Debevoise & Plimpton

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From the Editors

The private equity industry moves into 2026 with surer footing and solid reasons for optimism, fueled by greater market stability and lower interest rates. The fundraising environment is becoming less foreboding and the high-yield debt market remains favorable. The M&A market in Europe and Asia is more robust, and while sponsors in the United States have been focused on bolt-on opportunities, the combination of pent-up dry powder and narrowing valuation gaps points toward the possibility of more transformational deal activity in 2026. U.S. fund regulators have made dialogue with the industry and alignment with market innovation an explicit priority, while in the European Union, progress (albeit slow) continues toward streamlining regulations to enhance competitiveness and free up investment capacity.

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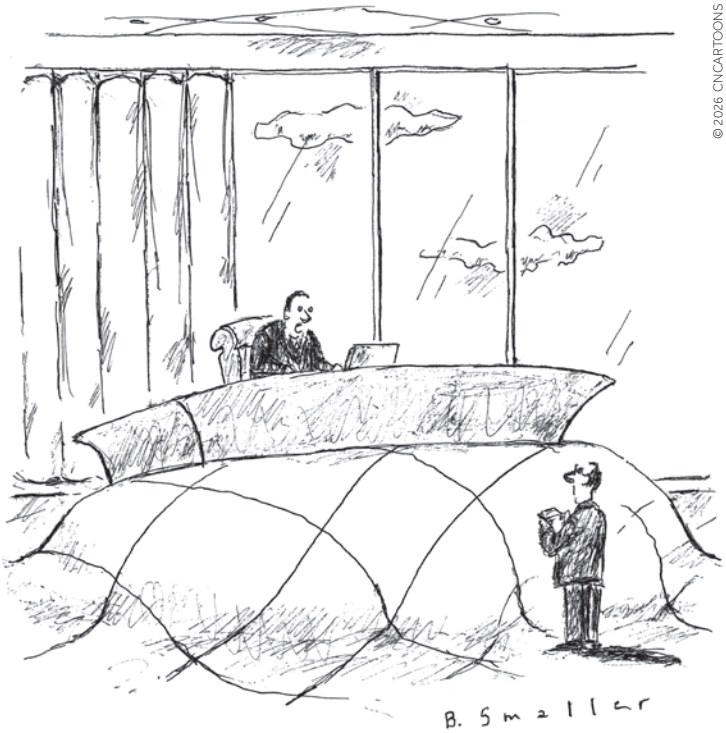

"Bubble? What bubble?"

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What's Inside

But even with these numerous positive developments, there is still plenty of uncertainty. Real estate investors must contend with fragile capital structures, a bifurcated office market and supply-side challenges to data centers and other industrial facilities. A flurry of litigation battles over fair use in training AI models is requiring a closer look at diligence considerations and risk management calculations, while funds and companies that look to train models on non-public data in the search for a competitive AI advantage are likely to face a thicket of rights limitations and contractual issues. And national security regimes related to U.S. economic interests continue to expand in the face of evolving geopolitical concerns, creating an increasingly complex regulatory landscape for inbound investment.

We hope you find the *2026 Private Equity Outlook* to be a useful summary of both the positive developments and the new challenges shaping the market as you navigate the year ahead.

This report is a publication of **Debevoise & Plimpton LLP**

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There are signs that the recent period of tepid private equity fundraising and limited exit activity may be coming to an end, encouraged by recent interest rate cuts, greater market stability and less geopolitical volatility. While aggregate capital raised and total fund count for 2025 were down year-on-year (continuing a slide that began in 2021), we believe there are reasons for optimism. Led by the $55 billion take-private of Electric Arts, aggregate deal volume nearly doubled in Q3 2025 from the prior quarter, reaching levels not seen since 2021. According to Pitchbook, private equity fundraising ticked up in the same quarter to $175.8 billion, with dry powder also increasing, supporting expectations for increased deal activity for 2026.

Secondaries fundraising was also particularly strong in 2025, as the growing number of alternative assets reaching maturity collided with limited opportunities for traditional exits. According to Private Equity International, secondaries funds have captured approximately 14% of global private equity fundraising (roughly double their 10-year average share), driven by large fundraisings such as the $30 billion Ardian Secondary Fund IX raise, the $20 billion AlpInvest Secondaries Program VII raise and the $11 billion ICG Strategy Equity Fund. Given the ability of secondaries funds to provide liquidity to an otherwise illiquid asset class while allowing managers to maintain control over key assets pending more attractive exit opportunities (whether through sales or the still-recovering IPO market), we expect the secondaries market to continue to grow through 2026 and beyond. We also expect to see an increase in fundraising for general partner staking funds, providing liquidity for managers while helping them to offset the slower pace of exits and the increasing operational costs that have become more common across the industry.

In addition to secondaries funds, we also expect to see investors move toward talented, forward-thinking managers who use creative or novel approaches to source attractive exits, as well as mega-funds that invest across multiple asset classes and provide diversification in choppy markets where one or more industries are challenged while others support more robust deal activity.

Echoing trends in other capital markets segments, larger sponsors are expected to maintain, if not widen, their competitive advantages as they continue to draw on both their privileged fundraising position and the benefits of scale in leveraging AI and data analytics to enhance deal sourcing and execution. We expect technology to remain an important theme in 2026, both in fundraising and deal-making environments, with tech-focused managers such as Thoma Bravo and Vista continuing to find outsized success. According to KPMG, technology has consistently been the largest share of global buyout deal value in private markets, with fintech and health tech seeing strong activity—a trend we expect to persist into the coming year.

Finally, we expect that the growth in retail-oriented products over the last few years will continue into 2026, propelled by a number of tailwinds. The concentration of public market returns among a relatively narrow group of AI-related companies has

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Fundraising

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intensified concerns among investors around portfolio diversification, leading to increased interest in private markets (and the ability to access private market returns). The Trump administration has signaled its commitment to removing, including through the use of executive orders, regulatory barriers that have historically limited individual investors' access to private equity. In keeping with that theme, the SEC has granted regulatory approval for KKR and Capital Group to launch credit funds that target retail investors, and other fund managers (such as Carlyle) are seeking approval for funds that target Accredited Investors. Looking ahead, we expect to see a continued focus among managers on retail and semi-retail-oriented fundraising in the private equity space, with additional products raised using existing templates and new templates developed in response to changing regulation or regulatory guidance.

Private Funds Transactions

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Over the past year, secondaries deal volume has continued to increase. According to Pitchbook, 2025 recorded approximately $226 billion in deal volume (up 41% on 2024), with LP-led and GP-led deals representing 53% and 47% of that volume, respectively. Multi-asset continuation vehicles (CVs) expanded their share of GP-led volume due to a combination of older vintage funds looking to realize remaining assets, buyer demand for diversified exposure and sponsors who may have previously raised a single-asset CV becoming more familiar with CVs as a liquidity solution.

As sponsors, existing LPs and buyers become repeat participants in GP-led deals, market terms continue to evolve. Sponsors who have raised more than one CV have sought to establish consistency in their "house terms," while balancing buyer-negotiated terms with the expectations of existing limited partners—many of whom are institutional investors with considerable CV experience and their own expectations of what they consider to be best practice. In the last 12 months, we have seen evolving market terms in the following areas:

- **"Status quo" options**—GPs are facing expectations from continuing LPs (and guidance from the Institutional Limited Partners Association) for "status quo" terms—that is, no changes to the management fee rate or base or carried interest charged by the existing fund. While market practice is still evolving, what's emerging is "close to status quo," given that maintaining true status quo can be more easily said than done. For example, a CV often includes an unfunded commitment to be deployed for follow-on investments, and CV investors may expect the existing fund's continuing LPs to fund a pro rata portion of follow-ons. Some CV investors may want the CV to be treated like a co-investment fund of the existing fund, with rights to exit at the same time and on the same terms as the existing fund. As CVs sometimes have restrictions on early exit, this creates a conflict of interest for the GP who may not want to constrain exit opportunities for an existing fund, especially one that is coming to the end of its term. Continuing LPs may also bear a portion of transaction expenses even though they are not selling. As GPs grapple with the question of how to fairly

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Private Funds Transactions

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allocate transaction expenses among selling LPs and continuing LPs, some GPs may take the view that it is fair for all LPs to bear fees incurred to structure and negotiate a transaction, as all LPs are being given a liquidity option even if they ultimately decide not to sell. It is also increasingly common for the carried interest of only active GP personnel to be rolled into the continuation fund, while inactive GP personnel may be given a liquidity option.

- **Deferred consideration, financing and earnouts**—The use of deferred consideration and earnouts to bridge pricing gaps continues to grow, particularly in credit CVs and multi-asset CVs, where some CV investors have negotiated a deferral of 50% or more of the purchase price. We have also seen sponsors use leverage to fund a portion of the upfront purchase price (or to increase the portion of the purchase price funded as an upfront payment) using subscription lines, NAV facilities and other structured or finance products.
- **M&A technology in CV deals**—In single-asset CV deals where the CV is obtaining control of the portfolio company, we have seen an increase in closing being concurrent with a debt refinancing at the portfolio company and the implementation of new or modified management incentive plans. We expect the use of terms from buyout transactions to become more prevalent in the CV space.
- **CV on a CV**—As more CVs reach maturity, certain sponsors have explored raising a new CV to give liquidity to investors in an existing CV—a CV-squared. Earlier this year, for example, Accel-KKR raised a CV-squared on its workforce management software portfolio company, isolved. However, these deals remain rare and are usually reserved for assets with a compelling growth story (notwithstanding the extended duration from the original CV). Concerns regarding CV-squareds have resulted in some investors seeking to negotiate protections from the outset. These include lead investor or LPAC consent rights on a CV-squared and an agreement to maintain "status quo" or no-less-favorable economics for existing CV investors who choose not to sell, including not extending the duration for payment of a management fee. While in the past, terms have frequently been negotiated on a deal-by-deal basis, sponsors may now have to grapple with restrictions or parameters on future transactions.

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As private equity sponsors reflect on 2025, the year will be remembered less for headline volume and more for disciplined execution. Macroeconomic uncertainty and persistent valuation gaps shaped dealmaking throughout the year. Yet sponsors remained active and creative, deploying capital through add-on acquisitions, carve-outs and alternative liquidity solutions, including continuation vehicles.

New platform deal volume in 2025 stayed on the lower end of recent years, despite new platform deal value that was exceeded only by that of 2021. Sponsors continued to approach control investments with caution, driven by financing costs, underwriting discipline and a persistent—though narrowing—valuation gap between buyers and sellers, but were ready to draw on their considerable dry powder given the right opportunity. Rather than control investments, the M&A activity of many sponsors was focused on supporting portfolio companies in pursuing bolt-on opportunities to drive growth, build scale and consolidate fragmented sectors. While overall add-on activity was down, this was not a trend we saw consistently across the market. Indeed, our sponsor clients were particularly active in this regard, using add-ons as a capital-efficient way to advance long-term investment theses amid market uncertainty.

Broader uncertainty, including trade- and tariff-related concerns, weighed on transaction activity at times during the year, particularly in sectors with global supply chains or cross-border exposure. As 2025 progressed, however, those dynamics achieved relative stability, allowing buyers and sellers to better assess risk and engage in transactions with greater confidence.

Corporate carve-outs were a relatively active source of deal flow in 2025, with non-core corporate assets presenting opportunities for sponsors to roll up their sleeves and pursue upside through operational improvements and supporting investments neglected during strategic ownership.

Additionally, continuation vehicles remained an important source of liquidity, allowing sponsors to provide returns to investors while retaining ownership of high-conviction assets. Rather than bringing assets to market in an uncertain exit environment, sponsors increasingly turned to these vehicles to extend hold periods and capture additional value.

From a regulatory perspective, under the Trump administration, the FTC and DOJ showed renewed willingness to consider remedies to address competitive concerns and clear transactions, representing a notable shift from the more rigid approach of the previous administration.

As sponsors look to 2026, we expect greater confidence and pent-up capital to translate into increased pursuit of large platform transactions, particularly as macro conditions stabilize and valuation expectations continue to converge. While add-ons, carve-outs and continuation vehicles will remain important tools, the coming year is likely to see a broader reopening of the market for transformational deals.

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Tracking the region's public markets, European private equity enjoyed a more bullish end to the year. Heading into 2026, dealmakers remain selective but willing to write larger checks when conviction is high.

In the last half of 2025, European buyout volumes stayed well below the peak seen in 2021 and 2022, but total deal values recovered toward the end of the year, as sponsors focused their capital deployment on fewer, larger tickets. Q3 2025 saw European private equity M&A deal value reach €177 billion, with 37% of value attributable to just 19 "megadeals" above €1 billion. Q4 2025 deal value is expected to close out the year-end total at around €250 billion, marking 2025 as one of the strongest years in recent history.

Against a backdrop of moderate economic growth, supportive monetary policy and slowly easing inflation across Europe, we expect sponsors to direct capital toward high-quality, revenue-generating targets. Building on the momentum from deals like Apollo's acquisition of a majority stake in Atlético Madrid, we anticipate the European sports universe, including club franchises and associated media platforms, to remain a sector of interest. Professional services, including consultancies, law firms and corporate service providers, have become attractive propositions for their scalable business models, dependable client bases and potential for operational efficiencies and buy-and-build opportunities. More such firms are publicly discussing or even inviting bids. Asset and wealth managers offer a healthy recurring revenue base and the chance for intra-industry consolidation to boost returns, with Franklin Templeton's purchase of Apera Asset Management (advised by Debevoise) earlier this year being one notable example. High-growth technology companies across Europe are maturing into resilient buyout targets. Healthcare retains its status as a cornerstone countercyclical sector, accelerated by aging global populations, elevated public spending levels and increased digitization, as demonstrated by Warburg Pincus' acquisition of Health Partners Group (advised by Debevoise). Across many industries in the United Kingdom, bolt-on acquisitions have been a particularly prevalent means of value creation for mid-market portfolio companies.

With the rise of artificial intelligence, private equity has a new lens through which to evaluate sectors: Is an industry "defensive" or "offensive" in the age of AI? Defensive industries, such as European sports and entertainment, are structurally insulated from AI advances, and value is linked to one-of-a-kind brands and live experiences. For bearish investors, these businesses present an attractive hedge against slower-than-expected AI efficiencies and shallow AI adoption across Europe in 2026. Offensive industries, by contrast, are ripe for AI-driven efficiency gains, as witnessed in data-rich financial services firms and healthcare and med-tech companies. But AI does not stop at the pitch deck. For example, EQT's continuing investment in its Motherbrain platform, with a dedicated European team to integrate AI and data management throughout its funds' investment lifecycle, illustrates how private equity firms are leveraging technological change to enhance performance. Other European funds are investing heavily in AI strategy as one of the single most important ways to improve portfolio company management and performance, which is a trend we expect to continue.

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M&A (Europe)

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The exit environment, however, remains modest in value and splintered in execution. Despite relatively robust realizations last year, a bifurcated market will continue to present challenges in 2026. Difficulty reaching agreeable valuations, elevated holding multiples, fewer large-participation auctions and concern around stalled, failed or aborted public processes have encouraged bespoke, tightly controlled or quasi-bilateral arrangements. For bidders, preemptive offers, compressed diligence timelines and structuring creativity will endure as competitive advantages.

Such trends guarantee that alternative structuring will remain popular in 2026. GP-led secondaries will increasingly be seen as a mainstream liquidity option by the European market. The past year saw a move toward single-asset (as opposed to multi-asset) continuation vehicle transactions in Europe, as illustrated by CapVest's $7bn recapitalization of Curium via a new CV supported by the likes of ICG, TPG Solutions, Goldman Sachs Alternatives and Ardian. Demand for co-investment participation looks healthy, and the so-called "club" or "consortium" deal will continue to be an attractive option for large and complex acquisitions at the top end of the European market.

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Private equity M&A across Asia showed a noticeable rebound in the second half of 2025 after initial uncertainty following the U.S. tariff announcements. India and China were the clear drivers of this regional momentum, with India continuing its strong multi-year upswing and China showing a meaningful increase in activity after a prolonged quieter period. Japan and South Korea also remained active, although growth was more modest. Southeast Asia, while slower than its post-pandemic peak, remained relatively stable (albeit with generally smaller deal sizes).

China's Recovery

China's M&A landscape has strengthened as macro indicators stabilize and investor sentiment improves. Against this more favorable environment, foreign investors have begun to reassess China's market, which can be seen in a sharp rise in offshore inflows into Chinese equities and a rally in both mainland and Hong Kong listings driven in part by renewed enthusiasm for China's technology and AI ecosystem. Further, a rebound in valuations has improved liquidity conditions and created a more credible exit environment for sponsors and corporates.

A particularly visible trend involves multinational consumer brands recalibrating their China exposure through structured divestments and joint-venture realignments. Recent transactions, such as those involving the new joint venture arrangements in China of Starbucks and of Burger King, reflect a growing preference for structures that rebalance risk while preserving commercial upside. In these deals, the foreign brand typically sells down to a minority stake but retains long-term participation through brand and IP licensing. A Chinese private equity sponsor takes control and leads operational

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expansion. This approach lets multinational brands stay economically invested while reducing operational exposure by entrusting day-to-day execution to a local partner with stronger on-ground capabilities and more familiarity with local consumers.

India as the Regional Standout

India continues to demonstrate the strongest growth profile in Asia and one of the most resilient globally. Strong macroeconomic fundamentals, a deepening domestic capital base and sustained consumer demand have attracted record levels of private equity interest, buoyed by the track record of deals there that were both successfully executed and exited during the period of lighter PRC activity. Deal value expanded across acquisition strategies, co-investments and continuation fund transactions, with this momentum largely unaffected by the brief border dispute with Pakistan in May 2025.

The ongoing strength of the Indian market has intensified competition for high-quality assets, pushing investors to accommodate more seller- and GP-friendly terms. Compressed timelines, lighter due diligence requirements and buyer-funded transaction costs have become more common, particularly in processes involving the most sought-after assets.

India's capital markets have remained active but experienced a choppier trajectory in 2025. After a steep correction between late 2024 and early 2025 that reset valuations across several sectors, dealmakers have found M&A opportunities more feasible and relatively more attractive for both strategic and financial buyers. IPO volumes have moderated from prior peaks, and the pipeline has been more concentrated in a smaller number of large-cap issuers. Despite the volatility, IPOs continue to be the principal pathway for private equity exits, and market sentiment has improved in the second half of the year as valuations stabilized and investor demand began to recover.

Looking Ahead to 2026

As we move into 2026, the dynamics that influenced deal activity in Asia this year are expected to carry forward. The impact of the U.S. tariffs has so far been more limited than many initially anticipated, but their longer-term implications for investment appetite, as well as wider geopolitical issues, will remain an important focus for investors.

Capital Markets

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U.S. debt capital market activity was strong in 2025. Favorable conditions in the credit markets resulted in significant volumes in the corporate bond market, and high-yield securities issuances increased year-over-year. In addition, all major fixed-income sectors, including high-yield and investment-grade corporates, mortgage-backed securities and asset-backed securities, exhibited strong performance. Looking ahead to 2026, current economic conditions are expected to support fixed-income issuances, and the stable credit environment should persist, particularly if rates continue to decrease.

2025 Market Review

All major fixed-income sectors saw positive returns on both a quarterly and year-to-date basis, with emerging markets debt and preferred securities exhibiting the highest returns. Year-to-date performance increased by approximately 6% or more across numerous segments, driven by declining interest rates and sustained investor risk appetite.

As a result of tight credit spreads and a stable outlook for economic conditions, the credit markets operated in exceptionally favorable conditions, with both investment-grade and high-yield credit showing low distress levels. Corporate credit has continued to outperform government bonds, with investment grade outperforming high-yield. Global high-yield spreads have remained low amid resilient consumer spending, strong growth and anticipated rate cuts.

High-yield activity increased in 2025, with U.S. issuances reaching $341.6 billion across 390 transactions, a 20% increase year-over-year, as investors aimed to lock in the historically high yields ahead of further potential rate cuts by the Federal Reserve. Refinancings comprised nearly three-quarters of the total high-yield security issuances, a trend driven by tightening spreads and lowering rates. The tech market led the charge in loan and bond activity, with the computers and electronics sector dominating high-yield volumes.

Last year saw an increase in buyout financing activity, with total transaction volume rising to $81.4 billion, a 12% increase year-over-year. Leveraged loan and direct-lending activity decreased in 2025. Further, last year saw declines in buyout-related leveraged loan issuances and direct-lending market activity, which fell 5% to $69.5 billion and 11% to $247 billion year-over-year, respectively. Based on year-to-date results through the first three quarters of 2025, issuance of high-yield bonds backing leveraged buyouts increased 73.2% year-over-year to $8 billion across seven deals, with almost three-quarters of the volumes attributed to the second quarter of 2025. Similarly, private equity buyouts in the United States significantly increased to $356.7 billion in the first three quarters of 2025, a 55% increase year-over-year.

2026 Outlook

The 2026 outlook for U.S. debt capital markets is optimistic, supported by improving economic conditions and ongoing Federal Reserve easing; following the Federal Reserve's quarter-point reduction in its benchmark interest rate on December 10, 2025 —its third cut of the year—most commentators expect the Federal Reserve to continue

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Capital Markets

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cutting rates gradually. High-yield issuance activity is expected to remain strong in 2026, with the number of issuances continuing to rise as investors look to secure attractive yields before additional rate cuts. Tightening spreads and improving market conditions may also continue to drive refinancing activity.

Moderating inflation, near-term fiscal stability and a resilient consumer backdrop support a constructive environment for sponsors and their portfolio companies accessing the U.S. debt markets heading into 2026. In the last quarter of 2025, broadly lower base rates and strong investor demand drove positive returns across major fixed-income sectors, creating a receptive primary market for new issuances. For private equity-backed issuers, this has translated into opportunities to refinance existing debt, extend maturities and finance acquisitions or dividend recapitalizations. At the same time, credit spreads over government bonds are near historic lows, suggesting that the current window for issuers to lock in favorable pricing may be finite. While spreads could tighten further in 2026, the scope for additional compression appears modest, underscoring the importance of proactive liability management and thoughtful transaction timing.

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Tax reform in 2025 came and went like a whirlwind, with seemingly as many changes left off the table as were included in the final One Big Beautiful Bill (OB3). The proposals excluded from OB3 included carried interest reform, SALT reform and a penalty "revenge tax" regime aimed in response to the Pillar 2 global minimum tax framework. (See our client alert for more detail on OB3.)

Separately, the courts and Treasury have continued their steady course of updates to U.S. tax law and regulations. We detail here a few key changes in 2025 that may affect private equity transactions in the coming year.

Ordinary Income Treatment for Certain Breakup Fees

The Tax Court, in *AbbVie Inc. v. Commissioner*, issued an opinion in June 2025 regarding the character of breakup fees that was favorable to that taxpayer. AbbVie entered into an agreement with Shire plc in 2014 to affect a $54 billion combination, in what would have been the largest corporate inversion to date. AbbVie agreed to a breakup fee of approximately $1.635 billion if AbbVie, among other things, failed to recommend the merger to its shareholders. When the IRS issued unfavorable corporate inversion rules prior to closing, AbbVie abandoned the deal and claimed an ordinary deduction for the payment of the breakup fee.

The IRS argued the breakup fee was capital in nature. However, the Tax Court concluded that the breakup fee was ordinary in nature, because it related to the services of the AbbVie board failing to recommend the combination, rather than to the failure to transfer AbbVie stock.

The Tax Court's treatment of break-up fees as ordinary may not be desirable for recipients of these fees, since ordinary income treatment may attract withholding and U.S. business income to non-U.S. investors unless special structuring is implemented.

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Private equity buyers will want to consider structuring their receipt of breakup fees in a manner that is distinguishable from the ruling in *AbbVie*.

Shut Off of DC-REIT Corporate Look-Through Rules

On October 20, 2025, in an unexpected but welcomed move, Treasury issued proposed regulations reversing its position in final regulations promulgated only 18 months before requiring the "look-through" of certain domestic C-corporations that are more than 50% foreign-owned for the purposes of determining whether a REIT is "domestically controlled." A REIT is domestically controlled if at all times through a testing period (typically the prior five years) less than 50% by value of the stock of the REIT was held directly or indirectly by foreign persons. Non-U.S. investors are generally exempt from U.S. tax on the sale of domestically controlled REITs. The proposed regulations will now treat a domestic C-corporation shareholder of a REIT as a U.S. shareholder for the domestically controlled REIT test regardless of who owns the corporation. The proposed regulations will be a boon for many private equity REIT structures that had relied on U.S. blocker corporations before the final regulations were issued and will provide clarity for private equity funds that were previously hesitant to use U.S. blocker structures for their foreign investors.

The proposed regulations, once finalized, will revoke the final regulations with retroactive effect and taxpayers are permitted to rely on the proposed regulations prior to their finalization.

Withdrawal of Proposed Section 382 Regulations

On July 2, 2025, Treasury withdrew the taxpayer-unfavorable proposed Section 382 regulations issued in 2019. This means the existing framework under Notice 2003-65 remains in effect, and taxpayers retain the flexibility to choose between the "338 approach" and the "1374 approach."

To police trafficking in tax assets, Section 382 of the Internal Revenue Code limits a loss corporation from using net operating losses (NOLs) following an ownership change. The annual Section 382 limitation generally equals the corporation's equity value immediately before the ownership change multiplied by the long term tax exempt rate. During the five year recognition period, a corporation with a net unrealized built-in gain is permitted to increase its annual limit by its recognized built in gains (RBIG).

Under Notice 2003-65, taxpayers may choose one of two overall methods to identify RBIG over the five-year recognition period. The 1374 approach treats as RBIG only those items actually recognized during the recognition period that are attributable to pre-change built-in gains, typically producing a narrow set of RBIG items. By contrast, the 338 approach, which uses a deemed-asset purchase model, often yields additional RBIG items.

Under the 2019 proposal, Treasury would have eliminated the 338 approach and effectively mandated a modified 1374 approach, which was broadly viewed as unfriendly to taxpayers. Because those rules were only proposals, they never became effective, and with the withdrawal, the status quo continues. For dealmakers, the practical impact is that pre-closing NOL utilization planning remains more flexible.

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The second half of 2025, in the lead-up to the United Kingdom's Budget, was dominated by rumors about potentially significant tax increases for those taxpayers "with the broadest shoulders" to plug the United Kingdom's fiscal "black hole." However, the actual reforms announced in the Budget on November 26 and detailed in draft legislation published in the Finance (No. 2) Bill on December 4 were far less sweeping than anticipated. The focus for investment fund sponsors and their portfolio companies instead remains on the previously announced reforms to the taxation of carried interest and stamp duty. These reforms, together with relevant changes from the Budget and the Finance Bill, are summarized below.

Carried Interest Reform

Following previous consultations in 2024 and 2025, and the publication of initial draft legislation in July, the UK government published revised draft legislation on carried interest reform in the Finance Bill, which remains largely in line with the proposed changes covered in our separate client alert. In brief:

- From April 2026, carried interest will be taxed as arising from *trading* activity (as opposed to *investment* activity), ostensibly at a rate of up to 47% (comprising 45% income tax plus 2% self-employed national insurance contributions).
- *Qualifying* carried interest will benefit from a lower tax rate of up to approximately 34.1%. To qualify, a carry recipient must determine that their carried interest arises from a fund that has an average investment holding period of at least 40 months. This determination is currently required for a small minority of carry recipients (who fall under the so-called "income-based carried interest" rules) but will now apply to *all* carry recipients.
- The new regime brings non-UK resident carry recipients under the umbrella of UK tax for the first time, to the extent that they have performed investment management services in the United Kingdom for the relevant fund sponsor. While the initial draft legislation included some valuable limitations on this extra-territorial effect, those limitations did not apply if the carried interest was *non-qualifying*. The revised legislation improves on this slightly—the limitations will apply to non-qualifying carried interest if it was "reasonable to assume" at the outset that the carried interest would be qualifying. However, there remains considerable exposure for non-UK residents.

We strongly recommend that investment fund sponsors obtain advice to understand the potential UK tax exposure of their non-UK carry recipients.

UK Stamp Duty Reform

The Budget confirmed that the UK government will be moving forward with proposed measures to replace stamp duty and the Stamp Duty Reserve Tax (SDRT) on transfers of shares and other securities with a new, simplified Stamp Tax on Securities (STS), with effect from 2027. This reform should generally be favorable to buyers of UK companies and secondaries funds and is covered in our separate client alert.

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Tax (UK)

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Other noteworthy UK tax developments

The following UK tax changes were announced as part of the Budget:

- **Increases in the tax rates on dividend, property and savings income.** From April 2026 or 2027, as applicable, the tax rates on dividend, property and savings income will increase by 2% across all tax brackets (with the exception that the highest, additional rate bracket for dividend income will remain unchanged, at 39.35%).
- **Increase in the rate of UK withholding tax on interest.** The government has indicated that, from April 2027, the rate of withholding tax on UK source interest paid to nonresidents will rise from 20% to 22%. This is a material development for financing transactions in the United Kingdom.
- **Share exchanges.** With respect to shares issued on or after November 26, 2025, the anti-avoidance provision that can frustrate UK tax deferral on M&A and reorganizations involving equity rollover and/or share-for-share exchanges by UK shareholders will be broadened to capture more scenarios in which a share exchange is used to ultimately reduce a UK tax liability. In addition, the exclusion from anti-avoidance considerations for shareholders who own less than 5% of a company has been removed. Parties that are currently involved in UK share exchanges should confirm that their prior tax analyses still stand.
- **Permanent Establishment.** With effect from January 1, 2026, the definition of "permanent establishment" and the Investment Manager Exemption (IME), a safe harbor protecting non-UK investors in case a fund has a UK permanent establishment, will both be expanded. Investment fund sponsors with operations in the United Kingdom and internationally may face an overall increased UK tax exposure under the new rules.

National Security

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With the Trump administration's declaration that "economic security is national security," private equity is navigating an investment environment shaped by expanding and overlapping regulatory regimes that target both foreign inbound and outbound investment. At the same time, U.S. sponsors and investors from partner and ally countries are beginning to feel the positive impact of the second Trump administration's efforts to lessen regulatory burdens on passive investment from those countries—at least where there is no nexus to the People's Republic of China (PRC) or other identified foreign adversaries.

We expect these trends to intensify as efforts to implement the administration's *America First Investment Policy* continue into 2026. We highlight here some expected near-term developments that may affect private equity sponsors in the coming year.

An Increasingly Complex Regulatory Landscape for Inbound Investment

National security regulatory regimes—particularly those related to U.S. economic interests—continue to expand in response to changing geopolitical concerns, implicating

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National Security

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more sectors and new commercial technologies outside of the traditional defense industrial base. As a result, we are seeing more transactions subject to notification or reporting requirements, often to multiple regulatory bodies.

Recent actions by the Trump administration suggest this expansion will continue, and that we may see more overlap with regimes not traditionally tied to national security. For example, in an Executive Order issued in December, President Trump directed the heads of the Department of Justice and the Federal Trade Commission to establish a Food Supply Chain Security Task Force to, among other things, investigate whether foreign control of food-related industries creates a "national or economic security threat." The Executive Order may signal enhanced CFIUS scrutiny of investments in food-related industries and of the security implications of any competitive effects of such transactions.

New Efficiencies for Passive Investment

With respect to inbound investment, Treasury has indicated that it continues to review its processes, practices and authorities pursuant to the directives of the *America First Investment Policy*. While this may lead to an expansion of the scope of existing categories and/or geographies that can be subject to CFIUS jurisdiction, we expect it will also bring new efficiencies, particularly for passive investment from partner and ally countries, such as the further development of the "Known Investor" pilot program announced by Treasury in May. However, as telegraphed by the *America First Investment Policy*, we expect these efficiencies to come at the cost of demonstrating "verifiable distance and independence" from, and potential agreements to "avoid partnering with" the PRC or other identified foreign adversaries.

Expansion of the Outbound Investment Regulatory Regime

The year closed with President Trump signing into law the Comprehensive Outbound Investment National Security Act (the COINS Act) as part of the Fiscal Year 2026 National Defense Authorization Act, which authorized the expansion of the existing U.S. outbound investment regime, significantly broadening the scope of targeted countries, technologies and investment transactions. While the existing regime remains in effect until Treasury issues regulations pursuant to the COINS Act, we expect firms will begin to prospectively evaluate their existing compliance programs in the coming year.

Looking Ahead

- **Expect enhanced scrutiny of investments in more sectors.** The second Trump administration has signaled particular focus on agriculture and food-related investments, as well as efforts to promote domestic mineral and energy production. Technological focus remains on AI, quantum information computing, semi-conductors and biotechnology, with new attention on hypersonics and advanced computing.

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National Security

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- **Stay attuned to new or evolving filing or reporting requirements, particularly at the portfolio company-level.** As the scope of items subject to control expand, more businesses are subject to reporting and other notice requirements in the event of a change in control and/or foreign investment. Be particularly mindful of businesses with government contracts or other sources of funding or that manufacture defense-related items.
- **Be aware of commercial and other ties to PRC-affiliated persons.** To be poised to take advantage of regulatory efficiencies, know where ties to PRC or other foreign adversary-affiliated persons exist, both within your investor base and at target businesses.

People Solutions

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As private equity sponsors begin 2026, familiar questions around management incentive plan (MIP) design continue to drive negotiations with acquisition targets—particularly around pool size, initial allocation levels and the depth of employee participation. Below, we briefly summarize our observations of market practice and emerging developments on these issues.

Equity Pool Size and Initial Pool Allocation

MIP pool sizes most commonly fall between 8% and 10%—with 10% the most consistent data point—but we also see pools as low as 4% and as high as 12%. This aligns with the limited third-party survey data published on the topic over the past several years. Several factors drive the wide range:

- **Industry Orientation.** Where a private equity sponsor acquires a target in the venture-backed or tech space, including where the target's recruiting pool is from venture or tech, one expects to see larger pools. "Old economy" businesses may be on the lower end of the scale.
- **Vesting Terms.** Equity pools tend to be larger where a significant percentage of the award pool is subject to performance-based vesting, such as Multiple of Invested Capital (MOIC) or Multiple of Money (MoM) thresholds. In particular, where these thresholds are set high enough to only pay out for "home-run" performance, a sponsor might gladly accept an outsized return to management.
- **Sponsor Practice.** Many sponsors treat their MIP design as part of their "special sauce" for retaining and motivating management teams. Where prior methods of setting pool size have resulted in a successful track record for the sponsor, the decision to replicate those terms in future deals may be an easy one, even when those terms diverge from perceived market norms.
- **Exit Allocation.** One occasionally sees management and sponsors negotiate whether any portion of the MIP pool that remains unallocated at exit must be allocated to management. When sponsors agree to do so, they tend to focus more closely on setting an appropriate pool maximum.

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One might expect deal size to play a factor in pool size, with larger deals having smaller pools: 8% of a $2 billion equity check has a very different return profile than 8% of $250 million. Our observation, however, is that pool sizes are frequently set without direct reference to the sponsor's equity investment.

One consideration that indirectly influences MIP pool size is how much of the pool is granted at closing versus reserved for future grants, typically for new hires and promotions. We generally see 75%–80% of the pool granted at closing, but this figure can vary—often driven by target-specific considerations rather than market trends. For example, where a management team is fully in place at closing and tied to the business through a healthy equity rollover, one would expect to see very little of the pool reserved for the future. However, in a carveout transaction where new hires are anticipated or where departures (forced or voluntary) are expected, the reserve may be higher. Post-closing acquisition activity or an expected longer hold period also can increase the perceived need for a larger reserve. The limited survey data that exists supports any closing allocation greater than 60%.

Higher Employee Participation Levels: Emerging Trend or Isolated Cases?

Historically, sponsors have limited MIP participation at their portfolio companies to those members of senior management who are critical to the success of the business and/or whose services will enhance equity value. Two other common reasons given for a narrower group of MIP recipients are (1) it can be challenging to communicate complex private company equity structures to a broader group of employees and (2) the inherent illiquidity of the awards. We have found that, at lower levels of an organization, cash is still king, and rank-and-file employees are less interested in securing tax-advantaged compensation such as partnership profits interests. There are also potentially difficult (but not insurmountable) tax, securities, cash-flow and administrative challenges arising from these expanded equity pools.

Nevertheless, in recent years, there has been a growing interest in expanding participation. For example, a 2024 *Wall Street Journal* article reported on Blackstone's announcement to grant equity to rank-and-file employees at its largest U.S. buyouts. This followed the 2022 launch of OwnershipWorks, a nonprofit founded by 19 private equity firms, whose goal is to promote broad-based equity ownership.

In practice, however, we have so far seen an expansion of recipients only in two contexts: first, industries where private equity overlaps with venture or tech and second, take-privates of public companies. In these cases, there may be industry, recruiting and cultural/historical pressures to grant equity more deeply into the organization. Outside of these contexts, deeper grants for rank-and-file employees, while attractive in concept, may not achieve the intended retention or incentive goals when compared with the resulting dilution.

If broader participation gains traction in 2026 or beyond, we expect to see equity-linked cash programs—such as cash-settled restricted stock units or stock appreciation rights—at lower levels rather than actual equity. Vesting may also differ for this group to make the awards more straightforward and understandable.

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The 2026 Priorities for the SEC Division of Examinations signal continued scrutiny of private equity sponsors and other private fund advisers. The Division again anchors its Priorities in fiduciary duties and conflicts of interest but now does so against a backdrop of changing market structures, growing private credit strategies and increased M&A among advisers.

For the first time since 2021, the Priorities do not separate private funds into a stand-alone section but instead incorporate private fund review areas into broader thematic categories, suggesting that private equity strategies are now viewed by the Division as part of the mainstream risk landscape rather than a niche product vertical. Areas called out for review include alternative investments (e.g., private credit and funds with extended lock-up periods), side-by-side management conflicts (e.g., advisers to private funds that also advise separately managed accounts and/or newly registered funds), advisers to newly launched private funds and advisers entering the private fund space for the first time. The Division will also focus on integration challenges (including when a registered adviser acquires or is combined with an exempt adviser), underscoring the importance of post-closing integration of compliance, valuation and conflict-management frameworks.

The Priorities reinforce that core compliance program effectiveness remains a baseline expectation for private equity advisers. Examiners intend to test regulatory awareness, liquidity and valuation practices, fee and expense allocations, and the adequacy of disclosures—all of which directly implicate common private equity practices such as complex waterfall structures, transaction and monitoring fees and cross-fund allocations. The Division will continue to probe whether policies and procedures meaningfully address fee-related conflicts, marketing, valuation, portfolio management, custody and filings, with a particular emphasis on recently registered advisers, which includes many newer or growth-stage sponsors. At the same time, cross-cutting risk issues—cybersecurity, identity theft, customer-information safeguards under Regulations S-P and S-ID, and the use of artificial intelligence and other automated tools—are expressly framed as applicable to all registrants. For private equity firms, this translates into exam attention on governance of vendor relationships (including administrators and portfolio company service providers), incident-response planning, the accuracy of any AI-related claims in investor communication and the robustness of controls around data used in deal sourcing, portfolio monitoring and trading or hedging activity.

Overall, the 2026 Priorities suggest that private equity sponsors should expect holistic examinations that cut across both traditional "private funds" topics and newer technology and resiliency themes, with particular sensitivity to conflicts, disclosure alignment and operational readiness.

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The U.S. regulatory outlook for private funds and their advisers in 2026 reflects the SEC's emphasis on dialogue, deregulation and modernization. Examinations remain rigorous, but the Commission's leadership is explicitly inviting industry engagement. Director of Investment Management Brian Daly has emphasized that the Division's top priority is to listen and to focus resources on initiatives "grounded in reality and responsive to the needs of investors and the industry alike." He has encouraged firms to engage the Commission with specific requests and clear rationales, noting that staff does not approach day-to-day operational issues with the same level of granularity.

Latest Reg Flex Agenda

This recalibration is reflected in the Commission's Spring 2025 Reg Flex Agenda, the first under Chair Atkins. (Detailed discussion of the Agenda can be found in our client alert.) Many of the Gensler-era proposals most relevant to private funds, including safeguarding of advisory client assets, predictive data analytics, adviser outsourcing and ESG disclosure, have been dropped. The Agenda instead emphasizes deregulation and modernization, including amendments to Rule 17a-7 (cross-trades), the custody rules under the Advisers Act and the Investment Company Act, disclosure burden reductions and updates to exempt offering pathways to facilitate private investment. Proposals on these topics are targeted for April 2026.

Democratization of Private Markets

In furtherance of the August 7, 2025 Executive Order to expand access to alternative assets for 401(k) plan investors, the Commission has made enhanced retail access to alternatives a core objective. (Additional insights on the Executive Order can be found in our client alert.) The Spring 2025 Reg Flex Agenda includes an initiative to "simplify the pathways for raising capital for, and investor access to, private businesses," potentially through changes to Regulation D, Securities Act Section 4(a)(2), Regulation A, Regulation Crowdfunding or a combination of these.

Chair Atkins has framed retail access to private market assets as a question of "freedom and fairness" and has said exposure "should not be reserved for the wealthiest." Director Daly has described democratization as an incremental process of targeted actions and staff guidance, rather than prescriptive new regimes or exam-driven de facto limits. He cited the Division of Investment Management's Accounting and Disclosure Information bulletin 2025-16 as a template for easing constraints on closed-end funds investing in private funds and emphasized giving the industry room to innovate, with Commission involvement when appropriate.

Clearing the Way for Crypto

Chair Atkins has stated that a key priority of his tenure is to institute "clear rules of the road" for the issuance, custody and trading of crypto assets while continuing to discourage bad actors. A joint statement with CFTC Acting Chair Pham noted that both agencies are open to changes that would explicitly permit peer-to-peer trading in spot crypto assets, including certain leveraged and derivatives transactions, over DeFi protocols.

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Several Spring 2025 Reg Flex Agenda items affect crypto, directly or indirectly. We expect early attention on modernizing custody rules under the Advisers Act and the Investment Company Act, reflecting a narrower, more practical approach to crypto custody and a reset from the withdrawn 2023 safeguarding proposal. Director Daly cited a recent no-action letter permitting in certain instances custody of client crypto assets with state-chartered trusts as a "good first step." We anticipate a 2026 proposal clarifying digital asset custody and qualified custodian issues in a more principles-based and less prescriptive manner.

Chair Atkins has also said the Commission is drafting an "innovation exemption" from securities laws to allow firms to experiment with crypto products, such as tokenized fund interests, with a proposal targeted for January 2026.

Adapting to AI

We continue to expect the Commission to address AI-related conflicts primarily through the existing fiduciary framework, guidance and examinations.

Chair Atkins has outlined a pro-innovation, principles-based approach to AI. Under his leadership, the SEC withdrew the Gensler-era predictive data analytics proposal, which would have imposed broad obligations on the use of AI by funds and advisers. Chair Atkins has described AI as ushering in "agentic finance" and has said the SEC should set "commonsense guardrails" without overreacting in ways that could stifle innovation. He has also argued that existing, materiality-based disclosure requirements should sufficiently capture AI-related risks, cautioning against disclosure mandates created specifically for AI.

Director Daly likewise has described AI as a "transformative force" the Commission seeks to "enable, support, and regulate thoughtfully." He has suggested a move from static PDFs to more interactive, AI-driven disclosure, while flagging open questions, such as when AI outputs may constitute marketing material or investment advice (potentially implicating registration) and how liability for erroneous outputs should be allocated among advisers, developers and platforms.

The Atkins SEC appears set to deliver on its promise of deregulation, democratization and digital revolution. While these shifts are likely to be welcomed by the private funds industry, investment advisers should carefully consider any substantive pivots in internal policies and strategies to evolve their businesses sustainably and consistent with fiduciary obligations.

European Funds Regulatory

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Over the second half of 2025, EU Member States have continued to implement the provisions of the amended Alternative Investment Fund Managers Directive (AIFMD 2) into national law. Given the implementation deadline of April 16, 2026, this activity will ramp up in the first quarter of the year. The new rules particularly govern managers and their alternative investment funds (AIFs) engaged in loan-origination activities. The provisions for loan-origination activities by AIFs create common rules for an efficient internal market, allowing AIFs to originate loans in all Member States and facilitating access to finance by EU companies. There are important new conditions for funds that engage in loan origination, including risk diversification and leverage limits, with significant impact on fund managers with funds whose investment strategy is predominantly loan origination. AIFMD 2 also enhances requirements on disclosure, delegation, reporting and liquidity management tools for open-ended funds. The European Commission adopted regulatory technical standards on liquidity management tools for open-ended funds on November 17, 2025.

The second half of 2025 also saw further incremental, albeit slow, progress towards finalizing amendments to the European Union's Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD), with a view to streamlining EU rules, enhancing the bloc's competitiveness and freeing up investment capacity. This culminated on December 16, 2025, with the European Parliament voting to adopt the Omnibus Amending Directive, which reshapes the scope, timing and substance of key reporting and due diligence obligations under the CSRD, the CSDDD and the European Taxonomy. The final text of the Amending Directive will be formally approved by the Council and will enter into force 20 days after its publication in the Official Journal of the European Union.

In a further change to its sustainability finance framework, the European Commission also published a proposal for changes to the Sustainable Finance Disclosure Regulation (SFDR) on November 20, 2025. This includes the introduction of a formal categorization scheme, with three new categories of funds with sustainability characteristics (Article 7, "Transition"; Article 8, "ESG Basics"; and Article 9, "Sustainable"), with minimum criteria in each case. Under the changes, all funds that are offered to EU retail and professional investors will either need to select a category and comply with the relevant criteria if they wish to claim the types of sustainable characteristics covered by each category or face restrictions on including sustainability information in their fund marketing materials. Grandfathering relief will be available for closed-ended funds that have held their final close before the new SFDR comes into effect. The proposal will need to be negotiated with the Council and the European Parliament and is expected to be finalized in late 2026, with application expected around 2028.

The European Commission also published a set of legislative proposals, the "Market Integration Package" as part of the European Union's broader Savings and Investments Union initiative. These proposals intend to integrate EU financial markets by breaking down barriers to cross-border business and encouraging greater capital flows. With respect to the asset management sector, the changes are intended to address the dominance of

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European Funds Regulatory

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Luxembourg and Ireland as fund and fund management domiciles and the limited use of the marketing and management passport for alternative investment funds established in other jurisdictions. The proposal includes measures for streamlined cross-border distribution, simplification to the marketing passport regime, reduced national discretion to avoid gold-plating and enhanced supervisory power for the European Securities and Markets Authority (ESMA) over very large pan-EU asset management groups.

Finally, the European Commission and European Parliament announced in December 2025 that they had reached a political agreement on the European Union's Retail Investment Strategy package (RIS), which will introduce targeted amendments to various EU regulations including AIFMD, the Markets in Financial Instruments Directive (MiFID) and the Regulation on packaged retail and insurance-based investment products (PRIIPs) to increase availability of private funds to retail investors. The final text of the RIS is set to be released in early 2026.

Real Estate

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Uncertainty appears certain as the real estate industry enters 2026. Elevated interest rates, fluctuating macroeconomic conditions and persistent tariff volatility have produced a market where capital is available but cautious. Borrowers and lenders alike remain fixated on the extent to which rate relief will materialize, with nearly 90% of commercial real estate owners and investors in a recent national survey citing interest rates and cost of capital as top concerns. In the meantime, private capital sources, including credit funds, have stepped in with additional mezzanine financing and other structured solutions to bridge the gap between maturing low rate debt and today's elevated cost of capital. These strategies have effectively kicked the can of anticipated foreclosures down the road, with only 21% of commercial real estate owners and investors in another survey expecting to pay their upcoming maturity in full—a finding that underscores the fragility of current capital structures. Still, the industry continues to move, albeit with sharper distinctions between outperformers and laggards.

Within the **multifamily sector**, demographic shifts are reshaping demand. Senior housing surged to the forefront in 2025, driven by a rapidly aging population and a growing share of older renters living alone with fewer caregiver safety nets. Despite this rising demand, supply growth has slowed, with fewer units breaking ground than listed online. With seniors projected to represent over 20% of all Americans by 2050, this dynamic is expected to intensify. Self storage also continues its ascent, as elevated home prices and mortgage rates continue to drive increased demand for off-site climate controlled space. Developers are similarly turning towards hybrid storage condos equipped with utilities and designed for small businesses such as HVAC companies and event service firms—a niche but growing market. Student housing, by contrast, faces headwinds. A peak in graduating seniors in 2025, visa constraints affecting international students and rising construction costs are prompting a retreat.

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Real Estate

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President Trump's statement at the start of the year that he intends to call on Congress to ban large institutional investors from buying more single family homes predictably rattled the market. Investors await further details when the President addresses the World Economic Forum in Davos in late January.

Data centers remain a focal point for investment and development in the **industrial sector**, buoyed by accelerating AI and infrastructure needs, robust performance and insatiable demand for power dense facilities. Yet, supply constraints in land availability, water access and power capacity continue to limit growth. Shortages of highly skilled technical workers, particularly in rural markets where many sites are located, further challenge implementation deadlines. That said, the ongoing blurring of traditional real estate and digital infrastructure will persist as a defining feature in 2026.

The office market continues its bifurcated path. Medical offices are attracting investors, supported by long term leases and contractual rent bumps that hedge against inflation. Traditional offices are showing incremental recovery, notably in central city and suburban locations, aided by office re entry momentum and historically low levels of new construction. Tenants, however, remain focused on quality, trading up to high amenity Class A spaces to entice workforce retention.

Residential conversions have gained momentum as a viable adaptive reuse solution. New York City leads the wave of conversion proposals, where Class A properties now represent a majority (52%) of proposed activity, reflecting tax incentive programs, zoning reforms and a reduction of administrative hurdles. Similar initiatives in Seattle (including a deferral of 10.3% sales and use taxes) and Washington, D.C. are helping older and less competitive buildings find second lives.

Ultimately, the real estate landscape entering 2026 presents a mix of complexity and opportunity. For investors, success will hinge on disciplined underwriting, creative structuring and a willingness to lean into sectors where demographic, technological and policy trends support long term value creation. While the fog of uncertainty has not yet lifted, the firms best positioned for the year ahead will be those prepared to deploy capital selectively, navigate regulatory tailwinds thoughtfully and move decisively when clarity returns.

Restructuring

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Regardless of industry, 2026 promises more liability management exercises (LMEs), as sponsors and borrowers seek to address capital structure stress and to avoid the costs and publicity of a traditional bankruptcy filing. We predict that the LME landscape will see a number of developments this year.

One important element of the historical LME landscape has been the use of cooperation agreements by some lenders to exclude other lenders from participation, resulting in so-called "creditor-on-creditor violence." More recently, cooperation agreements have tended to become less exclusive and to permit all lenders to join the co-op—but they still commonly permit differential treatment in a later LME among steering committee lenders, non-steering committee lenders that sign up early and other lenders that sign up later. At the same time, sponsors and borrowers, so as to limit how disadvantaged they might be in the event of restructuring negotiations, have gone on the offensive by attempting to introduce provisions preventing lenders from entering into cooperation agreements at all, as well as anti-boycott provisions to restrict cooperation agreements that would block new-money investments. Although these blockers have had limited success in clearing the market, we expect continued attempts at these provisions in 2026.

We also anticipate more creativity in litigation challenging LMEs and related arrangements. Notably, the end of 2025 saw the filing of new litigation using antitrust claims to challenge creditor cooperation agreements. In one case, antitrust claims are asserted by lenders excluded from an LME in connection with a broader challenge to the LME; in the other, antitrust claims are asserted by a borrower who alleges a cooperation agreement precluded its ability to explore certain LMEs. While these cases may temper the use of cooperation agreements in 2026, we anticipate that—as is common in LME litigation—the particular language of the documents at issue and the facts on the ground could distinguish these cases from other situations.

Finally, we are seeing an increasing number of companies returning to the market for second or third LMEs because the initial workout addressed near-term needs but did not fully resolve underlying leverage issues or business challenges. Those later transactions may be harder to pull off out-of-court because of document tightening in earlier LMEs. Accordingly, as borrowers' prior LMEs start to show their age, we expect to see a corresponding increase in the need for comprehensive restructurings, including bankruptcies, to put those borrowers on a track back to growth and profitability. And non-bankruptcy implementation, including foreclosures and assignment for benefit of creditors (ABCs), will continue to be more common when the costs and publicity of chapter 11 remain unpalatable for a company and its stakeholders.

Data Strategy & Security

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While it may be a little early to make the call for the biggest AI challenge of 2026, contractual use limitations are a strong contender, as they're poised to become a significant problem for private equity firms seeking to scale AI across their portfolio companies.

As AI model capabilities converge and plateau, improved generative AI performance will come from providing models with high-quality context derived from non-public, relevant data. Many of the new features recently announced by frontier large language model providers like OpenAI and Anthropic are designed to allow models to access such high-quality context from work emails, SharePoint sites, databases, customer service calls and so on. But often, portfolio companies that want to use these materials do not clearly own them or the right to use them in this way. Many of these materials were provided by customers, vendors or other third parties, with use conditions such as NDAs, software licenses and contractual terms and conditions that may place significant limitations on how those documents can be used.

There are also many provisions that were drafted either before GenAI was available or without the use of GenAI in mind, but which may nonetheless apply to the use of customer data for GenAI models. These provisions include restrictions relating to use limitations, technical segregation, data alteration, data dissemination, data destruction and IP rights.

Adding to the complexity of what is a very complicated analysis, the contracts that govern the datasets are often not standardized and govern numerous pieces of data, so finding which clauses apply to particular datasets can be very difficult. Given that portfolio companies may hold such agreements across decades, there may be thousands of applicable contracts, making it extremely difficult to know which datasets are actually available for AI reference data.

To illustrate the point, suppose an insurance company wants to use AI to reprice its auto insurance in a particular city, neighborhood by neighborhood, using a vast quantity of data that may be relevant for accident or theft claims in each location. They have collected or purchased data relating to weather conditions, road construction, crime statistics, past insurance claims, telematics, vandalism frequency by make and model of car, drone footage with analytics, etc. Each dataset may be subject to multiple contracts and therefore multiple possible restrictions, which may differ by provider, time period and location.

To help manage the legal issues raised by these kinds of large data projects, Debevoise has recently developed a customizable protocol that uses AI structuring solutions, identifies the applicable data restrictions, maps the data to the contracts and then addresses these restrictions through several creative and practical mitigation options.

Unlocking the value of AI will increasingly involve the messy exercise of assessing and addressing contractual restrictions on high-quality internal non-public data. This analysis can be time consuming and complex, often involving the management of several different legal, technical, business and reputational risks. The challenges can be significant but are solvable. However, if ignored, they are likely to get harder over time. Forward-thinking private equity firms will allocate the necessary resources to these data use questions as part of their ongoing AI integration.

Intellectual Property

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The past year brought major developments in intellectual property litigation over artificial intelligence, including in the battle over fair use. Dozens of still-pending cases promise more to come in 2026.

Key trends have emerged that are shaping the risks associated both with AI development and downstream AI use, which may directly affect portfolio company strategy and financial exposure. Large corporations are now pooling resources to sue AI developers, who can expect litigation costs to continue to rise. Class certification rulings are amplifying the financial risk of damages awards, and trademark claims have proven a durable source of potential liability. For investors, either in AI companies or the increasingly large percentage of companies that use AI in their day-to-day business, these developments require a proactive approach to risk management across their portfolio.

Fair Use: Initial Rulings Won't Be the Last Word

This year brought three fair use rulings but little certainty in the risk landscape:

- In *Thomson Reuters v. ROSS Intelligence*, the court held that using Westlaw headnotes to train AI-powered legal research tools was not fair use because ROSS's product was commercial and would compete directly with Westlaw. (This ruling has been appealed.)
- In *Bartz v. Anthropic*, the court held that using copyrighted works to train large language models was fair use but storing pirated datasets was not.
- In *Kadrey v. Meta*, the court similarly held that training was fair use (even when using pirated works) but included a detailed explanation of how future plaintiffs could overcome the fair use defense, with the court observing that "in most cases the answer" to whether training AI on copyrighted materials is illegal "will likely be yes."

The extent to which the case law is still developing can be seen in the courts' differing analytical approaches. *Bartz* analogized AI training to human learning and dismissed concerns about indirect competition, while *Kadrey* rejected this analogy, reasoning that generative AI's potential to "flood the market with competing works" makes market dilution "highly relevant." *Bartz* distinguished *Thomson Reuters*, observing that the lack of competition between the parties in Bartz changed the fair use analysis.

This uncertainty is likely to deepen. Future plaintiffs will likely use these early decisions as a roadmap to strengthen their arguments, particularly around evidencing market harm. Should a developer fail to establish fair use for training its model using copyrighted works, there may be downstream risk to its customers who used infringing software. Contractual indemnities and insurance may be appropriate to hedge such risks, especially where AI is being used in ways material to the business. Litigation risk in this space is still evolving both for AI developers and secondary liability, requiring ongoing monitoring.

Corporate Plaintiffs Join Forces

Corporations with extensive IP portfolios are increasingly teaming up rather than waiting for legal clarity. In February, 14 media companies sued AI developer Cohere, while in June,

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Disney and Universal City Studios sued AI research lab Midjourney, alleging infringements of plaintiffs' iconic IP, including Darth Vader, Elsa and Spider-Man.

Filing as co-plaintiffs can help manage the cost of AI-related discovery, which involves production of massive datasets and reams of internal communications. These cases may offer a roadmap for plaintiffs in other industries (like software developers and streaming platforms) that rely heavily on proprietary IP.

Not all corporations are opting to litigate, however. In November, Warner Music Group settled with two AI startups—then announced partnerships to develop AI-generated music. In December, Disney partnered with OpenAI to bring AI-generated videos to Disney+.

For portfolio companies that use or develop AI, leveraging IP through strategic licensing or partnerships should be evaluated as a potentially faster route to market and a more predictable cost structure than paths that might include high-stakes litigation. Disney followed its OpenAI partnership with a cease-and-desist letter to Google, however, demonstrating that licenses will not eliminate the potential for litigation.

The Next Battleground: Class Certification

Class certification has become a critical battleground, as it can dramatically increase financial exposure from a single lawsuit. While AI developers argue that copyright claims are too individualized for class treatment, plaintiffs counter that the underlying mechanism of AI training creates common legal and factual questions for a whole class of IP holders.

The first major development on this front came in July, when a class was certified in *Bartz v. Anthropic*. Demonstrating the significance of achieving certification, the parties settled just weeks later. The next case to watch is I*n re Google Generative AI Copyright Litigation*, in which the hearing for class certification is scheduled for February 4.

Trademark Claims Maintain Momentum

Lanham Act claims remain a viable tool in AI litigation, particularly where plaintiffs can allege confusion or reputational harm, as seen in the suit brought by Encyclopedia Britannica and Merriam-Webster against Perplexity alleging its AI falsely attributed outputs to their registered trademarks.

Many defendants did not move to dismiss Lanham Act claims, and recent rulings have confirmed the viability of these theories against early challenges. Where plaintiffs can identify confusion or reputational harm tied to AI outputs, Lanham Act claims thus present an additional path forward.

Attention to these risks is especially important for downstream users of AI if the software is not able to avoid generating outputs that contain third-party marks. Additional controls or layers of human review for AI-generated content, especially that used in product design or public marketing materials, is one way to guard against such risks.

Looking to 2026, this evolving IP risk will factor into diligence and portfolio management across industries. Understanding portfolio company exposure to AI litigation, and how risks can be mitigated without sacrificing value, will require a proactive strategy and careful attention to this evolving landscape.

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