct. 10, 2017) https://inthesetimes.com/article/how-private-equity-killed-toys-r-us
[39] Li et al, *supra* note 37, at 1414.
[40] Alison Granito, *Vornado to buy Toys "R" Us locations*, PERE NEWS (Sept 18, 2006) https://www.perenews.com/vornado-to-buy-toys-r-us-locations/.
[41] Jamie Morgan & Muhammad Ali Nasir, *Financialised Private Equity Finance and the Debt Gamble: The Case of Toys R Us*, 26(3) NEW POL. ECON. 455, 465 (2021).
[42] In re Toys "R" Us, Inc., 642 B.R. 727 (Bankr. E.D. Va. 2022).

fiduciary duty, fraudulent concealment, misrepresentations and negligence.[43] Toys "R" Us was controlled by a sponsor-dominated board, with directors affiliated with the company's PE owners.[44] Notwithstanding the company's deteriorating financial condition, the claimants alleged that the defendant directors pursued high-risk and large-scale debtor-in-possession (DIP) financing that benefited insiders at the expense of the creditors.[45] The claimants further alleged that senior executives had improperly extracted pre-bankruptcy bonuses despite legal advice that such payments would be impermissible.[46] Although no final judicial determination was made regarding the liability of the company's directors, the court approved a confidential settlement in October 2022 between the directors and the company's creditor litigation trust.[47]

A similar pattern of aggressive financial techniques and controversial asset transfers was observed in Caesars Entertainment.[48] Acquired in 2008 by Apollo Global Management and TPG in a $30.9 billion leveraged transaction, of which $25.2 billion was financed by debt,[49] Caesars faced declining revenues following the global financial crisis.[50] As distress intensified, the sponsors pursued a series of liability management transactions and asset transfers between 2011 and 2014, including the movement of intellectual property and prime real estate to affiliated entities at discounted prices.[51] At the same time, although the company's loan covenants appeared to restrict certain transfers of assets, Apollo and TPG were able to structure transactions designed to circumvent these restrictions. In particular, all of the operating company debt had been guaranteed by its holding company, thereby cutting off any value to the equity held by the sponsors.[52] Apollo sought to release these guarantees by separating the operating company from its parent company, but the operating company was deeply insolvent, which meant that no rational outside investor

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[43] *Id*.
[44] Complaint, *TRU Creditor Litigation Trust v. Brandon*, Index No. 651637/2020 (N.Y. Sup. Ct., N.Y. Cnty. Filed Mar. 12, 2020), [4].
[45] *Id.*, [18].
[46] *Id.*, [6] – [7].
[47] Eliza Ronalds-Hannon *Toys 'R' Us Creditor Trust, Directors Reach Sealed Settlement*. BLOOMBERG L. (2022, October 18), https://news.bloomberglaw.com/bankruptcy-law/toys-r-us-creditor-trust-directors-reach-sealed-settlement.
[48] This bankruptcy has been described as "the most brutal corporate restructuring in Wall Street history." See Sujeet Indap & Max Frumes, THE CAESARS PALACE COUP: HOW A BILLIONAIRE BRAWL OVER THE FAMOUS CASINO EXPOSED THE POWER AND GREED OF WALL STREET (2021).
[49] Kamensky, *supra* note 17, at 25.
[50] Sujeet Indap, *What happens in Vegas… the messy bankruptcy of Caesars Entertainment*, Fin. Times (Sept 26, 2017) https://www.ft.com/content/a0ed27c6-a2d4-11e7-b797-b61809486fe2.
[51] Kamensky, *supra* note 17, at 26.
[52] *Id.,* at 29.

would purchase its equity.[53] To overcome this obstacle, Apollo arranged a transaction with hedge funds already holding shares in the parent company, thereby facilitating a restructuring that sidestepped the guarantees.[54] By the time Caesars filed for bankruptcy in 2015 with approximately $24 billion in debt, the company's controversial transactions had significantly reduced creditor recoveries. While Caesars successfully negotiated a restructuring agreement with most creditors, two hedge funds refused to participate. Efforts to impose a cram down on the dissenting creditors proved unsuccessful, and an independent examiner subsequently uncovered evidence suggesting that Caesars' management and board had engaged in potentially fraudulent transfers.[55] These findings ultimately contributed to creditors securing a settlement worth approximately $5 billion from the casino chain's PE sponsors.[56]

Another high-profile case of the acquisition and subsequent collapse of a PE-backed firm was Neiman Marcus, which also involved a series of value-shifting transactions. Following its 2013 leveraged acquisition by Ares Management and the Canada Pension Plan Investment Board, the retailer struggled with declining performance in the face of structural shifts toward online commerce.[57] Its most valuable asset, the online platform MyTheresa, acquired in 2014, was designated as an "unrestricted subsidiary" under the company's debt covenants, based on contested valuation assumptions, enabling its transfer beyond the reach of creditors.[58] When Neiman Marcus filed for Chapter 11 in 2020, litigation focused on this transaction, along with allegations of broader governance failures. Following the bankruptcy filing, a group of creditors alleged that the transfer of MyTheresa formed part of a broader scheme to shift value away from creditors and filed a motion to appoint an independent examiner.[59] Concerns were raised regarding the independence and effectiveness of newly appointed restructuring directors, whose conduct drew judicial criticism.[60] Nevertheless, the company emerged from bankruptcy after eliminating roughly $4

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[53] *Id*.
[54] *Id*.
[55] Final Report of Examiner, Richard J. Davis at 1, *In re Caesars Entertainment Operating Co.*, No. 15-01145 (Bankr. N.D. Ill. Mar. 15, 2016).
[56] *Key moments in the contentious Caesars bankruptcy,* Reuters (Sept. 18, 2016*)* https://www.reuters.com/article/business/key-moments-in-the-contentious-caesars-bankruptcy-idUSL2N1BZ1T8.
[57] Neiman Marcus Group Ltd. LLC, Current Report (Form 8-K) (Oct. 7, 2013).
[58] Jared A. Ellias, Ehud Kamar & Kobi Kastiel, *The Rise of Bankruptcy Directors*, 95 S. CAL. L. REV. 1083, 1100 (2022).
[59] *Id.,* at 1101.
[60] *Id.,* at 1102.

billion in debt, with creditors assuming ownership, while the MyTheresa asset remained outside the bankruptcy estate and effectively insulated from their claims.

The collapse of J. Crew also represents another high-profile case involving a PE-backed firm. In 2011, private equity firms TPG Capital and Leonard Green & Partners acquired J. Crew in a $3.1 billion leveraged buyout.[61] The acquirers then caused J. Crew to borrow $787 million to fund dividend payments to TPG and Leonard Green,[62] further saddling J. Crew with an even heavier debt burden. In 2017, J. Crew transferred valuable intellectual property to unrestricted subsidiaries using a broad interpretation of covenant provisions.[63] That same year, a minority group of J. Crew's senior term lenders filed a complaint against J. Crew in the Supreme Court of the State of New York.[64] While the 2017 suit was still pending, J. Crew proceeded to use the new, asset-rich unrestricted subsidiaries to entice junior, unsecured bondholders to exchange their debt for new secured bonds with a lower principal amount and longer maturities.[65] J. Crew also sought the consent of its senior secured lenders to approve the restructuring transactions, and incentivized these creditors by offering to repurchase up to $150 million of senior secured debt at par value, notwithstanding that the loans were trading at a lower price.[66] The New York court dismissed most of the minority lenders' claims on the basis of the consent provided by the majority.[67] More controversially, the IP transfer, which involved a substantial portion of the collateral and arguably required unanimous lender consent, was upheld.[68] Ultimately, however, this litigation was resolved

[61] Kenneth Ayotte & Christina Scully, *J. Crew, Nine West, and the Complexities of Financial Distress*. 131 YALE L.J. F. 363, 368 (2021).
[62] Americans for Financial Reform Education Fund, *J. Crew Succumbs to Bankruptcy after Private Equity Debt*, *Financial Looting* (2020). https://ourfinancialsecurity.org/wp-content/uploads/2020/05/AFREF-J-Crew-PE-Bankruptcy-FS-5-2020.pdf.
[63] Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1363 (2021).
[64] Christine Dreyer McCay, George Ticknor & Johnathan Young, *J. Crew Group, Inc.: Use of credit facility baskets eviscerates value of term loan collateral*, JD Supra (Oct. 5, 2017), https://www.jdsupra.com/legalnews/j-crew-group-inc-use-of-credit-facility-48821; *J. Crew Group, Inc., et al. v. Wilmington Savings Fund Society, Index No. 650574/2017* (N.Y. Sup. Ct.) (2017).
[65] Memorandum of Law in Support of Motion for Leave to Amend/Supplement Counterclaims at 2, J. Crew Grp., Inc., No. 650574/2017.
[66] Dick, *supra* note 63, at 1365.
[67] *Id*. *See also* Transcript at 46-49, Eaton Vance Mgmt. v. Wilmington Sav. Fund Soc'y, No. 654397/2017, 2018 WL 1947405 (N.Y. Sup. Ct. Apr. 25, 2018).
[68] Douglas Mannal, Stephen Zide, Alon Goldberger & Isaac Stevens, *Liability Management Transactions (Part II): Drop-Down Transactions,* Dechert (Jan. 2023), https://www.dechert.com/content/dam/dechert%20files/knowledge/onpoint/2023/1/Liability-Management-Transactions-Part-II-Drop-down-Transactions.pdf.

as part of J. Crew's Chapter 11 reorganization procedure, initiated in 2020. Nonetheless, it did not lead to any additional recoveries for the objecting minority lenders.[69]

Finally, the acquisition and subsequent fall of Nine West also illustrate certain features and patterns in the collapse of PE-backed firms. After Sycamore Partners acquired the Jones Group in 2014, valuable brands were sold to sponsor-affiliated entities while new debt was layered onto the operating company. [70] Weak covenant protections for junior creditors allowed these transactions to proceed, effectively subordinating their claims. When Nine West filed for Chapter 11 in 2018, trustees pursued fraudulent transfer and fiduciary duty claims against Sycamore and former directors and officers.[71] However, settlement negotiations were derailed after Belk, one of Nine West's main customers and itself a Sycamore portfolio company, threatened to terminate its commercial relationship with Nine West. In response, the bankruptcy court ordered the parties into mediation to facilitate a negotiated resolution.[72]

2.2.2. Europe

In Europe, the collapse of TIM Hellas exemplifies the complexity of cross-border leveraged structures. Acquired in 2005 by Apax and TPG through a multi-layered Luxembourg holding structure, the company was subjected to a series of transactions that transferred value to sponsors in different ways, including the repurchase of deeply subordinated convertible private equity certificates (CPECs) and the payment of consulting fees.[73] Following insolvency proceedings across multiple jurisdictions, including the United Kingdom, the United States, and Luxembourg, creditors faced significant legal obstacles in challenging certain transactions entered into by the company and in seeking to hold directors liable.[74] On 23 December 2015, the Luxembourg

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[69] *Id*.
[70] Ayotte & Scully, *supra* note 61, at 373 (2021).
[71] *Id.*, at 376.
[72] *Id.*, at 377.
[73] Press Release, Apax Partners' Funds and Texas Pacific Group to Acquire Control of Tim Hellas Telecommunications S.A. in a 1.1 Billion Euro Transaction, (Apr. 4, 2005) http://www.apax.com/news/apax-news/2005/april/apax partners%E2%80%99-funds-and-texas-pacific-group-to-acquire-control-of-tim-hellas.
[74] In 2011, the English High Court discharged the administrators of Hellas II and ruled that Hellas II should instead be wound up through a compulsory liquidation. See *Re Hellas Telecommunications (Luxembourg) II SCA (in administration)* [2011] EWHC 3176 (Ch). In 2012, Hellas II's liquidators filed a chapter 15 petition with the U.S. Bankruptcy Court for the Southern District of New York, seeking recognition of the company's U.K. liquidation proceeding. The bankruptcy court entered an order granting recognition in 2012. The bankruptcy court however later dismissed fraudulent transfer claims asserted by the liquidators against TPG and Apax in 2015, holding that

Commercial Court rejected the liability action against the directors, holding that the payments made could not be requalified as illegal dividend distributions to the shareholders.[75] Notably, the court held that, although CPECs are hybrid instruments potentially convertible into shares, they are nevertheless regarded as debt instruments that do not confer voting rights or, per se, entitle their holders to participate in corporate profits, thereby rendering Luxembourg corporate law provisions governing unlawful dividend distributions to shareholders inapplicable.[76]

The acquisition and subsequent collapse of Four Seasons Health Care in the United Kingdom also offer valuable lessons for the analysis of PE-led insolvencies, and more generally for understanding the promises and perils of PE ownership, particularly in critical sectors. In 2012, Four Seasons Health Care was acquired by the PE firm Terra Firma in a leveraged transaction of £825 million, financed largely through the issuance of two tranches of high yield bonds: £350 million senior secured bonds and £175 million senior bonds.[77] As such, the acquisition by Terra Firma left the Group with substantial debt burdens and significant interest obligations. This was exacerbated after the acquisition when Four Seasons borrowed £220 million from Terra Firma subsidiaries at an annual compound interest rate of 15% for a period exceeding 10 years.[78] It was reported that Terra Firma intended to extract profits from the care homes while legally avoiding taxes that might otherwise have been due.[79] To achieve this goal, the company embarked on a variety of strategies that included the creation of subsidiaries to establish layered structures—often across multiple countries—followed by the transfer of cash and other assets, such as property or intellectual property rights, between them.[80] The complex structure of Four Seasons' organization also obscured its financial operations from nearly all observers except a limited group of insiders.[81]

Luxembourg appeared to have a greater interest than New York in having its law applied to the claim. See *Hosking v. TPG Capital Management LP (In re Hellas Telecommunications (Luxembourg) II SCA)*, 2015 BL 21823 (Bankr S.D.N.Y. Jan 29. 2015).

[75] Karyn Grasso, *Hellas Case: Court Rejects Claim*, LEXOLOGY (Jan. 5, 2016), https://www.lexology.com/library/detail.aspx?g=92cb8101-d5e5-46f6-b500-2da96579fd8

[76] *Id*.

[77] Tim Jarrett, *Four Seasons Health Care Group – financial difficulties and safeguards for clients* 12 (House of Commons Library, Briefing Paper No. 8004, 2019) https://researchbriefings.files.parliament.uk/documents/CBP-8004/CBP-8004.pdf.

[78] Juliette Garside, *Private equity firm made struggling care home operator take costly loan*, THE GUARDIAN (Nov. 8, 2017), https://www.theguardian.com/news/2017/nov/08/private-equity-terra-firma-care-home-four-seasons-loan.

[79] *Id*.

[80] *Id*.

[81] Andrew Dolan, *Britain's Care Homes Are Being Turned into Corporate Financial Instruments*, SOC. HEALTH ASS'N (Mar. 15, 2016), https://sochealth.co.uk/2016/03/15/britains-care-homes-turned-complex-financial-instruments/.

These operations included a series of discretionary accounting and financial decisions in the form of intra-group "charges," pointing towards a business model in which cash was extracted from the operating company while the sponsor positioned itself with creditor claims in the event of liquidation or sale.[82] Notably, notwithstanding the annual interest payments of £50 million arising from its debts of more than £500 million,[83] Four Seasons also had over £300 million of internal, intra-group debt.[84] Interest on this debt was charged at a high rate of 15% on a compounded basis, and the resulting intra-group borrowing accumulated as a liability that could potentially support claims over assets in the event of liquidation.[85] In late 2017, Four Seasons defaulted on its payments and its largest creditor, H/2 Capital Partners, a US hedge fund, took effective control of the company.[86] However, restructuring efforts were ultimately unsuccessful, and Four Seasons went into administration in April 2019.[87]

The crisis of Four Seasons Health Care and other care home operators in the United Kingdom brought to the fore concerns about whether PE firms are suitable owners of businesses that constitute a key component of a country's critical social infrastructure.[88] Concerns about the public accountability of private equity-owned care home operators were raised, given their short-term investment focus and complex structures involving scores of subsidiary companies, many of which were incorporated offshore. This episode helped trigger and intensify policy debates about financialized ownership structures in the care sector.[89]

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[82] *Id*.
[83] Michael Pooler, *Four Seasons insists it can make £26m interest payment*, Fin. Times (Oct. 25, 2015), https://www.ft.com/content/fd208c2c-7b2b-11e5-a1fe-567b37f80b64.
[84] Diane Burns, Luke Cowie, Joe Earle, Peter Folkman, Julie Froud, Paula Hyde, Sukhdev Johal, Ian Rees Jones, Anne Killett & Karel Williams, *Where Does the Money Go? Financialised Chains and the crisis in residential care* 8 (CRESC Public Interest Report, 2016).
[85] *Id*.
[86] Press Association, *US hedge fund puts Britain's biggest care home operator up for sale,* The Guardian (Oct 29. 2018) https://www.theguardian.com/business/2018/oct/29/us-hedge-fund-orders-sale-britain-biggest-care-home-operator-four-seasons-h2-capital-partners.
[87] *Four Seasons Health Care Goes into Administration*, BBC News (Apr. 30, 2019), https://www.bbc.com/news/business-48102859
[88] Garside*, supra* note 78.
[89] Grace Blakeley & Harry Quilter-Pinner, *Who Cares? The Financialisation of Adult Social Care* (Inst. for Pub. Pol'y Rsch, 2019) (arguing for policy interventions to arrest the growth of debt-fuelled private providers in social care); *The Dark Side of Private Equity*, U. CHI. BUS. L. REV. ONLINE (2026), https://businesslawreview.uchicago.edu/online-archive/dark-side-private-equity (arguing that tools of private equity value creation such as high leverage, cash extraction and short-term exit incentives externalize predictable risks onto third parties including workers, healthcare patients, consumers, unsecured creditors, communities and the environment).

Finally, the demise of the U.K. department store retailer Debenhams further illustrates the cumulative impact of leverage and asset disposals often observed in PE-backed firms. Acquired in 2003 by TPG, CVC, and Merrill Lynch in a leveraged buyout, the company underwent sale-and-leaseback transactions and multiple recapitalizations that increased its debt burden while enabling substantial dividend payouts to sponsors.[90] As retail conditions deteriorated, Debenhams struggled with high fixed costs and limited capacity to invest in digital transformation. After first entering administration in 2019, Debenhams entered administration again in April 2020 amid store closures and severe operational disruptions caused by the COVID-19 pandemic.[91] By late 2020, Debenhams was eventually wound down after announcing the closure of its remaining 124 stores.[92] Debenhams' brand and other business assets were later acquired by Boohoo for £55 million in 2021.[93] Debenhams' demise is often attributed, at least in part, to the conduct of its PE owners, who were alleged to have extracted value from the company in ways that constrained its ability to generate sufficient resources for reinvestment in the business. In particular, critics have argued that its PE owners burdened the business with excessive debt and disposed of much of its freehold property, thereby contributing to high fixed costs and ultimately exacerbating Debenhams' decline.[94]

2.2.3. Asia-Pacific

In Asia, the collapse of Homeplus offers valuable lessons regarding the involvement of PE firms in both solvent and financially distressed firms. MBK Partners, one of Asia's largest PE firms, acquired the South Korean retail chain from the U.K. retailer Tesco plc in 2015 for approximately US$ 6.1 billion through a heavily leveraged buyout.[95] Even at the time of acquisition, the business outlook for Homeplus—an offline retailer—was far from promising, as online retail competitors

[90] Robert Wachman, *Private Equity takes a hit at debt-laden Debenhams*, THE GUARDIAN (Jan. 4, 2009) https://www.theguardian.com/business/2009/jan/04/private-equity-debenhams.
[91] *Britain's iconic Debenhams' path to resurrection*, Reuters (Mar. 11, 2025) https://www.reuters.com/business/retail-consumer/britains-iconic-debenhams-path-resurrection-2025-03-11.
[92] Rob Neate, *Debenhams: The Rise and Fall of a British Retail Institution*, THE GUARDIAN (Dec. 1, 2020), https://www.theguardian.com/business/2020/dec/01/debenhams-the-rise-and-fall-of-a-british-retail-institution.
[93] See *supra* note 91.
[94] James Moore, *Debenhams Falls out of Fashion*, THE INDEPENDENT (Sept. 28, 2007), https://www.independent.co.uk/news/business/analysis-and-features/debenhams-falls-out-of-fashion-403782.html
[95] James Davey & Joyce Lee, *Tesco Sells South Korean Arm to Private Equity Group for $6.1 Billion*, Reuters (Sept. 7, 2015), https://www.reuters.com/article/business/tesco-sells-south-korean-arm-to-private-equity-group-for-61-billion-idUSKCN0R70J6/.

were already demonstrating significant growth trajectories in the Korean market. Nevertheless, the target presented a compelling strategic asset: a portfolio of stores occupying prime locations in major urban centers across South Korea, which proved highly attractive to the acquirer from a real estate perspective.

Following the acquisition, MBK Partners monetized this real estate portfolio through a series of sale-and-leaseback transactions, deploying the proceeds to service acquisition debt and distribute returns to limited partners.[96] As the operating performance of the retail business subsequently deteriorated, Homeplus found itself burdened by an unsustainable debt load—one compounded by the long-term lease obligations created by the very sale-and-leaseback arrangements that had been used to extract value at an earlier stage.[97] After repeated credit downgrades, Homeplus filed for corporate rehabilitation with the Seoul Bankruptcy Court in March 2025.[98] Following the court's approval to commence the restructuring process, MBK Partners disclosed plans to divest Homeplus by issuing new shares to a prospective buyer while cancelling its existing equity stake, valued at ₩2.5 trillion (approximately US$1.8 billion).[99]

Apart from the corporate and insolvency issues involved in the collapse of Homeplus, this case also attracted criminal and regulatory scrutiny. In 2026, South Korean prosecutors requested a warrant to arrest Michael Byungju Kim, the chairman of PE firm MBK Partners, on charges of fraud and violations of the Capital Markets Act.[100] Prosecutors had been investigating whether MBK Partners approved a Homeplus debt issuance in 2025 despite prior knowledge of a credit downgrade, which could have resulted in investor losses. MBK was also suspected of engaging in accounting fraud by changing the repayment terms of redeemable convertible preferred shares to

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[96] Kim Yoon-mi, *MBK Partners mulling sale and leaseback of Homeplus stores: reports*, Korea Herald (May 23, 2016), https://www.koreaherald.com/article/965706.

[97] *Homeplus woes reveal cracks in MBK's leveraging strategy*, The Investor (Mar. 23, 2025), https://www.theinvestor.co.kr/article/10447931

[98] Do-hyun Ko, *Homeplus files for corporate rehabilitation amid credit rating downgrade*, Korea Times (Mar. 4, 2025), https://www.koreatimes.co.kr/business/companies/20250304/homeplus-files-for-corporate-rehabilitation-amid-credit-rating-downgrade

[99] Hyunjoo Jin & Kane Wu, *MBK plans to sell its troubled Korean supermarket chain Homeplus*, Reuters (June 13, 2025), https://www.reuters.com/en/mbk-plans-sell-its-troubled-korean-supermarket-chain-homeplus-2025-06-13/.

[100] *Homeplus fraud pegged at $79m as MBK Chairman Kim faces warrant review*, Korea JoongAng Daily (Jan. 12 2026) https://koreajoongangdaily.joins.com/news/2026-01-12/business/finance/Homeplus-fraud-pegged-at-79M-as-MBK-Chairman-Kim-faces-warrant-review/2498505

hide the retailer's financial difficulties.[101] However, the Seoul Central District Court ultimately dismissed this prosecution request for an arrest warrant, on the grounds that the material submitted so far was insufficient to justify the charges.[102]

Finally, another interesting feature of the collapse of Homeplus, at least for Korean practice, is that the company filed for rehabilitation before it was factually insolvent.[103] Although more common in other jurisdictions, the initiation of reorganization proceedings by firms that are not factually insolvent has traditionally been rare in South Korea and has often been viewed with skepticism, raising concerns about the potentially opportunistic use of insolvency proceedings by the PE sponsor behind Homeplus.[104]

The failure of Dick Smith Electronics in Australia also illustrates some of the risks often observed in PE-backed firms, especially when they embark on certain strategies, including financial engineering and accelerated exits.[105] Acquired in 2012 by Anchorage Capital Partners for a relatively modest upfront investment, the company underwent significant inventory write-downs that inflated reported earnings.[106] This, combined with aggressive store expansion and favorable supplier arrangements, supported a public listing in 2013 at a substantially higher valuation.[107] However, underlying performance continued to deteriorate, and the company entered receivership in early 2016 after failing to meet debt obligations. After failing to attract a viable buyer, Dick Smith was ultimately wound up in July 2016.[108] Anchorage Capital Partners then came under

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[101] Im Eun-byel, *Arrest warrant sought for MBK chief in Homeplus probe*, The Korea Herald (Jan. 8, 2026), https://www.koreaherald.com/article/10651295.

[102] Heejin Kim & Heekyong Yang, *South Korea Court rejects arrest warrant for chairman of MBK Partners*, Reuters (Jan. 13, 2026) https://www.reuters.com/world/asia-pacific/south-korea-court-rejects-arrest-warrant-mbk-partners-chairman-media-says-2026-01-13/.

[103] No Kyung-min, *MBK Partners Under Fire as Homeplus seeks Rehabilitation Protection*, Korea Herald (Mar. 4, 2025) https://www.koreaherald.com/article/10433082.

[104] Jun Ji-hye, *MBK in hot seat over snowballing Homeplus debacle*, Korea Times (Mar. 6, 2025), https://www.koreatimes.co.kr/business/banking-finance/20250306/mbk-in-hot-seat-over-snowballing-homeplus-debacle.

[105] For a comprehensive view of some of the problems, see Jeffrey Knapp, *The Ugly Story of Dick Smith, from Float to Failure*, UNSW Sydney (Mar. 11, 2026) https://www.unsw.edu.au/newsroom/news/2016/03/the-ugly-story-of-dick-smith--from-float-to-failure.

[106] Roger Montgomery, *Dick Smith prospectus failed to disclose*, Firstlinks (Mar. 3, 2016) https://www.firstlinks.com.au/dick-smith-prospectus-failed-disclose.

[107] See *Dick Smith, bought for $20m, may fetch $344m in IPO*, ABC News (Nov. 14, 2013), https://www.abc.net.au/news/2013-11-14/dick-smith-to-be-publicly-listed/5092946.

[108] Sue Mitchell, *Dick Smith was an accident waiting to happen*, Austl. Fin. Rev. (July 16, 2016) https://www.afr.com/companies/retail/dick-smith-was-an-accident-waiting-to-happen-20160714-gq62kd

intense scrutiny over its management of the company.[109] The receiver and investors of Dick Smith brought proceedings against Dick Smith's then executive directors, Nick Abboud and Michael Potts, and its auditor, alleging that Dick Smith's prospectus contained misleading and deceptive representations regarding Dick Smith's inventory value and the transformation of the business following its 2012 acquisition by Anchorage Capital Partners.[110] The shareholder litigation ultimately culminated in *Findlay v DSHE Holdings*, where the New South Wales Supreme Court approved a settlement of approximately A$25 million.[111]

2.2.4. Lessons

The analysis of the high-profile cases examined in the previous section reveals a number of recurring patterns in PE-led acquisitions that later culminated in insolvency. Across jurisdictions, common features include high levels of leverage, aggressive financial engineering, and transactions that may shift value away from creditors. These practices often involve asset transfers to affiliated entities, sale-and-leaseback arrangements, intra-group financing, and the creation of complex, multi-layered corporate structures that can obscure financial positions and complicate enforcement. In several instances, particularly during periods of financial distress, PE strategies also included covenant exploitation, liability-management exercises that favored certain creditors over others, and various strategies aimed at postponing the initiation of insolvency proceedings, sometimes through the pursuit of excessively risky projects.[112]

As discussed in Section 3, some of the international divergences in the behavior of PE firms in the management of financial distress often reflect differences in legal and institutional environments. Nevertheless, one of the principal lessons suggested by the anecdotal evidence presented in the previous section is that, in addition to the exacerbated conflicts among creditors often observed in

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[109] Mark Williamson, Egor Serov & Sam Blight, *Dick Smith prospectus litigation*, Piper Alderman (Feb. 25, 2021), https://piperalderman.com.au/insight/dick-smith-prospectus-litigation/.
[110] *Id.*
[111] *Findlay v DSHE Holdings* [2021] NSWSC 249, [120] (Austl.).
[112] For an analysis of directors' incentives and how they may shift when a company becomes financially distressed, increasing directors' incentives to pursue risky strategies in an attempt to "gamble for resurrection," see e.g., Michael C. Jensen & William H. Meckling, *Theory of the firm: Managerial Behaviour, Agency Costs and Ownership Structure* (1976) 3 J. FIN. ECON. 305, 334–337 (1976); Barry E. Adler, *A Re-Examination of Near-Bankruptcy Investment Incentives*, 62 U. CHI. L. REV. 575, 590–598 (1995); John Armour, Gerard Hertig & Hideki Kanda, *Transactions with Creditors*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (3rd ed., Oxford Univ. Press 2017) 111. *See* also *infra* note 190.

financially distressed PE-backed firms, the rise of PE has intensified conflicts between shareholders and creditors. Although such agency problems may arise regardless of a debtor's financial condition, they become particularly acute when a company becomes factually insolvent but has not yet entered formal insolvency proceedings—that is, when it operates in the so-called "zone of insolvency."[113] In these circumstances, the directors continue to be appointed, removed and compensated by shareholders. As a result, even when creditors have effectively become the firm's residual claimants, the directors may still have incentives to advance the shareholders' interests sometimes at the expense of the creditors.[114]

This issue is particularly pronounced in private equity-backed firms due to the presence of a controlling shareholder. Since shareholders are often directly involved in the management, or are able to closely monitor and replace managers, the alignment of incentives between managers and shareholders is generally stronger than in the traditional U.S. public corporation characterized by dispersed ownership structures.[115] From a comparative perspective, this phenomenon is not new. In most jurisdictions around the world, companies generally have controlling shareholders.[116] Therefore, non-U.S. jurisdictions are accustomed to the type of intensified agency problems between shareholders and creditors that are currently observed in the United States. In fact, such exacerbated conflicts between shareholders and creditors have likely motivated the imposition of more creditor-oriented duties in the zone of insolvency in non-U.S. jurisdictions.[117]

In the United States, the growing prevalence of controlled firms is a recent development, driven in part by the rise of dual-class share structures and the expansion of private equity. As discussed in

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[113] For the purpose of clarifying the regime and beneficiaries of directors' duties, especially in jurisdictions where directors might be subject to special duties when a company becomes financially distressed, it has been pointed out that it is important to distinguish four stages in the financial situation of a company: (i) when a company is solvent; (ii) when a company is solvent but starts to face or foresee financial trouble ('zone of pre-insolvency' or 'vicinity of insolvency'); (iii) when a company is factually insolvent but it is not yet subject to a formal insolvency proceeding ('zone of insolvency'); and (iv) when a company is subject to a formal insolvency proceeding. By "zone of insolvency", this article refers to the third stage. *See generally* Aurelio Gurrea-Martínez, *Towards an Optimal Model of Directors' Duties in the Zone of Insolvency: An Economic and Comparative Approach*, 21 J. CORP. L. STUD. 365 (2021).
[114] *Id.*, 367.
[115] *Id*.
[116] *See* generally Rafael La Porta, Florencio Lopez de Silanes & Robert Vishny, *Corporate Ownership around the World* 54 J. FIN. 471 (1999); Gur Aminadav & Elias Papaioannou, *Corporate Control around the World*, 75 J. FIN. 1191 (2020); Adriana de la Cruz, Alejandra Medina & Yun Tang, *Owners of the World's Listed Companies*, OECD Capital Market Series (2019), www.oecd.org/corporate/ca/Owners-of-the-Worlds-Listed-Companies.pdf.
[117] For an analysis of such creditor-oriented duties and how they differ across jurisdictions, see generally Gurrea-Martínez, *supra* note 113.

Section 4, this transformation in corporate ownership structures may justify revisiting the rules governing directors' duties in the zone of insolvency, or at least the way such rules have been interpreted under Delaware law.

3. The Promises and Perils of the Rise of Private Equity Sponsors in the Management of Financial Distress

3.1. The Value-Enhancing Role of Private Equity Sponsors in Financial Distress

The empirical literature on private equity in insolvency suggests that PE-backed firms exhibit distinct advantages in navigating financial distress.[118] First, PE-backed firms exhibit a clear preference for resolving distress through quicker and less cost-intensive mechanisms.[119] Rather than relying on prolonged, court-supervised proceedings, they frequently pursue consensual out-of-court restructurings or pre-packaged reorganizations ("pre-packs").[120] Namely, it has been shown that approximately 52% of restructurings involving PE-backed firms are completed either entirely out of court or via pre-packs, whereas 64% of non-PE-backed firms proceed through traditional "free-fall" Chapter 11 filings.[121] This difference in approach is significant, given that out-of-court solutions and pre-packs can significantly reduce the direct and indirect costs associated with the resolution of financial distress.[122]

Second, PE-backed firms generally resolve financial distress more quickly than comparable non-sponsored firms.[123] On average, their restructuring processes are about 4.2 months (or 35%) shorter.[124] Even within formal bankruptcy proceedings, PE-backed firms progress through Chapter

[118] *See* generally Hotchkiss et al, *supra* note 16.
[119] *Id.*, at 697.
[120] *Id.*
[121] *Id.*, at 719.
[122] STUART C. GILSON, *Managing default: Some evidence on how firms choose between workouts and chapter 11*, 4 J. APPLIED CORP. FIN. 62 (1991) (comparing workouts and formal reorganization procedures and finding that the former are less expensive but not always feasible and that is why firms generally prefer workouts when they do not face significant coordination problems due to the existence of multiple creditors); EDWARD ALTMAN, EDITH HOTCHKISS & WEI WANG, CORPORATE FINANCIAL DISTRESS, RESTRUCTURING AND BANKRUPTCY (Wiley 2019) 83–84 (providing theoretical and empirical arguments to support the fact that workouts and pre-packaged bankruptcies are less costly than formal reorganization procedures); Aurelio Gurrea-Martínez, *The Rise of Pre-Packs as a Restructuring Tool: Theory, Evidence and Policy*, 24 EUR. BUS. ORG. L. REV 93 (2023) (summarizing the empirical evidence on pre-packs and showing how this restructuring tool can reduce the costs and length of insolvency proceedings).
[123] Hotchkiss et al, *supra* note 16, at 696.
[124] *Id.*, at 696.

11 cases roughly three months (25%) faster than comparable firms.[125] This shorter duration of bankruptcy procedures is itself an important factor in reducing the costs of insolvency proceedings, which, in turn, can increase the value available for distribution to creditors.[126]

Third, PE-backed firms are more likely to be reorganized rather than liquidated.[127] While reorganization is not inherently preferable to liquidation—unless the firm's assets are more valuable as a going concern than in alternative uses—there is little evidence to suggest that this outcome is driven by a reorganization bias that artificially preserves non-viable firms. Instead, there are compelling reasons to attribute higher reorganization rates to efficiencies in the insolvency process. Among others, PE-backed firms incur lower bankruptcy costs, in part due to the shorter duration of proceedings.[128] This alone helps preserve value and increases the likelihood of reorganizing insolvent but economically viable firms. In addition, PE sponsors often have access to "locked-in" capital, allowing them to provide timely liquidity to distressed portfolio companies without the delays and uncertainty associated with external fundraising.[129] As repeat participants in credit markets, PE sponsors are also subject to reputational constraints, which may incentivize them to manage distress efficiently and minimize losses to creditors.[130] Their accumulated restructuring experience—frequently complemented by expertise from affiliated distressed investment funds—further strengthens their ability to navigate complex insolvency processes.[131] These features, which contribute to greater value preservation, combined with the stronger bargaining position of PE sponsors relative to other shareholders and managers, help explain why PE-led insolvency proceedings not only result in higher reorganization rates but also more frequently allow sponsors to retain control. In particular, it has been shown that PE sponsors

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[125] *Id.*, at 697.
[126] *Id.*, at 697.
[127] *Id*.
[128] *Id*.
[129] *Id.*, at 701.
[130] *Id*. *See,* however, Sarah Paterson, *Private Equity in Distress and the Incentives of Collateralised Loan Obligations*, 77 CURRENT LEGAL PROBS. 13, 20–21 (2024) (explaining that debt markets are more dependent on the market cycle and are considerably less personalized. Instead, PE firms have stronger incentives to please their investors, whose decisions are likely influenced by past performance). It could also be the case that PE firms do minimize losses for creditors, but only for certain creditors—typically sophisticated lenders who may also act as repeat players. Therefore, rather than minimizing losses for creditors overall, PE behavior may simply shift losses from one group of creditors to another, which is consistent with the literature showing that, in companies with "bankruptcy directors," which are often PE-backed firms, unsecured creditors receive lower returns. See Ellias et al, *supra* note 58, at 1110.
[131] Hotchkiss et al, *supra* note 16, at 701.

maintain a controlling stake in approximately 28% of reorganized firms, compared to only 4% for non-PE equity holders, who are otherwise typically wiped out.[132]

Finally, PE sponsors may act as a counterbalance to dominant secured creditors in leveraged capital structures. Senior lenders often exert significant influence over restructuring outcomes.[133] By contrast, sponsors may bring financial resources, restructuring expertise, and bargaining power that enable them to propose alternative restructuring strategies, secure new financing, or resist creditor-driven liquidation scenarios that may destroy value when a firm is economically viable.[134] Thus, sponsor involvement can often lead to more value-maximizing outcomes.[135]

3.2. The Risks and Challenges of Private Equity-Led Insolvencies

Despite their potential advantages, the management of distressed scenarios by PE sponsors also gives rise to a range of risks and challenges. First, sponsor control may incentivize strategic delay in the commencement of formal insolvency proceedings.[136] PE sponsors, at least in the United States, typically have strong reasons to avoid bankruptcy, among other factors because of the existence of the absolute priority rule.[137] As a result, distressed firms may pursue alternative sources of liquidity outside formal proceedings and postpone filing for as long as possible.[138] Such delay often leads to value erosion, particularly where liquidity weakens and operational performance deteriorates, or where sponsors engage in value-destructive or value-diverting conduct in the zone of insolvency or the period preceding a situation of financial distress.[139] Our anecdotal evidence from the high-profile cases described in the previous section suggests that such delays may reflect sponsor incentives to retain control or extract value.[140] These dynamics are

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[132] *Id.*, at 697.
[133] Kenneth Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 512 (2009) (explaining that senior secured creditors came to dominate the Chapter 11 process); Bo Li, Lynette Purda & Wei Wang, *Senior Lender Control: Monitoring Spillover or Creditor Conflict?* 3 J.L. FIN. & ACCT. 373, (2018).
[134] Hotchkiss et al, s*upra* note 16; Acharya et al, *supra* note 35, at 370–373.
[135] Acharya et al, *supra* note 35, at 388 (showing that PE ownership tends to have a positive impact on firms' operating performance).
[136] Buccola, *supra* note 1, at 37.
[137] Paterson, *supra* note 130, at 19–20. While the absolute priority rule is a common rule in liquidation procedures in every jurisdiction, it is not a universal rule in reorganization procedures, though. See Anthony J. Casey & Aurelio Gurrea-Martínez, *Rethinking priorities in insolvency*, EMORY BANKR. DEVS. J. (Forthcoming, 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6622721
[138] *Id.*, at 32.
[139] *Id.*, at 25.
[140] *Id*.

closely linked to the increasing use of aggressive liability management techniques, including so-called "hardball" priming transactions.[141] Such transactions—frequently observed in sponsor-backed firms—allow distressed companies to incur new senior secured debt that effectively subordinates existing lenders, sometimes with the support of only a subset of creditors.[142] Mechanisms such as dropdown transactions and non-pro rata uptiers exploit contractual flexibilities in modern loan agreements to reallocate value and secure liquidity outside of bankruptcy.[143] While these strategies may provide short-term financing relief, they can intensify inter-creditor conflicts and complicate subsequent restructuring efforts.[144]

Second, the compensation and structural design of PE funds can create a misalignment of incentives at the portfolio-company level, particularly when a firm faces financial distress. Unlike non-sponsored firms, where management may be primarily focused on the long-term viability of a single enterprise, PE sponsors operate under a "fund-as-a-whole" incentive structure.[145] Carried interest—the primary performance-based compensation for general partners—is typically calculated based on the aggregate performance of the entire fund and distributed only after the fund surpasses a predetermined hurdle rate.[146] Consequently, sponsors are incentivized to maximize the fund's overall internal rate of return rather than the outcome of any individual portfolio company. As a result, while PE sponsors often provide capital infusions to distressed firms,[147] which is consistent with the behavior of other controlling shareholders in reorganization procedures,[148] they may refrain from doing so when it is not justified from the perspective of the fund's aggregate performance. Moreover, although PE sponsors often have access to committed

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[141] Buccola, *supra* note 1, at 32; Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIFORNIA L. REV. 745, 748 (2020) (arguing that the norms restraining managers of distressed firm have faded since the financial crisis, enabling managers now pursue strategies that harm creditors for the benefit of shareholders).

[142] See Robert W. Miller, *Liability Management Exercises Mature*, 28–29 (Sept. 30, 2025), https://ssrn.com/abstract=5549919. *See also* Roe & Rotaru, *supra* note 36.

[143] *Id*.

[144] Dick, *supra* note 63, 1370–1371 (explaining that while hostile restructuring techniques may enhance overall efficiency of the market, they also introduce uncertainty and carry substantial litigation costs).

[145] See Victor Fleisher, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U L. REV 1, 1–2 (2008) (explaining that private equity fund managers take a share of partnership profits as the equity portion of their compensation through carried interest).

[146] *See,* e.g., Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds*, 23 REV. FIN. STUD. 2303, 2310 (2010) (explaining that a GP would only receive carried return to LPs after providing a preset hurdle).

[147] Hotchkiss et al, *supra* note 16, at 701.

[148] Wai Yee Wan, Casey Watters & Gerard McCormack, *Schemes of Arrangement in Singapore: Empirical and Comparative Analyses*, 94 AMERICAN BANKRUPTCY LAW JOURNAL 463 (2020) (showing how the success of many schemes of arrangement in Singapore are likely explained by the new financing often provided by controlling shareholders).

capital, the capacity of a sponsor to support a distressed portfolio company can often be constrained by the fund's investment lifecycle. Indeed, most PE funds operate with a limited investment period, typically the first five years of a fund's life, during which capital calls from limited partners are permitted for new or follow-on investments. Once this period expires, the sponsor's ability to inject additional capital is restricted, often leaving a distressed company without a vital liquidity backstop. Furthermore, the finite life of the fund—typically ten to twelve years—imposes a structural mandate to exit all positions and return proceeds to LPs within a fixed horizon.[149] Upon the expiration of the fund's term, the sponsor typically becomes ineligible to receive management fees from investors,[150] which may diminish the incentive to exert diligent efforts in managing remaining portfolio companies. For a sponsor approaching the end of a fund's lifecycle, the structural pressure to liquidate assets and facilitate final distributions often outweighs the potential benefits of a protracted, uncertain restructuring.

Third, PE-driven insolvency proceedings may result in increased litigation and transaction costs.[151] Sponsor-led restructurings often involve complex financial engineering, which can generate disputes over fraudulent transfers, fiduciary obligations, and the interpretation of debt covenants. These disputes are frequently protracted and costly, diverting resources away from restructuring efforts and reducing overall recoveries. At the same time, the growing reliance on pre-bankruptcy contracting, particularly restructuring support agreements (RSAs),[152] and tightly structured DIP financing arrangements,[153] can further shape and constrain the restructuring process.[154] In sponsor-backed cases, such agreements may operate as vehicles for negotiated bargains between sponsors and select creditor groups, sometimes involving broad liability releases for sponsors in exchange for support of the restructuring.[155] Similarly, DIP financing arrangements often incorporate

[149] Hotchkiss et al, *supra* note 16, at 699; Kaplan & Strömberg, *supra* note 13, at 123.
[150] *See,* e.g., ILPA Model Limited Partnership Agreement (July 2020) (Articles 8.3.1 "Initial Term" and 18.1 "Term").
[151] Buccola, *supra* note 1, at 35; Ellias & Stark, *supra* note 141.
[152] Katherine Waldock, Anthony J. Casey & Frederick Tung, *Restructuring Support Agreements: An Empirical Analysis*, UNIV. OF CHI. COASE-SANDOR INST. FOR L. & ECON. RSCH. PAPER NO. 1008 (2024).
[153] Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1 (2022).
[154] Buccola, *supra* note 1, at 39–40 (explaining how prebankruptcy contracting like RSAs and DIP loan agreements can undermine statutory elements of bankruptcy designed to protect minority-creditor classes, and also shorten a bankruptcy case's duration substantially).
[155] *Id.*, at 40–41.

aggressive milestones and procedural constraints that prioritize speed while limiting scrutiny of pre-bankruptcy conduct, potentially benefitting sponsors and certain creditors.[156]

Fourth, while PE-led insolvency proceedings appear to generate important efficiency gains, they do not necessarily translate into higher creditor recoveries. As previously discussed, PE-backed firms tend to resolve financial distress more quickly, incur lower restructuring costs, and rely more heavily on out-of-court restructurings and pre-packaged proceedings. Interestingly, however, creditor recovery rates in PE-backed defaults are slightly lower than in comparable non-PE-backed cases, even if some of these differences become statistically insignificant once firm-level characteristics and other control variables are taken into account.[157] It has also been found that unsecured creditors recover on average 20% less when the company appoints a "bankruptcy director" typically appointed by PE sponsors.[158] Therefore, these findings appear to be consistent with our hypothesis that the rise of controlled firms in the United States, partly driven by the growth of private equity, intensifies conflicts between shareholders and creditors, as well as certain conflicts among creditors, once a company becomes insolvent.

Fifth, another central concern in PE-led insolvency proceedings is the risk of inefficient continuation. As has been mentioned, the empirical evidence indicates that PE-backed firms exhibit higher reorganization rates than their non-PE counterparts.[159] While this may be attributable to efficiency gains—such as shorter restructuring durations and better access to liquidity—it may also reflect the greater bargaining power of PE sponsors.[160] If such higher bargaining power, rather than underlying firm viability, drives higher reorganization rates, there is a risk that unviable firms might be inefficiently preserved.[161] This raises the possibility that some sponsor-led restructurings may prioritize continuation in an attempt to preserve value even if such

[156] *Id.*, at 42. *See also* Ayotte & Ellias, *supra* note 153, at 12–13 (explaining how DIP loans limit management discretion by imposing milestones that force managers to move through the bankruptcy process on an accelerated time frame and preidentified transactions and plans).
[157] Hotchkiss et al, *supra* note 16, at 726–728.
[158] Ellias et al, *supra* note 58, at 1110.
[159] Hotchkiss et al, *supra* note 16, at 697.
[160] Ivashina & Kovner, *supra* note 29, at 2462–2463 (arguing that PE sponsors with long-term relationships with banks obtain loans with lower interest rates and more favourable covenants in their deals).
[161] *See* generally Michelle J. White, *Does Chapter 11 save Economically Inefficient Firms?*, 72 WASH. U. L. Q 1319 (1994) (arguing that Chapter 11 may fail to distinguish adequately between economically viable and nonviable firms, thereby allowing inefficient firms to reorganize when liquidation would be preferable)

outcome does not lead to the efficient deployment of the debtor's assets. Further empirical research is needed to assess the extent to which this concern materializes in practice.

Sixth, a further structural concern relates to the inadequacy of monitoring by acquisition lenders and the resulting creditor-on-creditor conflicts in the event of financial distress. When a PE sponsor acquires a portfolio company, acquisition lenders often provide substantial financing at the fund level for the acquisition itself, while simultaneously refinancing the portfolio company's existing indebtedness.[162] Lenders, by extending credit both to the acquisition vehicle and to the operating company, can maximize interest income across the transaction. In some transactions, the repayment of these loans is typically pre-arranged from the outset, most notably by sale-and-leaseback transactions and various forms of recapitalization. Because acquisition lenders are repaid through these pre-planned mechanisms and secured by collateral that is provided by the PE sponsor and the portfolio company,[163] they have structurally diminished incentives to monitor the portfolio company's management or financial condition rigorously.

This dynamic represents a significant departure from the traditional account of creditor monitoring in corporate finance. In the conventional corporate borrowing context, creditors, and in particular institutional lenders, are expected to play an active governance role, monitoring and disciplining management.[164] In the PE-sponsored transaction context, however, this monitoring function is systematically attenuated, as acquisition lenders have already been made whole through pre-arranged distributions. The consequence is a structural creditor-on-creditor conflict. Acquisition lenders, having recovered their principal through recapitalization proceeds or asset monetization, are insufficiently incentivized to police PE sponsor or portfolio management that exploits the remaining creditor constituency, including trade creditors, and retail investors of the portfolio company. Additionally, the capital structures associated with LBOs are often highly fragmented and complex.[165] Multiple layers of debt, divergent covenant protections, and intricate corporate group arrangements can hinder coordination among creditors and create opportunities for sponsors

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[162] Ulf Axelson, Tim Jenkinson, Per Strömberg & Michael S. Weisbach, *Borrow Cheap, Buy High? The Determinants of Leverage and Pricing in Buyouts*, 68 J. FIN. 2223, 2235 (2013) (showing the structure of LBO debt and finding that in most LBOs, existing debt is also paid off as part of the transaction).
[163] Kaplan and Strömberg, *supra* note 13, at 124 (explaining that a debt almost always includes a loan portion that is senior and secured).
[164] Jensen, *supra* note 14, at 323–29.
[165] Buccola, *supra* note 1, at 35.

to exploit inter-creditor tensions.[166] This fragmentation is frequently the result of successive liquidity-generating transactions—such as asset transfers, sale-leasebacks, and other structured financings—which carve out distinct pools of collateral and claims.[167] While such strategies may enhance flexibility ex ante, they often complicate restructuring negotiations ex post and increase the likelihood of contentious and inefficient outcomes.[168]

Taken together, these considerations highlight that, notwithstanding their potential efficiencies, the management of financial distress by PE sponsors may give rise to significant frictions and distributional concerns. As discussed below, some of these frictions may be created, or at least exacerbated, by legal and institutional environments that have not traditionally been designed to address distressed scenarios involving controlled firms, as is the case in the United States. Against this backdrop, Section 4 examines whether existing insolvency and insolvency-related frameworks remain fit for purpose in light of this new reality in corporate ownership and governance characterized by an increasingly prominent role of PE sponsors in the management of solvent and insolvent firms.

3.3. International Divergences

Our anecdotal evidence from the analysis of various high-profile cases in the United States, Europe and Asia-Pacific suggests that PE sponsors behave differently when dealing with financially distressed firms, potentially reflecting differences in legal frameworks, regulatory design, and market practice. One point of divergence concerns the timing of insolvency filings. For instance, in the United States, delayed filings appear to be the prevailing pattern. Sponsor-backed firms often seek to postpone the initiation of insolvency proceedings by relying on pre-bankruptcy liquidity measures and liability management strategies. This approach is facilitated by a legal framework that encourages workouts, provides permissive contractual frameworks and flexible directors' duties in the zone of insolvency, and suffers from certain weaknesses in the system for

[166] *Id.*, at 37.
[167] *Id.*, at 36 (arguing that the complexity in capital structure is a byproduct of sequential efforts to create liquidity, such as dropdowns, sale leasebacks and related-party-asset sales).
[168] *Id*.

the avoidance of actions.[169] As a result, in the United States, sponsors can undertake transactions that redistribute or erode value in ways that would be more constrained elsewhere.

By contrast, in jurisdictions such as South Korea, Homeplus involved a PE sponsor initiating insolvency proceedings when the company was not even factually insolvent, a practice that has even drawn some criticism in South Korea.[170] The early initiation of reorganization proceedings, however, should not be a cause for concern. The suspicion surrounding early filings largely reflects the legacy of legal frameworks that traditionally required proof of actual insolvency before insolvency proceedings could be initiated. Although most jurisdictions around the world now recognize more flexible standards for the initiation of reorganization procedures, such as "imminent insolvency" or "likelihood of insolvency,"[171] concerns about opportunism persist when a non-insolvent firm initiates a reorganization procedure.

From a policy perspective, restricting early access to reorganization procedures, or even requiring proof of financial conditions as a prerequisite for the initiation of the process, can be counterproductive, as it may delay the initiation of reorganization procedures and contribute to the dissipation of firm value at the expense of creditors and the survival of viable firms. If requiring such financial conditions raises concerns about opportunistic filings, lawmakers should bear in mind that bankruptcy costs, which are not negligible,[172] already serve as a deterrent to such behavior.[173] Moreover, countries can and should implement additional safeguards, such as allowing courts to dismiss insolvency proceedings filed opportunistically,[174] even imposing

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[169] Ellias & Stark, *supra* note 141, at 785–786.

[170] See *supra* note 104.

[171] For an overview of the financial conditions generally required for the initiation of insolvency proceedings around the world, see GURREA-MARTÍNEZ, *supra* note 2, at 59–60, 72–73, 82–83, 95–96.

[172] For instance, some studies have found that the direct costs of a reorganization procedure in the United States represent about 7.5% of the value of the insolvent firm. See Edward Altman, *A further empirical investigation of the bankruptcy cost question*, 39 J. FIN. 1067 (1984). For a summary of the empirical literature measuring the direct costs of insolvency proceedings, see ALTMAN, HOTCHKISS & WANG, *supra* note 122, 72–73.

[173] Aurelio Gurrea-Martínez, *Insolvency Law in the Global South: Lessons for the Global North*, AM. J. COMP. L, 15 (2026) (explaining that because the significant costs of Chapter 11 are ultimately borne by creditors, the costs of bankruptcy is a factor which increases the bargaining power of because when negotiating a workout).

[174] This approach has been adopted in some jurisdictions, such as the United States. While it offers several advantages, it requires efficient and competent courts, and the existence of objective requirements that may not necessarily met with the current "good-faith-filing" test adopted in the United States. See Anthony J. Casey, *Good-Faith Filing in Chapter 11* (Wharton Initiative on Fin. Pol'y & Regulation White Paper, Aug. 22 2024) https://wifpr.wharton.upenn.edu/wp-content/uploads/2024/09/WIFPR-Chapter-11-Casey.pdf (suggesting that courts should replace the good-faith-filing requirement with an objective-futility test).

sanctions to those who have sought to abuse the system,[175] or enabling creditors to terminate reorganization procedures and even place the company into liquidation.[176] Such ex post remedies would provide creditor protection and deter opportunistic filings without delaying the initiation of insolvency proceedings at a time when bankruptcy protection may be urgently needed to preserve firm value.

Further divergences in the management of financial distress by PE sponsors may arise from the availability and design of restructuring tools. In the United States, pre-packaged bankruptcies and out-of-court workouts are central features of the restructuring landscape. By contrast, in jurisdictions such as Australia, pre-packaged procedures remain unregulated, and informal workouts have historically been constrained by strict insolvent trading liability rules, notwithstanding partial relaxation in 2017.[177] Consequently, regulatory design plays a decisive role in shaping both sponsor strategies and the management of financial distress.

Outside insolvency scenarios, there are also significant cross-jurisdictional divergences that shape PE strategies in the period preceding, and in some instances triggering, financial distress. These divergences are reflected, in particular, in regulatory responses to aggressive and potentially value-shifting transactions undertaken by PE sponsors and the resulting financial fragility of portfolio companies. For example, in the European Union, the Alternative Investment Fund Managers Directive imposes asset-stripping restrictions that prohibit, for a period of twenty-four months following the acquisition of a portfolio company, distributions, capital reductions, share redemptions, and certain other transactions that would reduce the net assets of the acquired entity below the level of its subscribed capital plus non-distributable reserves.[178] These provisions were specifically designed to prevent PE sponsors from rapidly extracting value from newly acquired

[175] For instance, this solution has been adopted in India. See Insolvency and Bankruptcy Code 2016, s 65(1).
[176] This solution has been adopted in Uruguay. See Gurrea-Martínez, *supra* note 173, at 22.
[177] For an analysis and critic of the insolvent trading regime traditionally existing in Australia, see Andrew Keay & Michael Murray, *Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvency Trading in Australia* 14 INT'L INSOLVENCY REV. 27 (2005); Jason Harris, *Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?* 23 AUSTL J. OF CORP. L. 266 (2009). For an overview of the 2017 reform and how it provides further room for negotiating an out-of-court restructuring in the event of financial distress, see Ian Ramsay & Stacey Steele, The *"Safe Harbour" Reforms of Directors' Insolvent Trading Liability in Australia: Insolvency Professionals' Views*, 48 AUSTL. BUS. L. REV. 7 (2020).
[178] Council Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, art. 30.

companies, thereby destroying a viable business.[179] In South Korea, the leverage capacity of private equity funds is subject to a statutory ceiling: under the Financial Investment Services and Capital Markets Act, a private equity fund's borrowings and guarantees may not exceed four hundred percent of its equity capital commitments, placing an explicit limit on the debt multiples available in sponsored acquisitions.[180] Following the Homeplus insolvency—in which MBK Partners' aggressive use of acquisition leverage and subsequent sale-and-leaseback transactions were widely criticized—the Korean government announced that it would develop guidelines strengthening the monitoring obligations of major institutional limited partners, including public pension funds, over their general partners.[181] Regardless of the desirability of these regulatory interventions,[182] they do constrain the behaviour of PE firms, even during periods in which target firms remain solvent. Therefore, the predominance of PE-led insolvency proceedings in the United

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[179] European Commission, Report from the Commission to the European Parliament and the Council on the Application of the Scope of the Alternative Investment Fund Managers Directive, at 39, SWD (2020) 110 final (June 10, 2020)

[180] Financial Investment Services and Capital Markets Act, Act No. 8635, arts. 249–7, 249–12 (S. Kor. 2007, amended).

[181] Kim Won, *FSC to Get Stricter on Private Equity Funds in Wake of Homeplus Collapse*, Korea JoongAng Daily (Dec. 22, 2025), https://koreajoongangdaily.joins.com/news/2025-12-22/business/finance/FSC-to-get-stricter-on-private-equity-funds-in-wake-of-Homeplus-collapse/2483674.

[182] The desirability of these regulatory interventions likely depends on one's view of the value of private equity and the risks that the PE industry may generate in general or in certain sectors. For example, the PE industry has been criticized for the aggressive techniques often employed by PE firms, as well as for issues relating to transparency, fee structures, and the overstatement of industry performance. *See, e.g.*, Anonymous, *The Dark Side of Private Equity*, U. CHI. BUS. L. REV. ONLINE (2026) (arguing that "core tools of PE value creation—high leverage, cash extraction, and short-term exit incentives—externalize predictable risks to third parties including workers, healthcare patients, consumers, unsecured creditors, communities and the environment" and proposing targeted regulatory framework to internalize these costs, especially given that the "debt-amplified fragility and profit-pressure dynamics [in the PE industry] can degrade quality, safety, and resilience particularly in sensitive sectors such as healthcare, energy, education, childcare and corrections"); Steven N. Kaplan & Antoniette Schoar, *Private Equity Performance: Returns, Persistence, and Capital Flows*, 60 J. FIN., 1791, 1810 (2005) (investigating the performance of PE partnerships and documenting that "on average, fund returns net of fees are roughly equal to those of the S&P 500"); Ludovic Phalippou, PRIVATE EQUITY LAID BARE (3rd., 2021); Alexander Ljungqvist, *The Economics of Private Equity: A Critical Review*, (CFA Inst. Rsch Found., 2024) https://rpc.cfainstitute.org/sites/default/files/-/media/documents/article/rf-brief/economics-of-private-equity.pdf. Nonetheless, the value created by PE firms, as well as the effectiveness of some of the techniques they employ, has been widely recognized and empirically demonstrated. *See, e.g.,* Michael C. Jensen, *Eclipse of the Public Corporation,* HARV. BUS. REV. 1989 (envisioning the decline of the public corporation due to the rise of private markets and the superiority of highly leveraged and tightly controlled PE-backed firms as a way to mitigate agency problems); Steven N. Kaplan, *The Effects of Management Buyouts on Operating Performance and Value*, 24 J. FIN. ECON. 217 (1989); Frank Lichtenberg & Donald Siegel, *The Effects of Leveraged Buyouts on Productivity and Related Aspects of Firm Behavior*, 27 J. FIN. ECON. 165 (1990); Paul A. Gompers, Steven N. Kaplan & Vladimir Mukharlyamov, *What Do Private Equity Firms Say They Do?*, 121 J. FIN ECON 449 (2016); Abbie J. Smith, *Corporate Ownership Structure and Performance: The Case of Management Buyouts*, 27 J. FIN. ECON. 143 (1990); Douglas Cumming, Donald Siegel & Mike Wright, *Private Equity*, *Leveraged Buyouts and Governance*, 13 J. CORP FIN 439 (2007) (summarizing the empirical literature and concluding that certain practices used by PE firms, such as LBOs and MBOs, enhance performance); Kaplan & Strömberg, *supra* note 13, at 131-133 (showing that PE investors create value through financial and governance engineering and improve operating performance post buyout).

States compared to Europe and the Asia-Pacific appears to be explained not only by the increasing size of the PE industry but also by the strategies employed by PE sponsors in the management of portfolio companies, which are shaped by the legal and institutional environment.

4. Is There a Need for Legal Reform?

4.1. Introduction

The cases examined and the review of the legal and finance literature analyzing the role of private equity in insolvency reveal both the advantages and the risks associated with the rise of PE sponsors dealing with distressed firms. While the involvement of PE sponsors can often facilitate a more efficient resolution of financial distress, it can also lead to exacerbated conflicts between shareholders and creditors, as well as among different groups of creditors, potentially resulting in a loss or opportunistic transfer of value. In our view, while the challenges identified in sponsor-led insolvencies do not generally call for sweeping reforms, they do invite regulators and policymakers, especially in countries that have not traditionally been equipped to address distressed scenarios involving companies with controlling shareholders, to revisit their insolvency and insolvency-related frameworks, particularly in areas that may be critical for protecting creditors from shareholder opportunism.

4.2. Revisiting the Regulatory Framework of Directors' Duties in the Zone of Insolvency

One area of particular relevance for protecting creditors against shareholder opportunism is the regulatory framework governing directors' duties in the zone of insolvency. For that reason, it is unsurprising that most jurisdictions around the world impose some special duties, more focused on protecting creditors, when a company approaches insolvency and especially when it becomes financially distressed.[183] Such regulatory responses have been justified by the conflicts between shareholders and creditors that arise in financial distress, which are typically more acute in companies with controlling shareholders.[184]

[183] Gurrea-Martínez, *supra* note 113 (analyzing the regulatory framework of directors' duties in the zone of insolvency and pre-insolvency, and showing that most jurisdictions around the world impose some special directors' duties when a company is factually insolvent but not yet subject to a formal insolvency proceeding).
[184] *Id.*, at 368–370, 388.

The United States, however, adopts a distinctive approach under which directors are generally required to continue acting in the best interests of the corporation.[185] While this model offers certain advantages,[186] it raises concerns when the firm's residual claimants shift from shareholders to creditors. Indeed, given that directors are appointed and removed by shareholders—when they are not themselves shareholders, as is often the case in controlled firms—they may have incentives to advance the interests of shareholders at the expense of creditors.[187] Moreover, in the United States, even though creditors may bring derivative actions when a company is factually insolvent but not yet subject to formal insolvency proceedings,[188] decisions that are not in the best interests of the corporation, while technically constituting a breach of fiduciary duties, may neither be challenged nor result in liability for directors. This is particularly the case because, in the absence of conflicts of interest or egregious breaches of good faith and informed decision-making, directors generally remain protected by the business judgment rule.[189] As a result, they may pursue strategies that favor shareholders even when they are detrimental to creditors and to the corporation as a whole. This may include, for example, undertaking high-risk, high-reward projects with a negative net present value that shareholders themselves would not have pursued if the company were, and is expected to remain, solvent.[190]

The current flexible regime governing directors' duties in the zone of insolvency in the United States could be justified, at least in part, by the traditionally dispersed ownership structures prevailing in U.S. public companies.[191] In such firms, directors, while formally appointed and

[185] *North American Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92 (Del 2007)
[186] Gurrea-Martínez, *supra* note 113, at 384–386 (highlighting that the regulatory model of directors' duties in the zone of insolvency adopted in the United States can avoid uncertainty and litigation costs associated with determining when the company becomes factually insolvent, it may enable out-of-court restructurings, and it can also maximize firm value by preventing excessively risk-averse behavior).
[187] *Id.*, at 367–368.
[188] *North American Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A.2d 92 (Del 2007).
[189] *In re Hechinger Investment Company of Delaware*, 327 B.R. 537, 548–49 (emphasizing that the business judgment rule applies even in the event of financial distress). *See also Quadrant Structured Prods Co v Vertin,* 102 A.3d 155 (Del Ch 2014).
[190] See *Credit Lyonnais Bank v Pathe Communications Corp,* No 12150, 1991 WL 277613 (Del Ch Dec 30, 1991), footnote 55 (stating that "the possibility of insolvency can do curious things to incentives"… "in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act"). In the academic literature, see Robert Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505 (1977); Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 INT'L REV. L. & ECON. 223 (1991); Paul Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, 7 EUR. BUS. ORG. L. REV. 301 (2006).
[191] Gurrea-Martínez, *supra* note 113, at 388.

removed by shareholders and frequently incentivized to maximize shareholder value through equity-based compensation, are relatively more independent from shareholders.[192] Moreover, collective action problems have historically limited shareholders' ability to closely monitor or easily replace the directors.[193] For these reasons, directors' greater independence has supported a more deferential approach to decision-making even in the zone of insolvency.[194] However, this premise is increasingly less accurate due to the rise of institutional investors and the growing number of companies with controlling shareholders, a trend partly attributable to the exponential growth of the private equity industry and the popularity of dual-class share structures.[195] As a result, the conflicts between shareholders and creditors arising in the zone of insolvency in many U.S. corporations are increasingly converging with those observed in many jurisdictions across Asia, Europe, Latin America, and beyond. In this context, the United States may need to reassess whether its regulatory framework governing directors' duties in the zone of insolvency remains fit for purpose and, if so, whether some adjustments are needed in a world increasingly dominated by controlled firms and exacerbated conflicts between shareholders and creditors.

In our view, such adjustments are indeed needed. At a minimum, the United States, as well as other jurisdictions with similarly flexible frameworks governing directors' duties where controlling

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[192] *Id*.

[193] *See* generally Adolf A. Berle, Jr. & Gardiner C. Means, THE MODERN CORPORATION AND PRIVATE PROPERTY (Harcourt, Brace & World, 1932); Mark J. Roe, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (Princeton Univ. Press 1994). *See* also Jensen & Meckling, *supra* note 112.

[194] Gurrea-Martínez*, supra* note 113, at 388.

[195] For an analysis of the growth of institutional investors in U.S corporations and their increasing role and influence in corporate governance, see Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721 (2019); Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. 569 (2021); Alejandra Medina, Adriana De La Cruz & Yun Tang, *Corporate Ownership and Concentration* 7 (OECD Corp. Governance Working Paper No. 27, 2022), https://www.oecd.org/content/dam/oecd/en/publications/reports/2022/09/corporate-ownership-and-concentration_071a223d/bc3adca3-en.pdf; John Coates, THE PROBLEM OF TWELVE: WHEN A FEW FINANCIAL INSTITUTIONS CONTROL EVERYTHING (Columbia Glob. Reps. 2023); Dorothy S. Lund & Adriana Robertson, *Giant Asset Managers, the Big Three, and Index Investing*, in Luca Enriques & Gionvanni Strampelli (eds), BOARD-SHAREHOLDER DIALOGUE: POLICY DEBATE, LEGAL CONSTRAINTS AND BEST PRACTICES (Cambridge Univ. Press, 2024) 158–184; Robert E. Bishop, Tyler Grace & Yaron Nili, *Influence Without Control: Private Funds, Shareholder Engagement, and the New Law of Control*, JOURNAL OF CORPORATION LAW (Forthcoming, 2026). For the rise of companies with dual-class share structures, see e.g., Robert J. Jackson, Jr., *Perpetual Dual-Class Stock: The Case Against Corporate Royalty*, U.S. Sec. & Exch. Comm'n (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty; Aurelio Gurrea-Martínez, *Theory, Evidence, and Policy on Dual-Class Shares: A Country-Specific Response to a Global Debate*, EUR. BUS. ORG. L. REV. 475 (2021); Adi Libson & Sharon Hannes, *The Dual-Class Stock Revolution*, Bar-Ilan U. Fac. L. Research Paper No. 5755065 (2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5755065.

shareholders are present or becoming increasingly common, should ensure that directors' incentives are aligned with those of the corporation and its (new) residual claimants.[196] This may require, first of all, reaffirming that, in the zone of insolvency, directors should act in the best interests of the corporation rather than in the interests of shareholders.[197] Although this principle has been recognized by courts,[198] the continued reliance on the business judgment rule suggest that, in practice, shareholder-oriented incentives may continue to dominate, even if they lead to decisions that are not necessarily in the best interests of the corporation.

If a company is factually insolvent, courts should apply greater scrutiny to decisions made by corporate directors, not to second-guess their managerial decisions, but to determine whether, given the information available at the time, the decisions made by the directors were reasonably in the best interests of the corporation rather than in the interests of the shareholders.[199] Accordingly, such a stricter application of the business judgment rule should not be understood as restricting managerial discretion or second-guessing business decisions, but rather as preventing the types of conflicts of interest that undermine reliance on the business judgment rule in the first place.[200] Where a decision made in the zone of insolvency exclusively favors the shareholders rather than the firm itself, courts should consider that the directors acted under a conflict of interest—likely exacerbated in controlled firms—and, therefore, should not be entitled to the protection of the business judgment rule or exculpatory provisions relating to the duty of care,[201]

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[196] Ellias & Stark, *supra* note 141, at 784–785 (2020) (arguing that judges can provide greater protection to creditors against debtor opportunism without the need to impose a duty to act in the interest of the creditors but simply focusing on whether the directors make reasonable decisions that maximize the value of the firm and adopting a more rigorous application of the business judgment rule).
[197] Ellias & Stark, *supra* note 141, at 785 (2020) (advocating for such interpretation of the fiduciary duties owed by corporate directors).
[198] *Quadrant Structured Prods Co v Vertin*, 102 A.3d 155.
[199] Ellias & Stark, *supra* note 141, at 785 (2020) (advocating for a more aggressive application of the business judgment rule in distressed firms). For the adoption of a similar approach in other jurisdictions, see *Foo Kian Beng v OP3 International Pte. Ltd.* [2024] SGCA 10 (where the Singapore Court of Appeal determined that the level of scrutiny courts apply when reviewing managerial decisions depends on the financial situation of the company).
[200] *See,* e.g., *Sinclair Oil Corp. v. Levien,* 280 A.2d 717 (Del. 1971); *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); *Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345, 360 (Del. 1993). More generally, for an analysis of the conditions that justify, and in some circumstances preclude, reliance on the business judgment rule in the United States, see Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004). For the application of the business judgment rule in non-U.S. jurisdictions, see Aurelio Gurrea-Martínez, *Re-Examining the Law and Economics of the Business Judgment Rule*: *Notes for its Implementation in Non-US Jurisdictions*, 18 J. CORP. LAW STUD. 417 (2018).
[201] As with the business judgment rule, these exculpatory provisions do not protect directors from liability in situations involving conflicts of interest. See Delaware General Corporation Law, § 102(b)(7). For an analysis of the scope and

which are frequently included in the charters of Delaware corporations.[202] It should be noted, however, that such an interpretation of the business judgment rule, and more generally the proposed understanding of directors' duties in the zone of insolvency, would not require corporate directors to take into account the interests of creditors, as exists in other jurisdictions,[203] and was debated in the United States, especially after a controversial decision of the Delaware Chancery Court.[204] Instead, it would simply mean that the directors should always pursue those projects and strategies that maximize the value of the firm.[205] If a firm is solvent, such strategies will benefit shareholders; if the firm is insolvent, those strategies will benefit the company's creditors.[206]

Thus, pursuing high-risk, high-reward projects that, while potentially desired by shareholders in times of financial distress, have a negative net present value would clearly constitute a breach of fiduciary duty. In our view, a similar conclusion could be reached under current law. However, factors such as the business judgment rule, would likely prevent directors from being held liable for such breaches even if they occurred when the company is factually insolvent. Accordingly, our proposal, while remaining relatively consistent with the existing framework of directors' duties in the United States, would provide further protection to creditors—particularly those who may not be sophisticated enough to secure protection through contractual arrangements—against shareholder opportunism in the zone of insolvency while also offering greater certainty to corporate directors by clarifying that, even if a company is factually insolvent, they must act in the best interests of the corporation. Hence, this approach could partially address some of the problems

limits of such provisions, see Zohar Goshen & Tomer S. Stein, *Leaving Delaware? The Essential Role of Specialized Corporate Courts*, 125 COLUM. L. REV. 2077, 2118–2121 (2025).

202 Jens Frankenreiter, Cathy Hwang, Yaron Nili & Eric Talley, *Cleaning Corporate Governance*, 170 U. PA. L. REV. 1, 37 (2021) (reporting that 96% of Delaware corporations had adopted such provisions in their charters by 2006).

203 Some jurisdictions with some forms of creditor duties in the zone of insolvency include the United Kingdom and Singapore. In the United Kingdom, see *Sequana S.A.* [2022] UKSC 25. In Singapore, see *Foo Kian Beng v OP3 International Pte. Ltd.* [2024] SGCA.

204 See *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp* (1991). For a critical analysis of this decision and more generally the adoption of a corporate duty to creditors, see Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321 (2007).

205 Ellias & Stark, *supra* note 141, at 784 (2020) (arguing that "state court and federal judges adjudicating contract disputes should consider whether management's proposed course of action is a reasonable, good faith display of business judgment that promises to maximize the value of the firm"). In a landmark decision, Judge Frank Easterbook argued that such approach, focused on whether a decision maximize the value of the firm regardless of the financial situation of the company, should be adopted even in bankruptcy. *See In re Cent. Ice Cream Co*., 836 F.2d 1068, 1069–70 (7th Cir. 1987).

206 Gurrea-Martínez, *supra* note 113, at 385 ("If the company is solvent, this mandate will indirectly benefit or harm the shareholders. If the company is insolvent, this mandate will indirectly benefit or harm the creditors—especially the class of creditors becoming the residual claimants of the firm").

currently observed in the context of PE-backed firms and other U.S. companies with controlling shareholders that become insolvent, without requiring a shift to alternative regulatory models of directors' duties in the zone of insolvency that, while commonly observed internationally, may entail additional challenges and drawbacks.[207]

4.3. Revisiting the Regime of Avoidance Actions

Another area that warrants closer scrutiny concerns the design and effectiveness of avoidance actions, that is, the legal mechanisms that permit the retrospective avoidance of harmful transactions entered into by the debtor prior to the commencement of insolvency proceedings.[208] While most, if not all, jurisdictions formally provide for such actions, at least in the context of formal insolvency proceedings,[209] they do not always operate effectively in practice. This may result from several factors, including the lack of resources or incentives to bring avoidance actions, procedural barriers, or delays often associated with such actions.[210]

Therefore, countries concerned with opportunistic behavior in the zone of insolvency, whether by debtors vis-à-vis creditors or among creditors themselves, should consider revitalizing their avoidance regimes.[211] This can be achieved in several ways. First, they should ensure that

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[207] Emphasizing some of these challenges and mentioning how various country-specific factors may reduce or exacerbate the potentially costs and risks possessed by different models of directors' duties in the zone of insolvency, see GURREA-MARTÍNEZ, *supra* note 2, at 370–384, 388–394.

[208] In addition to avoidance actions within insolvency proceedings, most jurisdictions provide for analogous mechanisms outside formal bankruptcy. In civil law systems, such actions are generally referred to as 'actio pauliana.' In common law jurisdictions, comparable remedies typically take the form of fraudulent conveyance actions, which may be invoked even where the company is not formally subject to insolvency proceedings. *See, e.g.,* John Armour, *Transactions at an Undervalue*, in John Armour & Howard Bennett (eds), VULNERABLE TRANSACTIONS IN CORPORATE INSOLVENCY (Hart Publishing 2003) 38.

[209] In hybrid procedures, such as the scheme of arrangement found in many common law jurisdictions, avoidance actions—at least those generally provided under insolvency law—are typically unavailable. Therefore, they remain tools largely confined to formal insolvency proceedings and, in some countries, are unavailable even in certain insolvency proceedings, especially reorganization procedures.

[210] Ellias & Stark, *supra* note 141, at 785–786 (highlighting that avoidance actions have been "devalued as an insolvency remedy" due to the duration associated with "scheduling hearings and ruling on fraudulent transfer motions").

[211] Generally, a regime of avoidance actions distinguishes between transactions that favor debtors (or their related parties) at the expense of creditors and those that favor certain creditors at the expense of other similarly situated creditors. The former are usually captured under the concepts of "undervalue transactions" or "fraudulent transfers" and include transactions in which the debtor receives inadequate or no consideration. The latter are often referred to as "unfair preferences" and generally include advance payments and other transactions that enhance the position of a pre-existing creditor within the scheme of distribution in the event of liquidation. While countries around the world differ in the design of avoidance actions and the terminology used to describe such transactions, most regimes allow the retrospective avoidance of both types of transactions. *See* generally Aurelio Gurrea-Martínez, *The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach*, 93 CHI.-KENT L. REV. 711 (2018).

avoidance actions are available in both liquidation and reorganization procedures. While this is already the case in most jurisdictions, at least in formal insolvency proceedings, in certain countries, such as Australia and Brazil, avoidance actions remain primarily available in liquidation procedures.[212] Second, countries should facilitate the use of litigation funding in avoidance actions.[213] This would ensure that a lack of resources to investigate transactions or bring actions is no longer a constraint. Third, creditors should be empowered in avoidance actions. In particular, creditors should be able to bring avoidance actions on behalf of the estate, and to oppose or halt actions where trustees or debtors in possession propose the initiation of avoidance actions that, in the creditors' view, may not be clearly desirable or may be excessively costly.[214] Fourth, jurisdictions with a weak system of avoidance actions should consider revisiting certain requirements that may unduly restrict the avoidance of value-diverting transactions commonly undertaken prior to the commencement of insolvency proceedings. Depending on the jurisdiction, such requirements may include complex subjective elements that are difficult to prove, such as intent on the part of the debtor or the debtor's counterparty, the imposition of short look-back periods, or the need to prove the debtor's state of insolvency even in transactions involving related parties and those taking place shortly before the commencement of insolvency proceedings where the law could adopt a presumption of insolvency as a means to reduce litigation costs while still providing commercial certainty.[215]

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[212] For an analysis of the regulatory framework governing avoidance actions in Australia, see Corporations Act 2001 (Cth) pt 5.7B. In Brazil, see Law No. 11.101 of 2005, arts. 129–138.

[213] Amrit Mahal, *Third-Party Litigation Funding for Avoidance Actions: The Key to Trapped Recoveries For Creditors* (Int'l Insolvency Inst., 2023), https://www.iiiglobal.org/file.cfm/12/docs/gold%20amrit%20mahal%20-%20tplf%20for%20avoidance%20actions.pdf. For an overview of the treatment and regulation of litigation funding in several jurisdictions, see Sulette Lombard & Christopher F Symes (eds.), *A Cross-Jurisdictional Comparison of the Use of Commercial Litigation Funding in Insolvency in Selected Jurisdictions* (INSOL Int'l 2022).

[214] Some of these solutions exist in various jurisdictions. For example, in Chile, Colombia and Spain, individual creditors are entitled to bring avoidance actions on behalf of the estate subject to certain requirements. In Chile, see Insolvency Act 2014, Art. 293. In Colombia, see Insolvency Act 2006, Art. 75. In Spain, see Insolvency Act 2020, Article 232. In Chile, creditors also have some veto rights over the initiation of avoidance actions that might not be desirable. See Insolvency Act 2014, Art. 290.

[215] Mechanisms seeking to facilitate avoidance actions by reducing the evidentiary burden for bringing such actions, at least in controversial cases such as those involving related parties, already exist in certain jurisdictions. For example, in the United Kingdom and Singapore, the debtor's "desire" to prefer creditors is presumed to be satisfied, unless the contrary is shown, in cases involving preferences granted to related parties. An analogous rebuttable presumption applies, in the context of transactions at an undervalue involving related parties, to the requirement that the debtor be insolvent (or rendered insolvent) at the time of the transaction. In the United Kingdom, see Insolvency Act 1986, ss 239(6) and 240(2). In Singapore, see Insolvency, Restructuring and Dissolution Act 2018, ss 225(5) and 226(3). Similar presumptions could be adopted, for example, for certain transactions—particularly undervalue transactions and some forms of preferences, such as those involving the granting of security for pre-existing unsecured debts or

In some countries, such as the United States, limitations on avoidance actions have been identified as one of the institutional shortcomings that leave creditors inadequately protected against opportunistic behavior by corporate insiders, including PE sponsors.[216] Therefore, assessing and, if necessary, revitalizing the system of avoidance actions can be another potential measure that countries should consider in adapting their frameworks to a new era of PE-backed firms and, more generally, in addressing more effectively the conflicts between shareholders and creditors, as well as those among creditors, that often arise in the zone of insolvency.

4.4. Revisiting the Governance Model of Reorganization Procedures

Most jurisdictions around the world adopt a relatively rigid, one-size-fits-all governance model of reorganization procedures that typically encompasses: (i) a DIP model, in which incumbent management remains in control without the appointment of an external insolvency practitioner (IP), as in the United States; (ii) an IP model, in which management is displaced and replaced by an external IP, generally adopted in administration or judicial management proceedings such as those observed in many common law countries, including Australia, Brunei, Ghana, Malaysia, New Zealand, Nigeria, Singapore and the United Kingdom; and (iii) an intermediate model in which the debtor remains in possession under the supervision of an IP (DIP-SIP), an approach widely adopted across the Americas, Europe, Asia, and beyond, especially among civil law

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the payment of debts not yet due—that, while not involving related parties, took place shortly before the commencement of insolvency proceedings. Other countries, such as Spain, go even further and do not require proof of any financial condition at the time of entering into the transaction. Thus, if the transaction is considered "harmful" to the debtor's estate and took place within the relevant look-back period, it may be avoided. Similarly, certain transactions, such as gifts, are automatically considered harmful. Therefore, prejudice to the debtor's estate does not need to be shown. For an analysis of the requirements for the avoidance of transactions in Spain, see Insolvency Act 2020, arts 226–230. While adopting non-rebuttable presumptions for certain requirements that typically need to be shown for the avoidance of transactions, such as the debtor's insolvency or prejudice to the debtor's estate, can significantly reduce the evidentiary burden for bringing avoidance actions, this policy choice may increase commercial uncertainty and undermine the economic justification for avoidance actions. For these reasons, if adopted, such presumptions should be confined to very limited circumstances and, as a general rule, to transactions that took place within a short period before the commencement of insolvency proceedings. *See generally* GURREA-MARTÍNEZ, *supra* note 2, at 238–242.

[216] Ellias & Stark, *supra* note 141, at 785–786 (2020) (emphasizing that "fraudulent transfer litigation has been devalued as an insolvency remedy", in part because "this kind of action currently takes a very long time to litigate" … and "the slow-moving trains of justice [in fraudulent transfer litigation] have broader consequences than denying justice to a particular plaintiff. It emboldens the entire private equity industry to extract excessive dividends from portfolio firms, knowing that it might take more than a decade to litigate the fraudulent transfer action, by which time every employee currently at the private equity firm will be gone").

countries.[217] In practice, however, the optimal model for the governance of reorganization procedures depends on the specific circumstances of the distressed firm. Where a company remains viable and is managed by competent directors, for example, the automatic displacement of management may increase costs, result in the loss of firm-specific expertise, and discourage early recourse to restructuring mechanisms.[218] By contrast, a pure DIP model, while addressing some of these concerns, may exacerbate conflicts between shareholders and creditors, particularly in controlled firms.[219] For this reason, despite the increasing popularity of the DIP model, it is not surprising that, although this regulatory choice has been adopted and could have been justified in jurisdictions with historically dispersed ownership structures, such as the United States, it does not constitute a standard feature of formal reorganization procedures in most jurisdictions, consistent with the widespread presence of firms with controlling shareholders worldwide.[220] The growing prevalence of controlled firms in the United States, however, may justify targeted adjustments to its current governance model for reorganization procedures.

At present, the DIP model operates as the default rule in the United States, although in certain circumstances the court may appoint an examiner or a trustee.[221] In our view, this flexible framework, which retains the DIP model as a default rule while allowing for case-specific adjustments, represents a sound starting point. However, further refinement is warranted, especially in a world increasingly characterized by controlled firms. In particular, creditors should be granted a more direct role in determining the governance model of reorganization proceedings.[222] In addition to existing grounds for the appointment of an examiner or trustee, the United States should grant a specified percentage of unsecured creditors (e.g., 30%), or at least a majority of such creditors, a statutory right to appoint an examiner or trustee, a rule that, with some variations, already exists in other jurisdictions that have adopted a DIP model as the default rule,

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[217] GURREA-MARTÍNEZ, *supra* note 2, at 60–61, 73, 83–84, 96, 213–224.
[218] *Id.,* at 214–215.
[219] *Id.*
[220] *Id.,* at 11–12*,* 60–61, 73, 83–84, 96, 213–225 (providing an overview of the governance models of reorganization procedures around the world and documenting the widespread use of the IP-led and DIP-SIP models). *See also supra* note 116 (showing the prevalence of controlled firms around the world). For a seminal article examining the relationship between insolvency law, corporate ownership structures and debt structures, see John Armour, Brian R. Cheffins & David A. Skeel, Jr., *Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom*, 55 VAND. L. REV. 1699 (2003).
[221] In practice, however, such appointments are rare. See Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1 (2010).
[222] Gurrea-Martínez, *supra* note 173, at 23–27.

such as Colombia.[223] Furthermore, as has been convincingly argued, given the influence of PE sponsors over the nomination of directors, including independent "bankruptcy directors" who are often appointed to manage restructuring proceedings, the independence of such directors should be subject to enhanced scrutiny,[224] and they should be regarded as independent only where their appointment is supported by an overwhelming majority of unsecured creditors.[225]

In the rest of the countries and regions where PE sponsors are increasingly prevalent, such reforms aimed at further protecting creditors in formal reorganization procedures may be less necessary, given that the appointment of an IP is the prevailing rule.[226] That said, an IP might not always be needed, and its appointment may generate costs that might not be justified in certain cases.[227] Accordingly, if the proposed reform for the United States consists of allowing a more flexible transition from a DIP model to a DIP-SIP or IP-led model upon the request of a specified percentage of creditors, jurisdictions that currently rely on IP-led or DIP-SIP models should conversely permit creditors to opt for a DIP model, if not adopt it as the default rule.[228] Such a regime would effectively protect creditors while avoiding the costs associated with governance structures that may be ill-suited to the circumstances of a particular distressed firm.

4.5. Enhancing Judicial Capacity

Finally, another important implication of the rise of PE-led insolvencies is the likely increase in litigation. As capital structures become more complex and restructuring strategies more sophisticated and, certainly, more contentious, disputes are likely to proliferate. Therefore, countries should anticipate these developments and ensure that their institutional frameworks, particularly judicial capacity and expertise, are adequately equipped to manage increasingly complex insolvency disputes in an efficient and timely manner.

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[223] *Id.*
[224] Ellias et al, *supra* note 58.
[225] *Id.,* at 1131 (arguing that "absent such support, the court should regard the bankruptcy directors as ordinary professionals retained by the debtor").
[226] See *supra* note 216.
[227] Gurrea-Martínez, *supra* note 173, 23–27.
[228] *Id.*

In particular, the increasing complexity of insolvency disputes may provide an even stronger justification for the creation or expansion of specialized insolvency courts,[229] an institutional model already adopted in many jurisdictions around the world, including the United States, China and South Korea, or, at least, the establishment of specialized judges or divisions within general courts, as exists in jurisdictions such as Singapore.[230] Alternatively, countries could consider establishing commercial courts handling a broader range of business disputes, including insolvency matters, where such courts do not yet exist.[231] This latter choice may be particularly appropriate for jurisdictions with a limited volume of insolvency cases, where the establishment of specialized insolvency courts may not be fully justified due to budgetary constraints, limited judicial exposure to insolvency disputes, or other institutional priorities. In such settings, general commercial courts may be warranted not only for insolvency matters but also for other business disputes similarly requiring specialized expertise.[232]

Regardless of the institutional model ultimately chosen to handle insolvency proceedings, courts dealing with insolvency disputes must be capable of understanding the core economic problems that insolvency law seeks to solve—particularly the conflicts between shareholders and creditors, as well as those among creditors, that may result in a loss or opportunistic diversion of value—and resolving those conflicts in a quick, fair, and effective manner. Additionally, courts must also be able to understand the various tools and strategies that different actors may use to shift or extract value, together with the mechanisms provided by insolvency and insolvency-related frameworks to prevent or remedy such conduct. This need for expertise becomes particularly salient in the context of PE-led insolvencies, where sophisticated financial engineering, aggressive restructuring techniques, and highly complex capital structures often magnify conflicts among stakeholders and increase the risk of opportunistic behavior.

[229] If this option is adopted, however, it is important to consider that, as with other institutional reforms, context matters. Accordingly, the optimal role and implementation of insolvency courts may depend on a variety of country-specific factors. *See* Anthony J. Casey & Joshua C. Macey, *Insolvency Courts: General Principles for Systems Design*, 33 INT'L INSOLVENCY REV. 23 (2024) (proposing several principles for the design of insolvency courts in different market and institutional environments).
[230] GURREA-MARTÍNEZ, *supra* note 2, at 103–107 (discussing different institutional models used to handle insolvency proceedings across jurisdictions).
[231] *Id.*
[232] Corporate law represents one of those areas in which specialized judicial expertise may be particularly valuable. *See* generally Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765 (2002); Goshen & Stein, *supra* note 201.

A growing body of empirical research suggests that specialized insolvency courts may generate meaningful benefits, including faster resolution of insolvency cases, greater predictability, fewer zombie firms, higher firm survival rates, and improved recoveries for creditors.[233] As insolvency proceedings become increasingly sophisticated, ensuring that disputes are adjudicated by competent and specialized institutions may become not merely desirable, but necessary for the effective functioning of modern insolvency systems.

5. Conclusion

The rise of PE sponsors in the management of insolvency proceedings is the result of a broader transformation in capital markets and corporate financing. To date, most PE-led insolvency proceedings have been observed in the United States, largely due to the scale and maturity of its PE market, as well as the growing number of portfolio companies operating with highly leveraged capital structures. As PE activity continues to expand globally, similar patterns are likely to emerge in other jurisdictions, increasing the prevalence of sponsor-led insolvencies.

This article has shown that PE sponsors can play a value-creating role in the management of financial distress by providing speed, expertise and access to capital. At the same time, the different legal and financial strategies employed by PE sponsors, together with the exacerbated conflicts between shareholders and creditors that arise in financially distressed firms—particularly those with controlling shareholders—and intensified conflicts among creditors arising from increasingly aggressive liability management exercises, may create new opportunities for value to be shifted away from creditors or certain groups of creditors.

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[233] *See, e.g.,* Bo Li & Jacopo Ponticelli, *Going Bankrupt in China*, 26 REV. FIN. 449 (2022) (finding that the introduction of specialized bankruptcy courts in China reduced case duration, improved judicial efficiency and independence, facilitated the reallocation of labor and capital away from zombie firms and increased capital productivity); Benjamin Charles Iverson, Joshua Madsen, Wei Wang & Qiping Xu, *Financial Costs of Judicial Inexperience: Evidence from Corporate Bankruptcies*, 58 J. FIN. & QUANTITATIVE ANALYSIS 1111 (2023) (finding that judicial inexperience in Chapter 11 proceedings in the United States increases bankruptcy duration and costs while reducing creditor recoveries, thereby suggesting that greater judicial specialization and expertise may improve insolvency outcomes); Samuel Antill & Aymeric Bellon, *The Real Effects of Bankruptcy Forum Shopping*, Working Paper (2026) (finding that firms subject to the same bankruptcy system—the United States—but choosing a more predictable and efficient forum for resolving financial distress, particularly Delaware, experience shorter case duration, fewer liquidations, improved creditor recoveries and higher post-bankruptcy employment), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5052176.

Our comparative analysis of the collapse of various high-profile PE-backed firms in the United States, Europe, and Asia-Pacific suggests that these risks may not be uniform across jurisdictions and are likely shaped by differences in legal and institutional environments. To address some of the risks and challenges associated with the involvement of PE sponsors in distress scenarios, we have argued that, while insolvency and insolvency-related frameworks generally remain fit for purpose, certain legal refinements may nevertheless be warranted, especially in countries that have not traditionally been equipped to address the heightened shareholder-creditor agency problems that arise in financially distressed firms with controlling shareholders.

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