LEGAL RISKS OF LEVERAGED BUYOUTS: CASE STUDY OF *IN RE NINE WEST LBO SECURITIES LITIGATION*[1]

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Year of Study: 3rd

Abstract

Corporate finance represents a dynamic world that is always evolving, but with it also intricate legal challenges arise - none more scrutinized than those regarding LBOs. This Article explores the complex legal landscape of LBOs through the analysis of one of the most important cases in this sector: In re Nine West LBO Securities Litigation. A leveraged buyout represents the mechanism through which a private equity firm acquires another company by using high levels of debt financing, leveraging the target's own assets to fund the acquisition. Unlocking financial value and generating investor returns are one of the main reasons behind this mechanism, however LBOs often attract financial and legal risk.

This paper examines the complex legal landscape of Leveraged Buyouts (LBOs), focusing on the inherent tension between aggressive financial engineering and corporate solvency. While LBOs are pivotal to modern corporate finance, they frequently expose directors and shareholders to significant legal liabilities, particularly regarding fraudulent transfers and breaches of fiduciary duties. Central to this analysis is the landmark case In re Nine West LBO Securities Litigation, which serves as a critical study on the failure of board oversight and the limitations of the Business Judgment Rule in high-leverage transactions. The article explores how the 'look-through' doctrine and the collapse of the multi-step transaction defence have redefined the risks for institutional investors and board members. Furthermore, it evaluates the efficacy of solvency opinions and proposed regulatory reforms aimed at aligning short-term Private Equity objectives with long-term institutional stability. By synthesizing statutory requirements under the Delaware General Corporation Law (DGCL) and recent federal jurisprudence, this study provides a framework for mitigating litigation risks in distressed LBO scenarios. The findings suggest that heightened transparency and more rigorous solvency testing are essential to prevent the systematic wealth transfer from creditors to equity holders that often precedes insolvency in such transactions.

INTRODUCTION

A leveraged buyout (LBO) is a corporate finance system that involves the acquisition of a company using a relatively small portion of equity and a larger one of debt financing.[2] Private equity firms utilize this kind of system with the expectation that the acquired company will generate enough returns for their investors and sufficient cash flow to settle the debt. Some of the largest private equity firms operating nowadays are The Blackstone Group Inc., KKR &

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[1] *In re Nine W. LBO Sec. Litig.*, 505 F. Supp. 3d 292 (S.D.N.Y. 2020).
[2] Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. Econ. Persp. 121 (2009).

Co. Inc., CVC Capital Partners, The Carlyle Group Inc. and Thoma Bravo.[3] These firms are large organizations that are typically structured as partnerships or limited liability corporations, allowing them to raise equity. LBOs are usually targeted toward struggling, undervalued companies that cannot manage themselves anymore. The private equity firms tend to buy the majority control of an existing firm to be able to make changes with ease. When this model emerged in the 1980s it was not considered to be very efficient. However, Michael Jensen predicted that it would become one of the most dominant corporate organizational forms.[4] This process is complex and includes many steps but if carried out successfully it can maximize short-term returns for investors.

LBOs are rather complex financial mechanisms, hence they require a strong legal framework. Delaware is the main jurisdiction in the United States for corporate litigation involving LBOs since the Delaware General Corporation Law (DGCL) provides a strong framework to govern these transactions.[5] As it includes rules for fiduciary duties, shareholder rights, and corporate governance it became a well-established legal infrastructure in cases of LBOs.[6] Fraudulent conveyance laws are also an essential part of the legal framework of LBOs as they allow courts to declare transactions invalid in case they disadvantage creditors or minority shareholders. Additionally, the Business Judgment Rule is crucial in determining if the directors benefit from protection or whether the latter vanishes in case they fail to act on an informed basis or disregard potential financial risks.[7] Revlon Duties also apply as imposing an obligation on directors to seek the highest possible value for shareholders. Fiduciary duties, such as duty of care and duty of loyalty are crucial legal responsibilities for directors to act in the best way possible in order to maintain the company's financial stability. Failure to comply with any of these duties can expose directors to litigation, and potential liability, especially if their decisions led to financial harm.

One of the main legal issues regarding LBOs is the difficulty for a firm to obtain the so-called "bridge loan". A bridge loan is a short-term loan available for use until the debtor secures

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[3] Mark Korlawski, Thomas J. Catalano & Suzanne Kvilhaug, *10 Top Private Equity Firms by Total Equity*, Investopedia (Jan. 11, 2016), available at: https://www.investopedia.com/articles/markets/011116/worlds-top-10-private-equity-firms-apo-bx.asp. , accessed on: 15.09.2026, at 15:32.
[4] Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance and Takeovers*, 76 Am. Econ. Rev. 323 (1986).
[5] Del. Code Ann. tit. 8, § 101 (2025).
[6] *Idem.*
[7] Daniel J. Block & H. Adam Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?,* 37 Bus. Law. 27, p. 27–75 (1981).

permanent financing or pays an existing debt.[8] As there is only a limited number of financial institutions with the right and ability to provide them, the granting of "bridge loans" is relatively complicated. Additionally, there is a general risk for private equity financing, because there are no set standards of legal provisions restricting the development of private equity funds.[9] The result is a lack of legal protection for investors as their legitimate rights and interests are not secured. This issue can also fragment into infringing the rights of the small and medium-sized shareholders, who may be overpowered by controlling shareholders colluding with directors and acquirers during the decision-making process. Hence, it becomes nearly impossible for them to obtain enough information about the LBO, and it may happen that the acquirers purchase shares only from the controlling shareholders.[10] Thus, due to collusive behaviour and the closed nature of private equity acquisitions, the small and medium shareholders may not have a choice or a say in the future of the company, leading to their rights being infringed and their interests disregarded.

While the aforementioned legal issues have repeatedly occurred in cases such as *Smith v. Van Gorkom*,[11] *In re Tousa, Inc.*,[12] *Lyondell Chemical Co. v. Ryan,*[13] they have been introduced here as a background to the legal consequences of an LBO. The legal risk that will be discussed throughout this Article is connected to issues such as breach of duty of care or duty of loyalty, fraudulent transfer laws or the accessibility of bridge loans. There has been an ongoing debate on these aspects that have the potential to change the future of LBOs. The problem at stake is whether the directors of a company acquired through an LBO can be held liable for the breach of their fiduciary duties. This problem arises if the company formed after the merger later becomes insolvent due to the impact of the LBO, as well as the related foreseeable actions taken by the new board, including the acquisition of significant debt as part of the LBO.[14] This could potentially have substantial repercussions in changing the way directors make decisions regarding an LBO. *In re Nine West LBO Securities Litigation* will be referred to in this Article to explain the fiduciary duties of directors and the legal framework

[8] Julia Kagan, *What Is a Bridge Loan and How Does It Work, With Example,* Investopedia (Feb. 27, 2024), available at: https://www.investopedia.com/terms/b/bridgeloan.asp accessed on: 15.09.2026, at 16:12.
[9] Yuanhlin Hu, *Legal Risks and Regulatory Suggestions for Cross-Border* 294 (Dep't of L., Henan U. of Econ. & L., Zhengzhou, China, 2023).
[10] *Id.* at 297.
[11] *Smith v. Van Gorkom,* 488 A.2d 858, 46 A.L.R.4th 821, Fed. Sec. L. Rep. (CCH) 91,921 (Del. Jan. 29, 1985).
[12] *In re TOUSA, Inc.*, 444 B.R. 613 (Bankr. S.D. Fla. 2011).
[13] *Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009).*
[14] *A Blow to Private Equity Leveraged Buyouts? A Delaware Law Perspective on the Groundbreaking New York Case In re Nine West LBO Securities Litigation**, Bus. L. Today (Aug. 2021), available at: https://businesslawtoday.org/2021/08/a-blow-to-private-equity-leveraged-buyouts-a-delaware-law-perspective-on-the-groundbreaking-new-york-case-in-re-nine-west-lbo-securities-litigation/. accessed on: 15.09.2026, at 16:22.

governing LBOs.[15] In 2014, Sycamore Partners decided that the Jones Group, which was at the time a struggling apparel company, was the perfect target for an LBO.[16] Sycamore made their initial offer of $15 per share for the stockholders with the intention of renaming the company to Nine West Holdings, Inc. (Nine West).[17] As part of the deal, Nine West's two successful brands would be sold separately to other Sycamore affiliates for less than the fair market value.[18] Their initial equity contribution was $395 million, and Nine West would increase its debt from $1 billion to $1.2 billion. However, the equity contribution was reduced to $120 million which led to the debt growth to $1.55 billion.[19] This change created a post-merger debt ratio of 7.8 times Nine West's EBITDA.[20] This was significantly higher compared to the expected 5.1 times EBITDA which was planned at the beginning of the negotiations. In 2018, Nine West filed for bankruptcy.[21] Shareholders accused the board of breaking their fiduciary duties by not evaluating the new changes in the equity contribution, debt and ratio of EBITDA, and by selling the company for $641 million when the market valued it at around $1 billion.[22] This led to the court finding that the directors had in fact ignored multiple factors and warnings that should have raised questions regarding the long-term success of the company after the conclusion of the LBO.[23]

1. CORPORATE LAW AND FIDUCIARY DUTIES IN LBOs

Delaware General Corporation Law (DGCL) is the statute of the Delaware Code included in Title 8, Chapter 1, that governs corporate law in the State of Delaware.[24] This statute contributed to making Delaware the most prominent jurisdiction in the United States for LBO litigation. The DGCL governs all aspects of a company's corporate existence: formation, dissolution, rights of stockholders, stock transfers, mergers, all included in 398 Articles.[25] The following three sections are most relevant for this Article. Subchapter I, Formation, Article 102 (b) (7): *Contents of certificate of incorporation* allows corporations to include provisions that

[15] *In re Nine W. LBO Sec. Litig.*, 505 F. Supp. 3d 292 (S.D.N.Y. 2020).
[16] *Id.* at para. 48.
[17] *Id.* at paras. 52-58.
[18] *Id.* at para. 61.
[19] *Id.* at paras. 103-06.
[20] Earnings before interest, taxes, depreciation, and amortization, is a financial metric used to assess a company's profitability and financial performance.
[21] *Id*. at para. 147.
[22] *Id*. at para. 136.
[23] *Id*.at para 95.
[24] *Del. Code Ann. tit. 8, § 102, supra note 5.*
[25] *Id*.

would either limit or fully eliminate directors' liability for breaches of the duty of care. However, the most relevant aspect to this Article is the fact that they are not protected for breaches of the duty of loyalty, bad faith or intentional misconduct.[26] Subchapter IV, Directors and Officers, Article 141 (a): *Board of directors; powers; number, qualifications, terms and quorum; committees; classes of directors; nonstock corporations; reliance upon books; action without meeting; removal* underpins the directors' fiduciary duties, establishes that the board has full authority to manage the business as well as introduces the presumption that the directors are acting in the best interests of the corporation.[27] Subchapter IV, Directors and Officers, Article 144: *Interested directors; quorum* primarily governs transactions when directors would have a conflict of interest, allowing for such transactions only under certain conditions such as full disclosure and approval of the board of directors or the committee.[28] Other Articles can be of relevance such as Article 145 (Indemnification), Article 220 (Inspection of Books and Records), Article 251 (Merger Requirements) or Article 262 (Appraisal Rights in Mergers).

The three aforementioned sections are used to evaluate whether the directors have complied with their fiduciary duties towards the corporation and its shareholders and most importantly the duty of care and the duty of loyalty whenever they make important decisions. The duty of loyalty essentially requires directors to act in the best interest of the corporation and its stockholders and to set aside their personal interest when making decisions, such as that to request an LBO. It has further been established through case law that directors should also act in good faith and be motivated by a genuine devotion to the interests of the corporation and its shareholders.[29]

The duty of care requires directors to exercise a high degree of prudence when managing the affairs of the company. They are expected to diligently inform themselves on the details regarding any major decisions as well as to act with the same degree of care throughout the exercise of their functions. When determining if directors complied with their duty of care, the standard of "gross negligence" is employed to assess whether the director took a decision outside "the bounds of reason" or with "reckless indifference to or a deliberate disregard of the stockholders".[30] In the context of leveraged buyouts, Section 102 (b) (7) of the DGCL plays a pivotal role in defining the limited circumstances under which personal liability of directors can

[26] *Id*. § 102(b)(7), Subchapter I, Formation.
[27] *Id*. § 141(a), Subchapter IV, Directors and Officers.
[28] *Id*. § 144, Subchapter IV, Directors and Officers.
[29] *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 755–72 (Del. Ch. 2005).
[30] *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 970 (Del. Ch. 1986).

be excluded in cases of monetary damages resulting from breaches of fiduciary duties. This section protects directors extensively; however, it does allow exceptions to ensure that directors remain accountable for serious infringements of their fiduciary duties, especially if they act against the interest of the corporation and shareholders.[31] Thus, this section is particularly relevant when considering the duty of care and the duty of loyalty regarding the decisions taken by directors affecting the health and solvency of the target company. LBOs require a significant financial risk, and directors must ensure that their decisions do not harm the company's success or the shareholders' financial health. This issue was raised in *Smith v. Van Gorkom*, considered to be one of the foundational cases involving business organizations. The ruling highlighted that directors are not entirely protected in the event in which they breach their duty of care.[32] In this particular case, a director chose the price of $55 per share without consulting any other financial experts except for the company's CFO, and they only considered a suitable price for the success of the LBO. The evidence in the case showed that the two actors had not considered the future financial health of the company.[33] The Court stated that "given these circumstances, at a minimum, (the directors) were grossly negligent in approving the sale of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency".[34]

This showed the degree of importance for directors to take into account every facet of the outcome of a high level decision in order to be compliant with their fiduciary duties, making efforts to ensure that their decision will not lead to insolvency. Moreover, the fiduciary duties of directors also extend to situations when the company is close to insolvency, and the focus of such duties might even shift from protecting shareholders to protecting creditors. In such a case directors can face liability if they ignore the financial struggles of the company when accepting the LBO.

In re Nine West LBO Securities Litigation is an obvious reference when the role of fiduciary duties are taken into consideration in examining the liability of directors. The directors' actions were scrutinized to establish whether they fulfilled their duties of care and loyalty as outlined in Section 141 (a) of the DGCL and in relation to Section 102 (b) (7), which does not protect directors in case they acted with gross negligence or breached their fiduciary

[31] Del. Code Ann. tit. 8, § 102(b)(7)(i) (2025.,
[32] *Smith v. Van Gorkom*, 488 A.2d 858, 46 A.L.R.4th 821, Fed. Sec. L. Rep. (CCH) para. 91,921 (Del. Jan. 29, 1985).
[33] *Id.*
[34] *Id*. at para. III (A)(3).

duties. As the directors did not assess the potential acts of the high level of debt and the undervalued asset sales, they disregarded the long-term stability of the company as well as the interest of stakeholders. Their failure to carry out all the necessary steps in order to ensure future sustainability of the company's finances reflected a breach of their duty of care and duty of loyalty, as seen in *Smith v. Van Gorkom*. Thus, this case clearly illustrates how breaches of fiduciary duties in LBOs can lead to severe legal and financial consequences.

1.1 Business judgment rule and Revlon duties

The Business Judgment Rule (BJR) is a case-law-derived doctrine that presumes that when making a business decision, the directors act on an informed basis, with good faith and in the honest belief that the action taken is in the best interests of the company.[35] Such a rebuttable presumption provides for another protection for directors. However, it is not an absolute protection as seen in *Lyondell Chemical Co. v. Ryan*, in which the directors took an unreasonable decision in accepting an offer below the market price which led to financial difficulties that could have been prevented had the directors duly gathered relevant information.[36] In this case, the directors breached the requirement of the BJR because they failed to inform themselves about all the specifics of the agreement which led to them accepting an offer below the market price.

The Revlon Duties, emerged from *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[37] represent a legal principle stating that a company's board of directors shall make a reasonable effort to obtain the highest value for a company when a hostile takeover is imminent. Due to the fact that LBOs can sometimes present hostile takeovers, this principle applies. Hostile takeovers can occur either when the buyer's initial "friendly" offer is rejected or the buyer does not even propose such an offer and instantly recurs to aggressive ways of acquiring the company.[38] One of the options would be to make an offer directly to the shareholders, which would incentivize them to pressure directors to sell if the deal is attractive.[39] A conception about LBOs is their intent to do anything in order to make a profit meaning they would restructure the company, cut costs, and even sell parts of the business, as long as it entailed financial gain.

[35] *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).
[36] *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009).
[37] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 66 A.L.R.4th 157, Fed. Sec. L. Rep. (CCH) 92,525 (Del. Mar. 13, 1986).
[38] G. W. Schwert, *Hostility in Takeovers: In the Eyes of the Beholder?*, 55 *J. Fin.* 2599, 2599–2640 (2000), available at: http://www.jstor.org/stable/222395 accessed on: 15.09.2026, at 17:01.
[39] *Id*. at 2613.

During an LBO negotiation, if the directors suspect these strategies would negatively affect the company, they can decline the initial offer which can lead to the buyer opting for more aggressive methods to finally complete a hostile takeover. Thus, since directors are required to maximize the shareholder value in case that the sale of the company becomes inevitable, multiple issues can arise, such as conflict of interest, unfair dealings, and entrenchment.[40] The Revlon Duties re-emphasize the importance of directors acting in an optimal manner for the company, and that failure to do so attributes liability to them. Essentially, the Revlon Duties are important in case of an unanticipated hostile takeover offer and the directors must "get the best price for the stockholders".[41] The company's long-term strategy should be considered by the directors and they should be able to use sequential sale procedures, such as go-shops, to fulfil their Revlon duty to maximize shareholder value.[42] Go-shops are arrangements whereby a seller can reach an agreement with one buyer but retains the right to solicit bids from other buyers for the next one to two months. If a higher offer is received by a new buyer, then the seller has the right to renegotiate with the first buyer to see if they can match the price offered by the new buyer.[43]

Such a rule, in combination with the fiduciary duties mentioned in the previous paragraph, reflected the main issue in *In re Nine West LBO Securities Litigation* in which the directors approved an LBO that risked making the company insolvent.[44] The BJR assumes that directors will take their decisions in the company's best interest while also analysing and informing themselves of any possibility and detail on the market and will act in good faith. However, in this case due to the fact that the debt-to-EBITDA ratio increased substantially, that there was a substantial reduction in the equity contribution and an increase in debt burdens, and that the directors sold the assets below fair market value, it was found that the directors had breached their duties. All of their actions led to financial instability due to disregard to changes in the deal, which ultimately determined that the BJR could not protect the directors. Furthermore, the Revlon Duties, which impose an obligation on directors to seek the highest bid for the sale, play a substantial role in this case. The shareholders argued that the directors disregarded such duty completely since they sold the company at a below-market-value price

[40] *Id*. at 2617.
[41] *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc., 506 A.2d 173, (Del. 1986).*
[42] S. Chatterjee, Does Increased Equity Ownership Lead to More Strategically Involved Boards?, 87 *J. Bus. Ethics* 267, 267, 270 (2009), http://www.jstor.org/stable/40294967
[43] J. W. Roberts & A. Sweeting, When Should Sellers Use Auctions?, 103 *Am. Econ. Rev.* 1830, (2013), available at: http://www.jstor.org/stable/42920631 accessed on: 15.09.2026, at 17:10.
[44] *In re Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292 (S.D.N.Y. 2020).*

(around $359 million less) which served as a later reason for their bankruptcy. This case has shown the limitations of both the BJR and the Revlon Duties as protections for directors. Neither of the doctrines manage to shield directors from liability in situations in which their decisions lack proper diligence, ignore warning signs of financial instability, or fail to secure a fair market value for the shareholders. In cases of insolvency, the directors' actions are meticulously examined by courts in order to determine whether they have complied with their duties.

2. FRAUDULENT TRANSFER LAWS AND SOLVENCY IN LBOs

Fraudulent conveyance is considered to be one of the major risks if not the most serious legal issue that firms can face while participating in LBO. A fraudulent transfer occurs if a debtor receives less than "reasonably equivalent value" during the transaction for the security interest as collateral for the loan to the acquiring company.[45] However, this fair consideration is not a sufficient condition to prove a fraudulent transfer because it also requires that the debtor "was insolvent on the date that such transfer was made, or such obligation was incurred or became insolvent as a result of such transfer or obligation".[46] Even in cases where fair consideration is not obvious, a fraudulent transfer can exist if the firm is insolvent or even if left with an unreasonably small capital following the transaction.[47] This can happen if the lender should have analysed the firm's situation and foreseen the firm's potentially insolvent situation or if as a result of a successful LBO, the firm's debt burden becomes so unreasonably large that it is unable to even cover short-term funding needs.[48] The reason why this is so crucial is that it can severely affect almost all the parties that took part in the LBO transaction such as lenders, selling stockholders, analysts, creditors and investment bankers, leading to costly litigation, loss of profits and damage to their reputation. However, rigorous financial planning, attention to guidelines and exercise of due diligence while performing such a complex transaction can minimize the risk of a fraudulent transfer. The reason for the possible insolvency is essentially the contested value that can lead to disputes between the debtor and the creditor. Undermining the value in an LBO transaction can lead to significant issues for the company as it can overextend its debt, impair cash flow, erode profits, sales or assets that could in its turn increase

[45] *Bankruptcy*, 11 U.S.C. § 101 et seq. (2011), available at: https://www.law.cornell.edu/uscode/text/11 accessed on: 16.09.2026, at 10:00.
[46] *Id.*
[47] A. Michel & I. Shaked, The LBO Nightmare: Fraudulent Conveyance Risk, 46 *Fin. Analysts J.* 41, 41–50 (1990), available at: http://www.jstor.org/stable/4479313 accessed on: 16.09.2026, at 10:17.
[48] *Id.* at 44.

the risk of insolvency substantially.[49] This issue was addressed in *In re Tousa, Inc*., 2011, in which it was proven that when the LBO occurred, the subsidiaries received less than reasonable value in exchange for giving up the property interest, which resulted in insolvency.[50] Thus, the court decided that because the LBO led to a significant debt to Tousa, eventually causing insolvency, this represented a fraudulent transfer under bankruptcy law.[51] The Bankruptcy Code should be referenced in this case, Section 548 in particular, which allows for the voidability of a transaction if the value is not reasonable or if the transfer becomes a cause of the company's insolvency.[52] Another piece of legislation that governs this rule is the Uniform Voidable Transactions Act (UVDA) which is designed to protect creditors in the eventuality that a transfer might defraud them.[53] Under this law, a fraudulent transfer is considered one that is made with the intent to defraud the creditor in a way which would lead to insolvency; here there is an emphasis on actual intent to create harm, rather than the result of defrauding.[54] One of the most difficult aspects of determining whether a fraudulent transfer occurred is establishing whether the company became insolvent specifically as a result of the LBO or the directors approved the transaction knowing that it would lead to insolvency. In the first scenario the focus is on the economic impact whether the financial burdens were too high for the company to sustain, which ultimately led to insolvency. If the directors acted according to their duties and the insolvency was truly unforeseen, the transaction may not be declared fraudulent. In the second scenario the focus is on whether the director has done everything in his powers such as conducting extensive financial assessment and ensuring the future benefit of such a decision for the company. In case the evidence shows that the directors proceeded with the LBO despite indications that it could lead to insolvency, the transaction would be found fraudulent.

The issue of fraudulent conveyance was present in *In re Nine West LBO Securities Litigation,* in which the defendant argued that the LBO contributed to the company's bankruptcy.[55] The decrease in equity contribution by $275 million in combination with the increase in debt by $350 million led to the substantial increase of the debt ratio by 2.7. This high debt ratio eventually made it extremely hard for Nine West to even cover their short-term financial needs because the debt obligations were disproportionate to their expected earnings

[49] *Id.* at 46.
[50] *In re Tousa, Inc.*, 444 B.R. 613 (S.D. Fla. 2011).
[51] *Id.*
[52] See 11 U.S.C. § 548 (2011).
[53] Nat'l Conf. of Comm'rs of Unif. State l
[54] *Id.*
[55] *In re Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292 (S.D.N.Y. 2020).*

which eventually led to them filing for bankruptcy in 2018. It was argued that the LBO constituted a fraudulent transfer because Nine West was left with insufficient funds and significantly high debt that was a direct reason for their insolvency. The directors did not act in the company's best interest, failed to assess the fairness of the transaction, and neglected the negative impact that this transaction would have on the firm. Thus, *In re Nine West LBO Securities Litigation* explains how the disregard of the directors to fully evaluate debt obligations, asset valuation, and capital sufficiency in an LBO can raise questions about a potential fraudulent conveyance. This case emphasizes the importance of the fiduciary duties that directors have when approving such financial strategies in order to prevent a company's solvency and damage to its reputation.

3. TRANSPARENCY AND CONFLICTS OF INTEREST IN LBO TRANSACTIONS

One of the main issues concerning LBO transactions is the fact that they are not completely transparent, specifically regarding the sharing of crucial information by majority shareholders to small and medium shareholders. Based on the Delaware General Corporation Law (DGCL) directors owe the duty of care and the duty of loyalty to all shareholders, regardless of their power and the number of shares they hold in the company.[56] However, in case of LBOs, small and medium shareholders can face some challenges when it comes to protecting their rights, because the controlling shareholders might be prioritized, and the interests of non-controlling shareholders might not be considered at all during the decision-making process. The crux of the issue lies in the decisions which might be taken in favour of the majority shareholders who would profit from them, rather than try and include the interests of minority shareholders. One of the goals of the Securities Exchange Act of 1934 is to create more transparency in companies' financial disclosures so as to provide enough information for investors to make a reasoned decision.[57] This Act can be used by minority shareholders, in case their rights have been violated by majority or controlling shareholders withholding certain information depriving them of the possibility to assess the risks and benefits of an LBO.

There are four main types of conflicts of interests that can occur during an LBO transaction: (1) large and short-term compensation v. long-term strategy and sustainability of

[56] Del. Code Ann. tit. 8, ch. 1 (2025),
[57] Securities Exchange Act of 1934, § 3(a)(1), as amended through Pub. L. No. 112-158, Aug. 10, 2012.

the firm, (2) new LBO owners v. old bond holders, (3) new LBO owners and managers v. old owners, and (4) new owners v. old employees.[58]

1. Successful LBOs tend to be rather profitable, at least in the short-term, and the parties that benefit from this the most are the directors and investors. However, it is often argued that these short-term and high-leveraged profits are not compatible with the long-term sustainability in respect to the long-term effect that the transaction may have on the acquired company, shareholders and stakeholders.[59]
2. It is believed that acquired companies and their other stakeholders such as employees, bondholders, new owners, and society will suffer in the long term. The increase in debt by the new owners of the acquired company in order to pay themselves dividends and make a profit will essentially result in the debt owned by older bond holders being considered more risky and decreasing in price.[60]
3. Another issue arises when the buyer can incentivise managers, by promising them a higher salary or bonuses, in order to accept deals that are against the best interests of the company or other shareholders during an LBO transaction.[61] This results in a higher interest for the senior management to accept a bid.
4. Since an LBO results in high levels of debt, companies tend to reduce costs with any available methods, such as cutting wages or even firing employees.[62] It has been shown that around 80% percent of the operating costs have to do with human resources and the taxes associated with them, and that is why they are affected the most in such cases. [63]

In Re Nine West LBO Securities Litigation emphasizes both issues of transparency and of conflicts of interests. This LBO transaction is an example of how short-term profits are prioritized over the company's sustainability as shown by Sycamore's desire to generate immediate profit through dividend payments and other ways of compensation, despite increasing Nine West's debt-to-EBITDA ratio by 2.7. Smaller shareholders were disadvantaged because they did not have a say in assessing the impact that the reduction in the initial equity contribution, the large increase in debt and the selling of shares below market value can have on the firm. This case highlights the need for more transparency to protect all shareholders and

[58] R. P. Nielsen, The Private Equity-Leveraged Buyout Form of Finance Capitalism: Ethical and Social Issues, and Potential Reforms, 18 *Bus. Ethics Q.* 379, 379–404 (2008), http://www.jstor.org/stable/27673241.
[59] *Id*. at 390.
[60] *Id*. at 393.
[61] *Id*. at 394.
[62] European Parliament, *Hedge Funds and Private Equity: A Critical Analysis* (2007).
[63] D. Ulrich & W. Brockbank, *The HR Value Proposition* 301–31 (Harvard Bus. Press 2005).

stakeholders and the obligations of directors to exercise their fiduciary duties in order to avoid financially damaging outcomes.

4. LEGAL PROTECTIONS FOR DIRECTORS

While leveraged buyouts can benefit struggling companies, they can also lead to serious financial issues such as bankruptcy. In order to avoid any financial struggles, these types of transactions require an extensive analysis, a solid financial planning, and a meticulous management of every operational detail. Thus, directors have a focal role and must be exceptionally diligent when assessing such transactions. In these cases, fiduciary duties play a pivotal part along with the entire legal framework including the Delaware law, the Business Judgement Rule and the Revlon Duties.

The decision-making process is complex and can be protracted which makes it difficult to find the exact moment of the directors' misconduct. The stakes and risks are extremely high in LBO transactions and even if a director's decisions are detrimental to a company, the laws that are supposed to limit their powers ultimately provide them with a protective shield against liability. To overcome the aforementioned presumptions, plaintiffs have to meet a heightened standard of negligence, as it would often require proof of gross negligence or bad faith.[64] The ordinary standard of negligence would generally require that a person fails to exercise reasonable care and their actions would be assessed based on what a reasonably prudent person in that same situation would have done.[65] In the context of corporate transactions, it would mean that the directors simply acted carelessly or failed to inform themselves before making decisions. However, this heightened standard of gross negligence which is needed in LBO cases requires the proof that directors acted with reckless disregard for their obligations. The decision would have to be so unreasonable and extreme that it would go beyond the protections of the business judgment rule. *Smith v. Van Gorkom* exemplifies the aforementioned, as the Delaware Supreme Court found that the duty of care was breached by the directors specifically because their acts constituted gross negligence, not mere ordinary negligence.[66] The overarching question is whether it is justifiable for private equity firms to prioritize short-term gains rather than pursuing long-term goals. From the standpoint of typical directors, it is evident that short-term gains are a more profitable option. However, is it ethical to burden a company with high

[64] *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 970 (Del. Ch. 1986).
[65] H. T. Terry, Negligence, 29 *Harv. L. Rev.* 40, 40–54 (1915), https://doi.org/10.2307/1325735.
[66] *Smith v. Van Gorkom, 488 A.2d 858, 46 A.L.R.4th 821, Fed. Sec. L. Rep. (CCH) 91,921 (Del. Jan. 29, 1985).*

debt and extract its value quickly, even though it may severely limit the company's chances of performing well in the future or even cause its economic downturns? Do the directors have responsibilities toward the acquired company, its employees, creditors, and minority shareholders or solely the investors and majority shareholders?

5. THIRD-PARTY SOLVENCY AND SUSTAINABILITY ASSESSMENT

The current system should be reformed in a way such that directors will have an incentive to improve the long-term stability and health of the company. A potential solution would be to involve third parties that would assess the solvency and long-term sustainability of an LBO prior to its approval. This would prove useful to determine in an objective way whether the post-LBO debt will be manageable for the target company and ensure that the latter will remain solvent and will not face further financial difficulties. The implementation of this solution would require defining strict criteria for assessment that would include leverage ratios, cash flow projections, as well as solvency stress tests. This way, there would be higher transparency toward minority shareholders and stakeholders preventing scenarios like *In re Nine West LBO Securities Litigation*, where the excessive debt burden was overseen. This solution might be difficult to implement since it would lead to additional costs for private equity firms and that would lead to resistance from investors that favour fewer regulatory challenges. Even though it might seem difficult to enforce this mechanism, it might be a step in the right direction.

6. RESTRICTIONS ON EARLY MANAGEMENT FEES AND CLAWBACK PROVISIONS

A practice often seen in LBOs is the withdrawal of management fees and dividends at an early stage of the acquisition which can drain the company of liquidity.[67] An introduction of legal caps on how much can be taken as fees in the early stages of the LBOs can help solve this issue. Furthermore, management fees should be dependent on the company's financial performance over a defined period and their distribution should start only after some financial

[67] R. P. Nielsen, The Private Equity-Leveraged Buyout Form of Finance Capitalism: Ethical and Social Issues, and Potential Reforms, 18 *Bus. Ethics Q.* 379, 379–404 (2008), available at: http://www.jstor.org/stable/27673241 accessed on: 16.09.2026, at 11:20.

health benchmarks are met. This would ensure that companies have sufficient capital to maintain their operations and to service their debt and it will push private equity firms to prioritize the long-term health of companies rather than immediate payouts.

Mandatory clawback provisions can be introduced so that directors are required to return a portion of their bonuses, dividends or profits if the company files for bankruptcy within a set period of time. A model of such a provision can be seen in the Section 304 of the Sarbanes-Oxley Act which allows the SEC to force a company's CEO or CFO to give up any executive compensation in case it was earned due to misconduct.[68] This would act as a deterrent for directors to act recklessly in their financial structuring and it will ensure that they take into account the company's long-term financial stability.

7. LOWERING THE BURDEN OF PROOF AND ENHANCING FIDUCIARY DUTIES

While this strong and rigid protective framework for directors has its benefit as it allows experts to make complex decisions, it can also lead to situations where many parties suffer and nobody can be held accountable. It is true that when the LBO fails, directors can lose reputation but the main financial burden falls on the stakeholders who cannot protect themselves from the directors' business strategies that ultimately led to the company's financial difficulties. This high threshold for proving a director's misconduct provides a legal standard that is arguably overprotective at the expense of the company's financial stability, minority shareholders' rights and stakeholders' interests.[69] Lowering the burden of proof in LBO cases would ensure that directors face greater accountability especially in cases when their wrongdoings jeopardize the financial stability of a company and the livelihood of numerous employees and consumers. It could also be helpful to modify the fiduciary duty standards in a more specific way in cases of LBOs by raising the standard of care directors must meet when they approve these transactions. They would have to be required to show that they thoroughly considered the long-term consequences on the company, not just short-term gains. A specific duty obliging directors to act in order to prevent insolvency could also be useful to incentivize them to focus on the long-term financial stability of the company.

[68] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).
[69] H. T. Terry, Negligence, 29 *Harv. L. Rev.* 40, 40–54 (1915), available at: https://doi.org/10.2307/1325735 accessed on: 16.09.2026, at 11:30.

8. SHAREHOLDER RIGHTS AND ACCESS TO INFORMATION

Transparency is yet another issue in LBO transactions that is not regulated enough and while there have been efforts in this sense, there are multiple ways in which directors can bypass these requirements. While the Delaware corporate law and federal securities regulations impose multiple mandatory disclosure requirements such as the disclosure of material financial risks and of the relevant financial risks to shareholders, there are still gaps.[70] Indeed, directors do not have to disclose important information such as the restructuring plans and the post-LBO sustainability assessments. This constitutes a significant disadvantage for the minority shareholders as they are unaware of the full implications of the LBO and the risks involved. This poses a serious threat because directors are allowed to prioritize their interests without considering to disclose important information that could affect other parties. Directors are protected by Delaware law because often they are not required to disclose certain financial risks or conflicts of interests unless they are explicitly asked to do so and the BJR will protect their decisions as long as they prove that they acted on an informed basis. This lack of transparency limits minority shareholder protection and also reduces the ability of creditors to assess the ethical aspect of the transaction.[71] While directors are the key decision-makers in LBOs, majority shareholders have a significant influence as their approval is often needed in order to execute the transactions. Given the fact that majority shareholders have a role in this, they should also bear responsibility for the financial risks. This would ensure a more balanced framework that would protect all stakeholders involved. There is a need for more stringent requirements in LBOs, particularly regarding disclosing all the important information such as debt levels, and financial plans to all parties that can be affected by the LBO. Without upholding transparency, directors could continue to act in a discretionary manner to prioritize short-term financial gains. While returns are generated for all shareholders, including the minority shareholders, the structure benefits majority shareholders and private equity firms disproportionately. Since they are more influential, decisions will generally prioritize their short-term gain over the company's long-term financial health. This means they will have limited accountability in case the LBO leads to serious financial struggles. Some stricter disclosure rules requiring private equity firms to provide all the relevant information on their

[70] G Del. Code Ann. tit. 8, § 101 (2025).
[71] R. P. Nielsen, The Private Equity-Leveraged Buyout Form of Finance Capitalism: Ethical and Social Issues, and Potential Reforms, 18 *Bus. Ethics Q.* 379, 379–404 (2008), available at: http://www.jstor.org/stable/27673241 accessed on: 16.09.2026, at 11:45.

acquisition strategy, plans and debt repayment strategy would make it easier for stakeholders to protect their rights. Moreover, requiring the approval of minority shareholders for certain high-risk transactions can strengthen the protection of minority shareholders and creditors.[72] This would require a legislative change to ensure that all shareholders, including minorities, have greater oversight in LBO transactions. A further way to improve transparency would be to introduce mandatory periodic post-LBO reports and performance audits regarding debt levels, cash flow, and how directors manage their financial strategy. These independent regulatory authorities would oversee the company's post-LBO performance. This would provide creditors with reliable information to assess risk and would enhance the accountability of firms as they would need to disclose their long-term financial strategies.

In re Nine West LBO Securities Litigation is a meaningful example that shows the complex legal issues and potential risks inherent to LBOs. The case exemplifies how the law can shield directors and how these protections impact the interests of minority shareholders.[73] The high burden placed on plaintiffs to prove gross negligence and bad faith is one of such protective mechanisms. Moreover, this case illustrates how the Revlon Duties may not be completely effective in LBOs, creating the need to review the impact of this law on these such transactions. As these duties focused on maximizing transaction value, they led to insolvency, when the financial stability of the company after the LBO should have been prioritized. This is also a case which highlights the ethical implications that may arise in LBOs, such as leaving the company with few assets and financial distress, while the managers and investors were receiving significant compensation.[74] Transparency would have been crucial in this case. Further obligations of directors for disclosure of information and implementation of additional oversight may have facilitated the identification of the high risk of insolvency. If all the relevant details regarding changes in the deal had been fully disclosed it would have minimized the chances of such an outcome. Finally, this case illustrates that there must be reforms within the legal framework regulating LBOs. While the decision in this case might not change the way private equity firms work on LBOs, it might have the potential of making directors of target companies more reluctant to approve these transactions. If directors faced direct liability based on the impact that the LBO had on the financial health and solvency of the surviving company, they would be less likely to approve an LBO. They would analyse the risks exhaustively and realize that the LBO might damage the company, and they may choose to opt for different

[72] *Id.* at 385.
[73] *In re Nine W. LBO Sec. Litig.*, 505 F. Supp. 3d 292 (S.D.N.Y. 2020).
[74] *Id.*

strategies aiming to improve the company's long-term financial success rather than to maximize shareholder value in the short-term.

CONCLUSION

Through the analysis of cases and various pieces of legislation it has been shown that there are multiple legal risks surrounding leveraged buyouts and these risks can affect various stakeholders such as directors, investors, shareholders, and the target company's long-term financial health. Specifically, the case of *In re Nine West LBO Securities Litigation* has highlighted the dangers of high debt burdens, breaches of fiduciary duties of directors and limitations on legal protections. This case has demonstrated that while LBOs can be profitable and can benefit all parties that take part in the transaction, they can also lead to financial difficulties and in extreme cases, insolvency.

To prevent financial distress and potential insolvency, there must be regulatory reforms focusing on increased accountability. Three potential solutions could improve the legal framework:

1. Third-party solvency assessments: Independent financial agents would assess the post-LBO solvency of target firms before the transaction is approved. This would ensure that the debt obligations can be sustained and insolvency can be avoided.
2. Limits on early dividends and management fees: The extraction of large fees and dividends shortly after an LBO is a frequent practice for private equity firms. Introducing legal caps and requiring a waiting period could mitigate the financial stability of a company.
3. Lowering the burden of proof and enhancing fiduciary duties: The threshold is too high to prove the directors' misconduct in order to hold them accountable. Lowering this burden and expanding their fiduciary duties to stakeholders can make it easier to lower their shields from liability.

In re Nine West LBO Securities Litigation case has been chosen as the leading case in this piece because it has significant implications for the future of LBO transactions. The legal shields the directors have been provided with are increasingly scrutinized by courts regarding their assessment for the long-term financial health of a company before approving an LBO. This might set a precedent for similar transactions in which directors will be held more accountable. Additionally, rather than the courts, regulatory bodies should impose more stringent rules on private equity firms that engage in LBOs. If the legal framework evolved to include greater protection for all the parties affected by the LBO, it could completely reshape the way private equity firms perform their deals.

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