THE MAJORITY V. THE MINORITY: *SERTA*, *MITEL*, AND PRO RATA SHARING PROVISIONS

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In the mid-2010s, a new field of financial restructuring, known as liability management, began to emerge. This field, characterized by transactions known as liability management exercises (LMEs), saw the adoption of an exclusionary stance by distressed debtors towards creditors. Rather than working with all holders of a given loan to devise solutions to financial distress, debtors began to work with only a subset of these holders to de-lever their businesses, obtain additional capital, and extend their businesses' runway.

One such transaction is an uptier—an LME which sees a debtor excluding a minority of the holders of a loan and employing the voting power of a majority of the holders of that loan to amend the credit agreement underlying the loan in a manner that is favorable to the debtor and the majority lenders. However, while amendments by voting are necessary to the execution of uptiers, they are not sufficient. Uptiers also require creative interpretations of certain contractual provisions within credit agreements. One such provision, the pro-rata sharing provision, was the subject of two recent court rulings in cases challenging uptier transactions. These cases, Serta and Mitel, present important and interesting implications for credit markets and participants.

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TABLE OF CONTENTS

Introduction

Among non-financial corporate businesses, approximately $14 trillion of debt is outstanding as of the fourth quarter of 2024.[1] The majority of this debt will be paid on schedule and in full.[2] However, a minority will not.[3] The debtors associated with this minority of loans will likely eventually file for bankruptcy protection under Title 11 of the United States Code.[4] While bankruptcy filings are not themselves new or surprising, the path to bankruptcy has become increasingly dynamic and complex.

When facing financial distress, debtors generally seek to engage in financial workouts; that is, they engage with lenders to receive forbearance of some form.[5] This forbearance, they hope, will buy them the necessary time to turn their businesses around. Often, such workouts take the form of simple adjustments to credit terms, such as extending debt maturity or amending restrictive loan covenants.[6] Others, such as debt-for-debt or debt-for-equity exchanges, may be somewhat more complicated.[7] Nonetheless, these amendments have one common feature. As pertaining to a given loan, all lenders live as one and die as one. Better terms for one means better terms for all. Worse terms for one means worse terms for all.

Not so anymore. Beginning in the mid-2010s, a new field of financial restructuring known as liability management began to gain vogue.[8] Liability management refers to "creative, albeit controversial, mechanisms for companies to raise debt capital" by engaging with a set or subset of lenders in a

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[1] Nonfinancial Corporate Business; Debt Securities and Loans; Liability, Level, St. Louis Fed, https://fred.stlouisfed.org/series/BCNSDODNS [https://perma.cc/SX6R-HQVJ].

[2] *See, e.g.*, Harry Goodacre, *How have corporate bond returns fared when spreads are tight?* Schroders (Sep. 23, 2024), https://www.schroders.com/en-bm/bm/professional/insights/how-have-corporate-bond-returns-fared-when-spreads-are-tight-/ [https://perma.cc/JQ8R-95WT] (noting that "[d]efault rates on investment grade (IG) corporate bonds have averaged 0.1% per year over the long run, meaning 99.9% have not defaulted in any given year."); *see also* Leveraged Loan, High-Yield Defaults Driven by Rates, Debt Maturities, FitchRatings (Dec. 11, 2024), https://www.fitchratings.com/research/corporate-finance/leveraged-loan-high-yield-defaults-driven-by-rates-debt-maturities-11-12-2024 [https://perma.cc/J5Q8-JL7Y] (forecasting default rate of 3.5%-4.0% for US institutional loans and 2.5%-3.0% for US high yield bonds).

[3] *See id.*

[4] *See The Year in Bankruptcy: 2022*, Jones Day (Jan. 24, 2023), https://www.jonesday.com/en/insights/2023/01/the-year-in-bankruptcy-2022 [https://perma.cc/Q497-DSDZ].

[5] *Thematic Review on Out-of-Court Corporate Debt Workouts*, Financial Stability Board (May 9, 2022), https://www.fsb.org/uploads/P090522.pdf [https://perma.cc/KN44-WNNN].

[6] Hyun Chul Lee, *Efficient and Inefficient Debt Restructuring: A Comparative Analysis of Voting Rules in Workouts*, 40 Cornell Int'l L. J. 662, 668 (2007) ("Creditors voluntarily consent to a package of reorganization arrangements, such as maturity date extension, debt-for-equity exchange, forgiveness of interest, and provision of additional debt, based on the belief that they stand to benefit from such voluntary concessions.").

[7] *Id.*

[8] William Derrough et al., *Liability Management Transactions*, American College of Bankruptcy (Mar. 25, 2023), https://www.americancollegeofbankruptcy.com/file.cfm/29/docs/liability%20management%20transactions%20cle.pdf [https://perma.cc/3NAE-W3BB].

manner that adversely affects another set or subset of its existing lenders.[9] These transactions, known as liability management exercises (LMEs), employ preferential treatment of some lenders as compared to others to provide a debtor with a capital infusion, the opportunity to de-lever, and, by extension, additional time or runway with which to turn around its business.

Broadly speaking, there are two types of LMEs: dropdowns and uptiers. This piece focuses on uptiers and so does not meaningfully engage with dropdown transactions.[10] The concept and mechanics of an uptier are discussed in Part II of the piece. To execute an uptier, debtors utilize the majority or supermajority voting power of the aforementioned favored lenders to amend various provisions of the credit agreement in question. Importantly, these amendments are being made to the provisions of the credit agreement which stand as contractual obstacles to executing the uptier. While this mechanism of employing majority or supermajority voting power to make amendments to credit documents is effective at removing most contractual obstacles to an uptier, some provisions require the consent of every affected lender to be amended. Thus, where a transaction such as an uptier affects all lenders, a majority or super-majority vote cannot be employed to amend them. These are called "sacred rights."[11]

One important sacred right is pro-rata sharing provisions. Pro-rata sharing provisions are clauses within a credit agreement requiring that repayment of a loan be made ratably as to all lenders.[12] Uptiers are inherently exclusionary and are comprised, in part, of loan repayment. Thus, on the face of it, they would run afoul of such provisions.[13] Nevertheless, credit agreements often contain exceptions to these pro-rata sharing provisions.[14] These exceptions allow for non-pro rata repayment of loans in some limited circumstances.[15] Importantly, for reasons discussed more thoroughly in Part II, distressed debtors and

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[9] *Lead Article: Liability Management Exercises: What They Are and What They Mean for Market Participants*, Quinn Emanuel Trial Lawyers (Jan. 15, 2025), https://www.quinnemanuel.com/the-firm/publications/lead-article-liability-management-exercises-what-they-are-and-what-they-mean-for-market-participants/ [https://perma.cc/B83V-YK2N].

[10] For more on dropdown transactions, see Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions*, 51 J. of Leg. Stud. 489 (2024).

[11] Stephen L. Sepinuck, *Lender's "Sacred Rights" Under Credit Agreement Did Not Prevent Lender From Becoming A Sacrificial Lamb*, 10 The Transactional Lawyer 1 (August 2020), https://www.gonzaga.edu/-/media/Website/Documents/Academics/School-of-Law/Clinic-and-Centers/Commercial-Law-Center/Links-and-Resources/2019-20/Transactional-Lawyer-202008.ashx?la=en&hash=AD3883A3F850A6F7541558E20FF80302C7AEFA9F [https://perma.cc/76XX-Y89H].

[12] Shana A. Elberg & Evan A. Hill, *Uptier Exchange Transactions Remain in Vogue, Notwithstanding Litigation Risk*, Skadden (Feb. 2, 2021), https://www.skadden.com/insights/publications/2021/02/uptier-exchange-transactions#:~:text=Elements%20of%20Recent%20Uptier%20Transactions,lenders%E2%80%9D4%20for%20such%20amendments [https://perma.cc/MZZ7-Y2HU].

[13] *Id.*

[14] *Id.*

[15] *Id.*

majority creditors creatively employ these exceptions to execute uptiers. This has produced mixed success. Almost universally, minority creditors sue both the debtor and the majority creditors, arguing that the cited exception to the pro-rata provision is inapplicable to the transaction.[16] Courts have ruled in favor of majority creditors in some instances, ratifying the uptier, and in favor of minority creditors in other instances, refusing to approve the uptier.

This article explores the use of exceptions to pro-rata sharing provisions in uptier transactions, through the lens of two recent cases: *In re Serta Simmons Bedding, L.L.C. 17* (Serta) and *Ocean Trails CLO VIII v. MLN Topco Ltd.18* (Mitel). To do this, the article proceeds in several parts. Part I introduces the piece. Part II provides a theoretical explanation of an uptier transaction. Part III discusses the *Serta* and *Mitel* cases. Part IV explores some implications of the courts' decisions in those cases. Finally, Part V concludes.

I. Uptiers

An uptier is an LME in which a debtor "offers new or pre-existing lenders an opportunity to provide new money financing by exchanging existing debt for super-priority debt."[19] The result is that among the holders of a particular loan to a company, a majority group of these holders exchanges its holdings of that loan for a new, senior loan. The majority group will often also provide new capital to the business via another loan that is also senior to the loan that they originally held. This series of maneuvers requires several amendments to the credit agreement on which the original loan is based. Moreover, it requires creative interpretation of several of the provisions in that agreement. These are described more thoroughly in this Part. But first, how do voting thresholds influence the process?

A. Credit Agreements and Voting Thresholds

Loans made by sophisticated corporate creditors to sophisticated corporate borrowers are made via written contracts.[20] These contracts describe the important details surrounding the loan, the identities of the creditor and the debtor, as

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[16] *See, e.g.*, *North Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC*, No. 652243/2020, 2020 WL 3411267 (N.Y. Sup. Ct. June 19, 2020); *see also LCM XXII LTD. v. Serta Simmons Bedding, LLC*, No. 21 CIV. 3987 (KPF), 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022).

[17] *In re Serta Simmons Bedding, L.L.C.*, 125 F.4th 555 (2024).

[18] *Ocean Trails CLO VIII v. MLN Topco Ltd.*, 233 A.D.3d 614 (2024).

[19] Joshua Bichovsky, *The Rise of Uptier Transactions in the Leveraged Loan Market*, 40 Emory Bankr. Devs. J. 512, 517 (2024), https://scholarlycommons.law.emory.edu/cgi/viewcontent.cgi?article=1257&context=ebdj [https://perma.cc/28ZQ-TQNX].

[20] Megan Elizabeth Jones, *Bankers Beware: The Risks of Syndicated Credits*, 3 N.C. Banking Inst. 169 (1999), https://scholarship.law.unc.edu/cgi/viewcontent.cgi?article=1053&context=ncbi&httpsredir=1 [https://perma.cc/4ZF7-PY4D].

well as obligations and restrictions each party must observe.[21] Generally, these obligations and restrictions serve to allocate risk and protect both parties. Such obligations protect creditors via specific lists of affirmative and negative covenants as well as by general contractual provisions that prohibit the issuance of senior debt, require repayment of debt to be proportional to creditors' loans, and incorporate other relevant contracts such as intercreditor agreements.[22]

Importantly, though, while these provisions are binding as to the parties, the credit agreement generally allows for amendments to be made to these terms based on specific voting thresholds.[23] Broadly, there are three primary voting thresholds: a majority, a supermajority, and unanimous approval.[24] Provisions that require a majority vote to be amended require holders of greater than 50% of the loan amount to vote in favor of the amendment.[25] Where a supermajority vote is required, the precise numerical criterion varies but tends to require the vote of holders of approximately 66.67% of the loan amount.[26] By definition, unanimous approval means 100% of the loan's holders must consent to the proposed amendment.[27] Importantly, where unanimous approval is required to change a given term, that term is known as a "sacred right."[28] To execute an uptier, a debtor and its creditors work in conjunction to make amendments to the credit agreement based on these voting thresholds.

Notably, technically, rather than "unanimous" approval, sacred rights sometimes require the approval of "all affected lenders" to make amendments. However, for the purposes of this piece, these terms are synonymous. Therefore, the piece deems sacred rights as those provisions requiring unanimous approval.

B. Mechanics of an Uptier

Simply put, "[a] financially distressed company is one that has an unstable capital structure."[29] Its debt (or liabilities, more generally) is too great, and it is generally unable to sustainably meet financial obligations such as interest payments.[30] Accordingly, it must reduce its debt, access new capital,

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[21] *Id.*

[22] *See, e.g.*, Wolverine Escrow, LLC Bond Indenture (November 27, 2019).

[23] *See* Judson Caskey et al., *Amendment thresholds and voting rules in debt contracts* (Working Paper), https://www.anderson.ucla.edu/sites/default/files/document/2023-03/SSRN-id3922893.pdf [https://perma.cc/E7MY-7F59].

[24] Jared Ellias, *Liability Management II: Uptiers* (Corporate Restructuring, Harvard Law School, Nov. 11, 2024) (on file with author).

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] Catherine Cote, *What Is Distressed Debt Investing?* Harvard Business School Online (Aug. 5, 2021), https://online.hbs.edu/blog/post/distressed-debt-investing [https://perma.cc/M66K-694U].

[30] *Id.*

or do both. Debt reduction, however, cannot be achieved unilaterally. A debtor would need the agreement of creditors in order to reduce the amount that it will repay them. Moreover, debt reduction is generally not enough. The business also benefits significantly from receiving a capital infusion to finance its operations during the difficult period.[31] Notably, though, it is equally difficult to access new capital. A new loan will likely not be available without some form of priority in repayment. Even if the lender were willing to provide junior or pari passu financing, the rates at which it would be provided would likely be unsustainably high for the company. Therefore, the distressed company faces a predicament: it needs to de-lever and to access new capital but is unable to secure a viable path to either. An uptier presents an attractive solution to this problem.

An uptier allows the debtor to de-lever by facilitating a debt exchange whereby current debt holders exchange their current debt holdings for new, senior debt instruments with a lower principal. It also provides access to new capital, as the debt holders who exchange their current debt holdings for new, senior debt will also provide new capital via additional senior financing.[32] But how precisely does this occur? How do the debtor and majority creditors amend the credit agreement to facilitate an uptier? How do they justify a non-pro rata debt-for-debt exchange?

These questions are answered below. As will be discussed, the mechanics of an uptier depend particularly on four protections or contractual provisions in credit agreements. They are: (1) debt capacity provisions, (2) subordination provisions, (3) provisions incorporating intercreditor agreements, and (4) pro-rata sharing provisions.[33] Each of these is examined in turn.

1. Debt Capacity

The first contractual obstacle to an uptier is debt capacity provisions. Such a provision may explicitly prohibit further incurrence of debt or may be found in the form of a leverage covenant[34] Generally, these restrictions on debt incurrence exist because of the risk associated with a firm being excessively levered. Because uptiers entail not only debt exchanges but also debt incurrence (to provide a capital infusion to the firm), such provisions in a credit agreement may stand as an obstacle to executing the uptier. To the extent that

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[31] Edith S. Hotchkiss et al., Private Equity and the Resolution of Financial Distress 21 (Eur. Corp. Gov. Inst., Working Paper No. 331, 2012).

[32] *See* Bichovsky *supra* note 19 at 517.

[33] Elberg & Hill *supra* note 12.

[34] A leverage covenant is a term in a credit agreement limiting the amount of debt that a company can issue based on a ratio of its total debt to some operating metric such as Earnings before Interest Taxes Depreciation and Amortization (EBITDA). *See* Simpson Thacher & Bartlett LLP, Leveraged Finance 101: A Covenant Handbook 7 (2022).

the issuance of additional debt would result in, or meaningfully increase the likelihood of, the company violating explicit numerical restrictions on debt incurrence or running afoul of a leverage covenant, majority lenders will vote to remove or amend the relevant provision such that it does not prevent the incurrence of the requisite debt.[35] With no limitation on the incurrence of further debt, the debtor and majority creditors must consider their next obstacle.

2. Subordination Clauses

An uptier transaction does not only entail the issuance of additional debt. The additional debt which provides a capital infusion and the debt being exchanged will both be senior to the company's existing debt. Accordingly, the second obstacle to the uptier transaction would be provisions limiting subordination of the current debt or preventing the issuance of senior debt.[36] Creditors include such terms prohibiting the issuance of senior debt to protect themselves in case of bankruptcy or liquidation.[37] However, because uptier transactions inherently require the issuance of senior debt, the majority lenders will use their majority voting power to amend the credit agreement to remove prohibitions on the issuance of senior debt.[38] This then permits the debtor to issue senior debt to the majority lenders.

3. Intercreditor Agreements

Thirdly, uptiers must also account for contractual provisions governing intercreditor agreements. Intercreditor agreements are agreements among lenders that permit one lender to be repaid in full before another lender receives any payment.[39] The lender who is to be repaid first is said to be senior, and the lender who is repaid second is said to be junior.[40] The credit agreement accounts for intercreditor agreements by noting that repayments to lenders are to be made in accordance with intercreditor agreement(s) among the company's creditors.[41]

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[35] *See, e.g.*, *LCM XXII LTD. V. Serta Simmons Bedding, LLC*, No. 21 CIV. 3987 (KPF), 2022 WL 953109, at *4 (S.D.N.Y. Mar. 29, 2022) ("the Amendments modified the definition of "Incremental Equivalent Debt" permissible under the Agreement to include Indebtedness issued under the PTL Credit Agreement …").

[36] *Id.*

[37] In bankruptcy, whether reorganization or liquidation, assets are distributed to creditors according to seniority. Therefore, to maximize their chances of recovery, senior lenders aim to prevent other lenders from issuing debt that is senior to theirs.

[38] *LCM XXII LTD. v. Serta Simmons Bedding, LLC*, No. 21 CIV. 3987 (KPF), 2022 WL 953109, at *4 (S.D.N.Y. Mar. 29, 2022).

[39] Intercreditor Agreement, Thomson Reuters Practical Law Glossary (2025).

[40] Subordinated Debt, Thomson Reuters Practical Law Glossary (2025).

[41] *See, e.g.*, *LCM XXII LTD. v. Serta Simmons Bedding*, LLC, No. 21 CIV. 3987 (KPF), 2022 WL 953109, at *4 (S.D.N.Y. Mar. 29, 2022).

With respect to intercreditor agreements, the majority lenders in an uptier will employ a two-step maneuver. First, they will create an intercreditor agreement that makes the current loan junior to the senior loans that will be issued.[42] Second, they will use their voting power to amend the credit agreement so that it is subject to that new intercreditor agreement.[43] Therefore, the new debt that will be issued—both that for which the majority creditors will exchange their current debt holdings and that which is the source of the capital infusion—will be formally senior to the current loan. If the debtor is to make payments, the holders of the new, senior debt will be paid in full before the remaining holders of the original, now junior loan, receive any protection.

4. Pro Rata Provisions

At this point, the majority creditors and the debtor have worked to ensure that the company can (1) issue additional debt, (2) issue senior debt, and (3) pay the majority creditors in accordance with the newly designed priority scheme as delineated by the new intercreditor agreement. However, for the uptier to be complete, the majority creditors will not only need to provide a capital infusion for new, senior debt instruments; they will also need to exchange their current debt holdings for new, senior debt. This, nevertheless, encounters the final major contractual obstacle: pro rata sharing provisions. These provisions effectively state that any payment or repayment made to creditors must be ratably distributed to each creditor based on the proportion of the loan held by that creditor.[44] For example, a creditor who owns 50% of a loan should receive 50% of any repayment made by the company to the creditors holding the loan in question. A debt exchange—whereby a lender gives up its current debt holding for a different one—is a form of repayment. The debtor is repaying the creditor in the form of a new debt instrument. This is an integral element of the uptier, but one which, nevertheless, would violate the pro rata provision of the credit agreement. If only the majority creditors receive the new, senior debt instruments, the repayment would not be ratable or proportionate. How then is this obstacle removed?

Each of the aforementioned obstacles have been removable via a vote of the majority creditors who are working with the debtor to execute the uptier.

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[42] *Id.*

[43] *Id.*

[44] Matthew Morgan & Gabriel Mathless, *Quick Guide for Assessing the Potential for Disparate Lender Treatment in a Credit Agreement: The "Tyranny of the Majority"*, MOORE & VAN ALLEN, https://www.mvalaw.com/media/news/15077_SS%20Client%20Bulletin%20-%20The%20Tyranny%20of%20the%20Majority.pdf [https://perma.cc/D3AW-YCXG] ("Most credit agreements include a pro rata treatment provision that requires all payments of principal and interest, as well as other payments such as commitment fees, to be made on a pro rata basis to all lenders.").

However, as discussed in Part II, some provisions of the credit agreement are sacred rights; they require unanimous approval to be amended.[45] The pro rata provision is one such provision.[46] Thus, amending the credit agreement to remove the pro rata provision or altering the pro rata provision itself would require a unanimous vote. Of course, minority lenders would not vote for this amendment. Thus, a vote and an amendment cannot solve this problem.

What serves to solve the issue, however, is that these provisions tend to contain exceptions—scenarios in which non-pro rata repayments may be made.[47] Such exceptions may range from "open market purchases," allowing the debtor to repurchase its own debt on a public debt exchange, to Dutch Auctions, allowing the debtor to hold an auction in which creditors can sell their debt to the debtor.[48] To execute the uptier, debtors and majority creditors creatively interpret these exceptions to facilitate the majority lenders' exchange of their current holdings for senior debt.[49] For example, if an exception to the pro rata provision allows for an "open market purchase," they will argue that the debt exchange was an "open market purchase."[50] In most cases, these interpretations are relatively controversial. Because of the creative and controversial nature of these interpretations, uptier transactions are often challenged in court by minority lenders.[51] They argue that the uptier transaction violates the pro rata provision of the credit agreement because the exception employed by the debtor and majority lenders was inapplicable.[52] In some instances, courts find for the majority lenders—arguing that the exception was applicable.[53] In other cases, it has found for the minority lenders—arguing that the exception was inapplicable.[54] This element of uptier transactions is rapidly evolving as courts and market participants seek to decipher what is permitted by exceptions to pro rata sharing provisions. Part III explores two recent rulings that surround this question.

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[45] *See* Part II *supra*.

[46] Morgan & Mathless, *supra* note 44 ("the pro rata provisions sacred right…").

[47] *Id.*

[48] *Id.*

[49] *See id.* ("This ambiguity can create opportunities for disparate treatment of lenders.").

[50] *Id.*

[51] Patrick D. Walling & David M. Hillman, *The End of Non-Pro Rata Uptiers? Fifth Circuit Rules that Serta Exchange was Not an "Open Market Purchase"*, Proskauer Rose LLP (Jan. 2, 2025), https://www.proskauer.com/alert/the-end-of-non-pro-rata-uptiers [https://perma.cc/AM7M-PL2M].

[52] *See id.*

[53] Kaitlin R. Walsh & Timothy J. McKeon, *Watch Your Language! Non-Pro Rata Uptier Transactions and the Serta and Mitel Decisions*, Mintz (Feb. 12, 2025), https://www.mintz.com/insights-center/viewpoints/2831/2025-02-12-watch-your-language-non-pro-rata-uptier-transactions-and#:~:text=Among%20the%20many%20financial%20innovations,2%5D [https://perma.cc/D5V4-BH6T].

[54] *See id.*

II. Serta Simmons & Mitel Networks

Two recent cases, *Serta* and *Mitel*, represent the divergence in various court rulings surrounding the exceptions to pro rata provisions. In one case, *Serta*, the court ruled against the transaction, finding that the exception to the pro rata provision employed by the majority lenders was inapplicable. In *Mitel*, alternatively, another court found that the exception to the pro rata provision, employed by the majority lenders and the debtor was applicable. This part presents the relevant details of both cases and the court's rulings.

A. Serta Simmons

1. Initial Leveraged Buyout

In August of 2005, Ares Management (Ares), in conjunction with Teachers' Private Capital, the private equity arm of the Ontario Teachers' Pension Plan (OTPP), acquired National Bedding Co., the manufacturer of Serta mattresses.[55] Five years later, in January of 2010, both parties again joined to acquire the Simmons Bedding Company out of bankruptcy.[56] After the latter transaction, Ares and OTPP consolidated ownership of both companies through a holding company, AOT Bedding Super Holdings (AOT Bedding).[57] Following a period of several successful years after the buyouts, Advent International, a private equity firm, purchased a majority stake in AOT Bedding, via a leveraged buyout, in August 2012.[58]

2. Financial Distress and Uptier Transaction

While the post-Advent buyout business was sufficiently satisfactory to support the issuance of $670 million in debt to finance a dividend to its equity

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[55] Ares, *Teachers' Private Capital Buy National Bedding Co.*, GlobalCapital (Aug. 5, 2005), https://www.globalcapital.com/securitization/article/28mwvjq67vofoev0ibksg/ares-teachers-private-capital-buy-national-bedding-co [https://perma.cc/ZZN7-A2MX].

[56] *Ares Management & Ontario Teachers' Pension Plan Complete Acquisition of Simmons Bedding; Simmons Bedding Company Emerges from Pre-Packaged Chapter 11*, Ontario Teachers' Pension Plan (Jan. 20, 2010), https://www.otpp.com/en-ca/about-us/news-and-insights/2010/ares-management-ontario-teachers-pension-plan-complete-acquisition-of-simmons-bedding-simmons-bedding-company-emerges-from-pre-packaged-chapter-11/ [https://perma.cc/57N8-QFV7].

[57] *Advent International to acquire majority interest in Serta & Simmons Bedding*, Ontario Teachers' Pension Plan (Aug. 5, 2012), https://www.otpp.com/en-ca/about-us/news-and-insights/2012/advent-international-to-acquire-majority-interest-in-serta-simmons-bedding/ [https://perma.cc/M2N8-CTPG].

[58] *Id.*

holders,[59] it was not a story of unhampered success. "Direct-to-consumer sales competition and wholesale customer demands for more favorable payment terms" began to burden Serta, leading it to retain investment bank, Evercore, in late 2019 to explore options pertaining to restructuring its balance sheet.[60] Subsequent to an extensive process of consultation with its financial and legal advisors, and further deterioration in its business given the onset of the COVID-19 pandemic, Serta decided to execute an uptier transaction in June of 2020.[61]

At the time of the transaction, Serta's capital structure was comprised of approximately $1.9b in first lien (1L) debt and $420m in second lien (2L) debt, both term loans.[62] The company also issued other debt instruments, but they are irrelevant to the controversy discussed here. An investor group consisting of Eaton Vance Management, Invesco Senior Secured Management, and several others, held a majority of both tranches of debt—the 1L and 2L debt.[63] Given the terms of the credit agreements on which both issuances of debt were based, a majority vote was sufficient to allow for the amendments necessary to execute the uptier. Notably, Serta's execution of this uptier effectively followed the steps described in Part II. [64] First, Serta and the majority holders amended the credit agreements to permit the issuance of additional senior debt.[65] Second, they amended them to remove their prohibitions on subordination.[66] This allowed for the issuance of new debt that would be senior to the 1L and 2L debt. Third, the agreements were amended such that they became subject to a new intercreditor agreement which would give the newly issued loans priority over the existing 1L and 2L debt.[67] Finally, pursuant to an "open market purchase" exception to the credit agreement's pro rata sharing provision, the majority holders of the 1L and 2L debt exchanged their 1L and 2L holdings for new debt instruments senior to the 1L and 2L debt.[68] The majority lenders also invested new capital into the company pursuant to a super-priority debt issuance.[69] Notably, this 1L and 2L debt, having been subordinated by the uptier, was now 1L and 2L in name only. The Eaton

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[59] Chris Cumming, *For Some Companies, Debt Downgrades Followed Payouts to Private-Equity Owners*, WSJ Pro Private Equity (Jun. 11, 2023), https://www.wsj.com/articles/for-some-companies-debt-downgrades-followed-payouts-to-private-equity-owners-e9cde86.

[60] In re Serta Simmons Bedding, LLC, NO: 23-90020, 2023 WL 3855820, at *3 (Bankr. S.D. Tex. Jun. 6, 2023).

[61] *Id.* at *4.

[62] *Id*. at *3.

[63] *See id.* at *6; *see also LCM XXII LTD.*, 2022 WL 953109 at *3 ("On June 8, 2020, Defendant issued a press release announcing the Transaction, which involved an agreement with a majority of first- and second-lien lenders.").

[64] *See* Section II *supra*.

[65] *See LCM XXII LTD.*, 2022 WL 953109 at *4.

[66] *Id.*

[67] *Id.*

[68] *See In re Serta*, 2023 WL 3855820 at *5.

[69] *Id.*

Vance-Invesco majority group were left holding newly issued debt at the top of the capital structure while the non-participating, minority holders of the formerly senior 1L and 2L debt were left holding now-junior 1L and 2L debt.

3. Litigation

Unsurprisingly, litigation ensued with the non-participating minority holders petitioning the court to disallow the transaction. In response to the litigation, several suits were filed, some being more successful for the plaintiffs, others for the defendants. Although the uptier delayed a bankruptcy filing, it did not prevent it. Eventually, in January of 2023, Serta filed for bankruptcy in the Southern District of Texas.[70]

Central to its bankruptcy proceedings and associated litigation was the legal issue of primary importance to this piece: the pro rata sharing provision in its credit agreement. In an adversary proceeding in bankruptcy, the minority, non-participating 1L and 2L lenders, then holding formerly senior, now junior, debt, argued that the transaction violated the credit agreement's prohibition on non-pro rata repayment because the privately negotiated exchange transaction employed by Serta and the majority 1L and 2L lenders did not fit the "open market purchase" exception to the pro rata sharing provision (by which the majority lenders purported the transaction was justified).[71] It, the minority lenders argued, was not an "open market purchase." The majority lenders, alternatively, argued that this was an "open market purchase."[72] The bankruptcy court ruled in favor of the majority lenders, finding that the majority and minority lenders were "[s]ophisticated financial titans" who "engaged in a winner-take-all battle" which produced "a winner and a loser."[73] The transaction was indeed an open market purchase, and the minority, non-participating lenders just happened to lose.

The minority, non-participating 1L and 2L lenders appealed this decision.[74] On December 31, 2024, the 5th Circuit Court of Appeals reversed the bankruptcy court's ruling, finding that the transaction was not an "open market purchase."[75] That term, it found, should be interpreted according to its technical meaning.[76] A privately negotiated transaction between a subset of lenders and a debtor could not, according to the 5th Circuit, qualify as an "open market transaction."[77] Given the dependence of many uptier transactions on this kind

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[70] *See In re Serta*, 2023 WL 3855820 (2023).
[71] *Id.* at *7.
[72] *See id.* at *4.
[73] *Id.* at *14.
[74] *In re Serta*, 125 F.4th 555 at 564.
[75] *In re Serta*, 125 F.4th 555 at 577.
[76] *Id.* at 578-79.
[77] *See id.* at 581.

of language in credit documents, there was significant engagement with the ruling among market participants. This engagement was further heightened by another ruling on another uptier transaction executed by Mitel Networks, a private equity-owned company experiencing financial difficulty.

B. Mitel Networks

On the same day on which the 5th Circuit reversed the Bankruptcy Court's approval of the Serta uptier, the First Department of the Appellate Division of the New York Supreme Court (Appellate Division) reversed a ruling by the NY trial court striking down a different uptier transaction. In approving the transaction, the Appellate Division found that the credit agreement governing the lending relationship between the creditors and the debtor, Mitel Networks, permitted the transaction.

Summarily, Mitel Networks, "a global leader in business communications," was acquired by Searchlight Capital Partners in an approximately $2b transaction in April of 2018.[78] To finance the transaction, Mitel issued $1.12b in 1L term loans and $260m in 2L term loans.[79] Given Mitel's focus on in-office communications systems, the rapid shift to remote and hybrid work during and after the COVID-19 pandemic presented financial challenges to the business.[80] Accordingly, by 2022, given the difficulties it was facing, Mitel, in conjunction with a majority of the holders of its 1L and 2L notes, decided to employ an uptier transaction.[81] This saw the majority holders of the 1L and 2L debt exchanging their 1L and 2L notes for new debt senior to the 1L and 2L notes.[82] Moreover, these lenders provided a capital infusion to the business via a super-priority revolving credit facility.[83] Notably, as with practically all credit agreements, the credit agreements governing the 1L and 2L notes both prohibited non-pro rata repayment of debt.[84] However, as is also customary, they provided for an exception allowing Mitel to "purchase

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[78] *Mitel Enters into Definitive Arrangement Agreement to be Acquired by Affiliates of Searchlight Capital Partners for $2.0 Billion*, GlobeNewswire (Apr. 24, 2018), https://www.globenewswire.com/news-release/2018/04/24/1486048/0/en/Mitel-Enters-into-Definitive-Arrangement-Agreement-to-be-Acquired-by-Affiliates-of-Searchlight-Capital-Partners-for-2-0-Billion.html [https://perma.cc/7UNG-5N9T].

[79] Steven J. Greene et al., *Mitel Networks — Another Development in Liability Management Transactions*, Hughes Hubbard (Jan. 27, 2025), https://www.hugheshubbard.com/news/mitel-networks-another-development-in-liability-management-transactions [https://perma.cc/S6UK-9BNS].

[80] Dietrich Knauth, *Telecom company Mitel files for bankruptcy to cut $1 bln in debt*, Reuters (March 10, 2025), https://www.reuters.com/legal/litigation/telecom-company-mitel-files-bankruptcy-cut-1-bln-debt-2025-03-10/.

[81] *See* Greene et al., Mitel Networks (2025).

[82] *See id.*

[83] *See id.*

[84] *See id.*

by way of assignment and become an Assignee with respect to" the loans in question.[85] Unlike in the *Serta* case, where the 5th Circuit found the "open market" qualifier to the pro-rata exception to preclude a privately negotiated transaction, the Mitel court found that the pro rata exception in this case was not so qualified.[86] Instead it simply authorized "purchase[s]." Accordingly, this permissive language justified the uptier.

III. Implications of the Rulings

Whether these rulings were accurate and well-reasoned has been a source of meaningful controversy. However, an arguably more important consideration is the implications that they hold for distressed credit markets and market participants. While reasonable minds may disagree, this article identifies three particularly likely implications. They surround the evolution in the degree of textualism employed by courts in interpreting these contracts, the extent to which uptier transactions will be exclusionary, and the variety of liability management transactions that will be employed by market participants.

The first primary implication of these two rulings is that courts are likely to be highly textualist, focusing intently on the language of the credit agreements underlying the loans in question.[87] Both the *Serta* and *Mitel* rulings saw the courts focusing primarily on the text of the relevant credit agreement, with little attention given to parties' intent or other terms of the relevant credit agreements. In fact, one could say that the fundamental driver of the difference in the rulings was the differing text of the pro rata sharing provisions in the relevant credit agreements. The "purchase" exception was qualified in the *Serta* credit agreement and was unqualified in the *Mitel* credit agreement. Therefore, the term was interpreted more narrowly in *Serta*, and the uptier was disallowed. Alternatively, where the language was more permissive in the *Mitel* credit agreement, the court interpreted the term broadly and allowed the uptier.

While this suggests that courts may be highly textualist in the near future, markets and market participants are not static. Because of this hyper-textualist approach, market participants—debtors, majority creditors, and their advisors—are likely to seek to exploit this textual focus by amending credit agreements so as to align directly with text that provided favorable rulings in the past. Over time, this precise tailoring of transactions will obviously, and probably egregiously, increasingly deviate from the intent of the

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[85] Julian Bulaon & Melissa Kelley, *The Next Episode: Understanding Non-Pro-Rata Risk After Serta, Better Health and Oregon Tool*, Octus (Mar. 3, 2025).

[86] *Ocean Trails*, 233 A.D.3d at 616.

[87] *See* Nicholas Baker et al., *Serta & Mitel: A Tale of Two New Year's Eve LME Decisions*, Simpson Thacher Bartlett LLP (Jan. 8, 2025), https://www.stblaw.com/docs/default-source/memos/firmmemo_01_08_25 [https://perma.cc/RJR8-83XE].

parties at the time that these contracts were formed. As courts recognize this trend, their analysis of credit agreements will begin to expand beyond the text of the specific pro rata provision in question to incorporate the terms of credit agreements in their entirety as well as the intent of the contracting parties. This is aligned with courts' desire to encourage stability and predictability in markets.

Notably, though, it is also possible that courts may refuse to protect sophisticated creditors once credit agreements are legally, even if egregiously, amended. These sophisticated creditors, courts would rule, should contract ex ante to allocate risk differently.

The second primary implication of these rulings is that a bifurcation in credit markets will likely develop as it relates to the degree to which liability management transactions will be exclusionary. Where credit documents are more like those found in *Serta*, the liability management transactions employed will be more inclusive.[88] In such cases, the 5th Circuit's ruling that the language found there precludes a traditional uptier—by which a majority of debtholders exchange their debt instruments for new, senior debt—will likely lead debtors, creditors, and advisors to develop recapitalization and restructuring solutions that include all creditors. However, while all creditors will be able to participate in the transaction, some may receive better terms than others.[89] While those receiving less favorable terms will probably be unhappy, the cost of litigation compared to the returns from being able to participate, even if on worse terms than majority creditors, will not justify challenging the transaction in court. However, where credit agreements are more like the contract in *Mitel*, debtors, creditors, and their advisors will employ more exclusionary liability management transactions.[90] A majority of creditors will participate in the transaction and the remaining creditors will be excluded.

Finally, the third implication is that there will probably be an evolution in the form of liability management transactions employed. Because *Serta* presents a hurdle to employing uptiers, it means that there will be at least some instances in which parties will want to employ uptiers but will be hesitant to do so because of non-facilitative documents. As such, to the extent that some restructuring solution is necessary, debtors will seek to employ other liability management transactions such as dropdowns or Article 9 foreclosure sales. Notably, though, because there are advantages and disadvantages to the various types of liability management transactions, debtors will not necessarily be able to simply employ another transaction in place of an uptier while achieving the same goals as the uptier would have. This will probably serve as a limiting factor as to the substitutes in the marketplace for uptiers.

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[88] *Id.*
[89] *Id.*
[90] *Id.*

Conclusion

The courts' opposing treatment of uptiers in the *Serta* and *Mitel* cases presents interesting and important implications for credit markets and participants. Of primary importance is how these rulings will influence courts' future rulings. In response to the rulings, courts are likely to approve uptiers where exceptions to pro rata sharing clauses are permissive and unqualified. Alternatively, where these provisions are qualified or somehow restrictive, courts will interpret them narrowly and will thereby be hesitant to approve uptier transactions. Secondly, for the foreseeable future, courts will be highly technical in their interpretation of contractual text. Nevertheless, this textualism may moderate over time if parties' conduct becomes exploitative. Finally, distressed debtors and favored lenders may seek to employ alternative forms of liability management transactions to the extent that the credit agreements underlying certain loans are insufficiently permissive in light of the *Serta* ruling. However the situation evolves, these two decisions will be sure to impact majority lenders, minority lenders, and their interpretations of pro rata sharing provisions.