

Private Funds in 2026:
Aligning Structure,
Process, and Proof

From Formal Protections to Functional Scrutiny

INTRODUCTION

General partners and fund managers have traditionally managed litigation risk mainly by adhering to the language and structure of fund agreements and maintaining formal corporate separation in the governance of fund and management entities. However, as private equity and private credit strategies have gone mainstream, scrutiny by regulators, counterparties, and even portfolio company stakeholders is increasing sponsor exposure to enforcement and litigation. Today, how decisions are actually made and documented is equally important to formal architecture of fund agreements.

Alongside structure, the key questions are now functional:

- Who made the decision in practice?
- Who benefited (and at whose expense)?
- What was disclosed, and when?
- What contemporaneous record supports the outcome?

For multi-strategy fund platforms, these questions carry greater weight. A single event can simultaneously trigger fiduciary scrutiny, LP or other stakeholder claims, and regulatory narratives.

Traditionally, sponsors relied on a straightforward premise: If governance steps are followed and contracts permit the action, litigation risk would be contained. Today, however, disputes and examinations increasingly turn on whether firms can point to a clear, contemporaneous basis for decisions, particularly where those decisions reallocate value or implicate conflicts.

Formal compliance remains essential. But where the factual record suggests disclosure gaps or functional control of a fund by managers with conflicted incentives, the structural protections offered by adherence to fund agreements and sound governance practices may not be sufficient, and courts may even entertain an argument to pierce the corporate veil between fund and management entities.

Formal structure may not prevent a challenge, and it may not resolve a challenge early. Take, for example, the case of *Fleming v. Black Diamond Capital Management LLC*, No. 24-30291, 2026 WL 1284835 (5th Cir. May 11, 2026). In *Fleming*, the U.S. Court of Appeals for the Fifth Circuit affirmed the district court's finding, after a bench trial, that there was insufficient evidence that private equity firm Black Diamond Capital Management exercised de facto control over one of its portfolio companies so as to be liable for claims brought by the portfolio company's laid-off employees. This was the second time the case had landed before the Fifth Circuit since the complaint was filed in 2020. A central issue on this appeal was the evidence before the trial court regarding who made the decision to shut down the portfolio company's steel mill and whether the board members representing Black Diamond Capital took part in that decision.

This is not to suggest that veil piercing is becoming routine or that entity separateness is collapsing. Rather, it shows that formal protections are less effective when they are not supported by credible evidence of how decisions were actually made.

Turning Governance into Evidence

When a fund platform engages in transactions with inherent conflicts of interest, such as when it operates both equity and credit sleeves, and affiliated funds invest in different layers of a portfolio company's capital structure, ordinary commercial decisions can be reframed as conflict-driven, even when they are economically rational. That dynamic can create leverage for plaintiffs and regulators. Indeed, the SEC's 2026 Exam Priorities made clear that the Division of Examinations remains focused on conflict transactions and adequacy of disclosures.

Common pressure points include:

- Opportunity allocation: which vehicle participates in financings, workouts, or amendments—and why
- Information barriers: how material non-public information is managed across lender and board channels
- Process integrity: whether decisions reflect independent governance or appear sponsor-directed
- Disclosure alignment: whether Form ADV, marketing, and investor reporting match operational reality

For large platforms, the issue is rarely whether conflicts exist. The issue is whether they were identified, mitigated, and documented in a way that withstands retrospective scrutiny.

Dispute risk typically surfaces when a contested event reallocates value or alters rights, such as:

- sponsor-backed restructuring or recapitalization,
- financing that benefits some stakeholders over others,
- GP-led or cross-fund transactions,
- cyber or operational incidents that reveal governance gaps.

These types of events can trigger parallel tracks of exposure:

- Regulatory scrutiny – SEC exams and enforcement, often framed around conflicts, disclosure accuracy, policies v. implementation, and operational readiness (including in respect of new rules such as the 2024 amendments to Regulation S P).
- Private litigation – LP disputes framed in contract or fiduciary duty terms, creditor disputes centered on “sacred rights” and priority, and follow-on claims leveraging regulatory findings.

In both contexts, the record becomes the case. Key artifacts include:

- board and committee materials
- valuation analyses
- communications with counterparties (including lenders)
- conflict reviews and approvals
- disclosure history (Form ADV, marketing, due diligence questionnaires, investor letters)
- compliance documentation and escalation logs.

Key Takeaway: Process Is Essential

Today, the “shield” is less about structural design. It is the ability to produce a defensible, contemporaneous record showing that the structure reflected reality. This is not an argument for more documentation across the board. It is an argument for clarity at moments where conflicts crystallize and value shifts are unavoidable.

Three themes emerge in the current litigation and regulatory landscape:

- 1 Process clarity matters more than process volume. Clear, intelligible decision making records can limit disputes by narrowing the range of plausible second guessing, particularly where conflicts or reallocations of value are obvious.
- 2 Conflicts governance is a proof system. Conflicts identification, escalation, and recusal should not be viewed as internal safeguards alone – they are also evidentiary tools. The quality of these controls can determine whether affiliated credit becomes manageable risk or litigation exposure.
- 3 Disclosure alignment is as important as disclosure volume. Consistency across disclosure channels (ADV, marketing, investor communications) is a core risk control. Misalignment invites scrutiny even where the underlying conduct is defensible.

To mitigate risk, sponsors can focus on a few high-impact practices:

- Identify decision inflection points in high-risk events (e.g., distressed financings, conflicted transactions) and document the rationale for those decisions contemporaneously.
- Clarify decision rights when affiliated credit participates, including when escalation or recusal is expected, and ensure those expectations are followed in practice.



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