

Deal Structures Under Stress: Courts Reexamine Prebankruptcy Transactions

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According to data from Epiq Bankruptcy, February 2026 marked a significant increase in commercial bankruptcy activity. Commercial Chapter 11 filings rose by 67% year over year, while Subchapter V elections by small businesses increased by an even more striking 91%. For restructuring professionals and deal participants, this surge is not merely a statistical datapoint. It is a harbinger of avoidance actions yet to come. As more cases move past the filing stage, trustees and debtors-in-possession will inevitably turn their attention to transactions that preceded bankruptcy, particularly those involving affiliates, directors and officers, sponsors, or asset purchasers. These challenges most often surface as fraudulent conveyance actions, and a mix of recent and historical cases serves as a pointed reminder of the practical exposure risks facing transaction participants. Courts are looking past labels, deal structures, and market conventions to examine the economic reality of transactions that leave debtors overleveraged and creditors exposed. Although these cases arise in very different factual settings, they converge on the same core principle: economic reality controls. Transactions that extract value while saddling a company with unmanageable obligations will receive heightened scrutiny if in financial distress and ultimately in a bankruptcy proceeding. The cases discussed below, spanning leveraged buyouts, subsequent transferee liability, merchant cash advances, and insider transactions, underscore a unified principle: courts are increasingly indifferent to form where creditor harm is real.

Market-standard LBO is not insulated from a fraudulent conveyance claim.

In *Worth Collection*, the Delaware bankruptcy court denied motions to dismiss a Chapter 7 trustee's amended complaint challenging a 2016 leveraged buyout that allegedly gutted the debtor while enriching insiders. Worth Collection Ltd. was placed in bankruptcy, involuntary by its inventory suppliers and service providers. After an earlier dismissal, the trustee returned with a much more detailed pleading that carefully laid out the transaction's financial consequences. According to the amended complaint, the LBO increased the debtor's debt from approximately \$2.4 million to more than \$25 million. Interest expense increased by over 5,000%, operating losses quickly followed, and the company's cash reserves fell from roughly \$12 million in 2014 to less than \$500,000 by 2016. At the same time, former equity holders allegedly received over \$39 million in closing distributions, leaving unsecured creditors to absorb the downside.

The trustee asserted a broad range of claims, including substantive consolidation, veil-piercing, the collapsing of the LBO transactions, and avoidance of transfers as both actually and constructively fraudulent under the Bankruptcy Code and Delaware law. Judge Shannon held that the amended complaint plausibly alleged each of these claims. Of particular importance, the court found that the traditional badges of fraud, like insider transfers, lack of reasonably equivalent value, and insolvency, were pleaded with sufficient detail to survive dismissal. The court also emphasized that fraudulent intent need not be shown directly and may be inferred circumstantially, especially in LBO cases where leverage spikes and liquidity collapses shortly after closing.

The significance of *Worth Collection* lies in its confirmation that leveraged buyouts are not insulated from challenge simply because they resemble market-standard deals. Where the economic effect of the transaction is to burden the operating

company while delivering value to insiders, courts will allow fraudulent conveyance claims to proceed, often into costly and protracted discovery.

“Purchase of Future Receipts” Called by Its Real Name: A High-Interest Loan

The Bankruptcy Court for the Northern District of Texas, *In re Denali Construction Services, LLC v. Cloudfund et al.*, dismantled the merchant cash advance model marketed as purchases of future receivables.

Denali experienced significant financial distress since its CFO embezzled funds by failing to fund union and tax obligations. The company's condition worsened with the onset of the COVID-19 pandemic in 2020. From 2019 through 2022, Denali unsuccessfully sought traditional bank financing. By late 2022, Denali could not continue operating without outside funding. Beginning in October 2022, Denali entered into at least 10 merchant cash advance agreements with eight different providers. Over time, Denali used later MCAs to repay earlier MCAs due to insufficient operating cashflow. Denali was never able to stabilize its cash flow, and it filed a Chapter 11 petition on October 3, 2024. On October 7, 2024, Denali filed an adversary proceeding against multiple MCA providers.

After trial, the Texas bankruptcy court concluded that the MCAs were loans in substance rather than true receivables purchases. Repayment was effectively fixed and absolute, enforced through daily ACH debits that operated regardless of actual revenue. Default provisions accelerated repayment obligations and expanded remedies to sweep assets, hallmarks of traditional lending rather than asset sales. When the court examined the pricing mechanics, the embedded “interest” produced effective annual rates ranging from approximately 348% to 427%, far exceeding Texas's 28% cap for commercial loans. As a result, the agreements were declared usurious and void, the lender was hit with treble damages exceeding \$2.6 million, and the liens securing the obligations were avoided as constructively fraudulent transfers under section 548.

Where risk is illusory, repayment is guaranteed in practice, and labels such as “revenue purchase” disguise functionally predatory lending terms, courts are increasingly willing to intervene.

The same lesson echoes earlier cases such as *Teligent* and *Coco Foods*, where courts placed greater weight on how transactions actually operated than on formal documentation.

The Coco Transactions: Structure, Control, and Fraudulent Transfer Exposure

Coco Foods, Inc. and Coco Partners, Inc. (the “Debtors”) filed voluntary petitions for relief under Chapter 7 on October 9, 2017. A little over a year before that, these two companies acquired the assets of Nelson and Son Formals and Rychards Formals. The Chapter 7 trustee brought fraudulent conveyance actions against the sellers, an affiliated entity, and the principal, Richard Nelson.

Coco Foods and Coco Partners were corporations wholly owned by Steven Fielitz. Richard Nelson was the principal and 100% owner of Nelson & Sons Formals Ltd., Rychards Formals Ltd., Nelson & Sons Rentals Inc. Nelson & Sons Formals and Rychards Formals operated tuxedo rentals and sales businesses on Long Island. Nelson & Sons Rentals Inc. functioned as the assignee of promissory notes arising from the debtors' purchases and was dissolved in September 2017.

During 2015–2016 Nelson and his business broker Transworld negotiated with Steven Fielitz for the sale of the businesses. Fielitz was given access to QuickBooks data and summarized financial records, and point-of-sale sales figures for the calendar year 2015. The financial materials initially provided reported positive net income for both businesses and significantly higher sales figures.

On May 18, 2016, two transactions closed simultaneously:

- Coco Foods purchased the assets of Rychards Formals for \$380,000
- Coco Partners purchased the assets of Nelson & Sons Formals for \$570,000

The combined purchase price was \$950,000, approximately two times the represented net profit of each business.

Each purchase consisted of a down payment, a promissory note, a cash payment at closing, and broker commissions. Although the sellers were Nelson Formals and Rychards Formals, none of the sale proceeds were received by those entities. All net proceeds were deposited into a Charles Schwab account held by Nelson & Sons Rentals, Inc. Both promissory notes were assigned to Nelson & Sons Rentals, and all payments under the notes were made to that entity. Richard Nelson controlled the flow of all purchase consideration through Nelson & Sons Rentals.

Shortly after closing, Fielitz discovered discrepancies between the pre-sale information and the actual operations of the businesses. Payroll data understated the number of employees. Additional employees were paid in cash and not reflected in the records. Actual payroll expenses were substantially higher than disclosed. Sales figures for 2015 were overstated by approximately \$113,000 across both stores. Actual sales for 2016 and 2017 were consistent with the lower corrected figures.

Within months of closing, Coco Foods and Coco Partners required outside financing to continue operations. Coco Foods obtained lines of credit and incurred credit card debt, all personally guaranteed by Fielitz. Fielitz invested personal funds to keep the businesses operating. Despite these efforts, the businesses were unable to stabilize financially. In February 2017, Fielitz attempted to sell both companies but received no viable offers.

Nelson & Sons Rentals received \$383,954 from the Coco Partners transaction, and \$255,968 from the Coco Foods transaction. In September 2017, Nelson & Sons Rentals was dissolved. At dissolution, the Schwab account held approximately \$340,000, all accessible to Richard Nelson as sole owner.

The court held that structure and formalities do not shield transactions from attack. Funneling proceeds through controlled entities did not protect recipients from liability. Disclaimers of reliance and boilerplate acknowledgments proved ineffective, as the court valued the transaction holistically rather than mechanically. In some cases, complex structures may actually increase exposure, where value flow and control are misaligned. As Judge Grossman noted:

The Defendants' argument fails to recognize that the statutes authorizing the recovery of constructively fraudulent transfers are drafted neither to reward the debtor, nor to punish the defendant for intentional wrongdoing. Rather, the basic intent of constructive fraudulent conveyance statutes is to protect creditors of a debtor from transactions where assets of a debtor's estate were transferred for less than fair value. Richard Nelson, who was the principal for each of the corporate defendants and orchestrated the structure of the transactions, may believe that he cleverly outwitted the principal of the debtors, but his maneuvers do little as a matter of law to protect the recipients of the fraudulent transfers from liability in these actions.

To the extent they as transferees have statutory or other legitimate defenses to such actions, they must assert them in the adversary proceeding itself. Having failed to assert any defenses, the recipients are liable for the fraudulent conveyances. The Court notes that Richard Nelson directed the flow of all consideration paid by the debtors to an entity he controlled. Neither that entity nor Richard Nelson transferred anything of value to either Coco Foods or Coco Partners.

Like the LBO and MCA cases, Coco demonstrates that layered entities and transactional complexity will not obscure where value actually went.

Informal Contemporaneous Statements Can Override Transaction Documents

In *Teligent*, the court notably credited the debtor's CEO's contemporaneous newspaper interview over the negotiated separation agreement, concluding that loan forgiveness was a voidable transfer. The case illustrates how informal explanations like emails, interviews, and casual descriptions can outweigh carefully drafted agreements. *Teligent* is also a reminder that any transaction that eliminates a claim, obligation, or enforcement right should be evaluated as though cash changed hands.

Teligent, Inc. was a telecommunications company that filed for Chapter 11 bankruptcy. Alex Mandl was *Teligent*'s former Chairman and Chief Executive Officer. Prior to joining *Teligent*, Mandl served as President and Chief Operating Officer of

AT&T. On September 1, 1996, Mandl entered into an employment agreement with Teligent's predecessor to serve as Chairman and CEO. As part of the same transaction, Mandl borrowed \$15 million from Teligent's original shareholders, evidenced by two promissory notes. In 1998, the notes were assigned to Teligent. The employment agreement included several provisions under which the loan would be automatically forgiven; the loan would be automatically forgiven if Mandl was terminated "other than for Cause" or if he resigned for "Good Reason," subject to notice requirements. Good Reason included Teligent's failure to comply with any material provision of the employment agreement, including a breach of the provision committing Teligent to employ Mandl as its Chairman and CEO, with the customary duties and responsibilities. If Mandl was terminated for Good Reason, his Notice of Termination had to detail the facts and circumstances claimed as the basis for the termination. Upon termination of his employment, Mandl was required to resign from the board.

On the first anniversary of employment, one-fifth of the principal and all accrued interest were forgiven automatically, leaving a remaining balance of \$12 million. On April 17, 2001, IDT Corp. acquired a controlling interest (approximately 41.1%) in Teligent's Class A common stock. As part of this transaction, new directors affiliated with IDT were installed on Teligent's board. The board composition changed substantially following IDT's acquisition. Mandl's employment was terminated after IDT assumed control. A Separation Agreement and Release, dated April 27, 2001, provided that Mandl's employment was terminated "other than for cause," Mandl resigned as Chairman, CEO, and from all board positions, and mutual releases were exchanged between Mandl and Teligent.

The agreement restructured forgiveness of the \$12 million loan into 20 annual installments, effectively canceling Mandl's repayment obligation. Mandl signed the separation agreement on May 8, 2001, and Teligent's general counsel signed on May 17, 2001. The newspaper interview that the court found more credible was made within months of his departure. The court concluded that the statements in the interview indicated that Mandl was not forced to resign but voluntarily separated. He stated that he was disappointed that the board rejected his \$700 million recapitalization plan and he had already discussed the possibility of resigning with the board.

Conclusion

The sharp increase in commercial bankruptcies in early 2026 signals an equally sharp rise in avoidance litigation. Recent decisions make clear that courts are increasingly focused on substance over form and creditor impact over transactional labels. Transactions that load debt, shift risk, or extract value during periods of distress or transition are especially vulnerable. As filings continue to climb, sponsors, lenders, directors, officers, and asset buyers should assume that past transactions will be reexamined with fresh skepticism and prepare accordingly.