By Stephen D. Zide and Eric O. Hilmo

Don't Tread on Me! Minority Lenders Score a Victory in *American Tire*

Stephen D. Zide
Dechert LLP
New York

Eric O. Hilmo
Dechert LLP
New York

Stephen Zide is a partner with Dechert LLP in New York and represents clients in chapter 11 and out-of-court restructuring matters. Eric Hilmo is an associate in the same office and represents secured and unsecured creditors, bondholder groups, bank groups and debtors in restructurings and reorganizations.

Minority lenders everywhere took a victory lap when the U.S. Bankruptcy Court for the District of Delaware put the brakes on debtor-in-possession (DIP) financing with a non-*pro rata* roll-up in the *American Tire* case. As is often the case when litigation over intercreditor issues arise, the key to the court's decision turned on the technical drafting of the credit agreement, which included an exception for non-*pro rata* DIP financing. *American Tire* should reinforce the importance of closely reviewing the technical terms in credit agreements if minority lenders hope to avoid getting run over in the future.

Background

American Tire filed for bankruptcy on Oct. 22, 2024, with $975 million in principal amount of debt outstanding under its first-lien term loan facility.[1] As part of the first-day filings, the debtors sought approval of DIP financing to be provided by lenders holding roughly 90 percent of the term loan facility.[2] The debtors and majority lenders argued that a provision for DIP financing in the credit agreement permitted the exclusion of the minority term lenders from participation in both the DIP financing's $250 million new money component and its roll-up of $750 million of the pre-petition term loans. Their proposed form of order included findings and other relief that would limit the minority term lenders' ability to sue the DIP-financing providers for breach of the pre-petition credit agreement.[3]

The credit agreement included customary "sacred rights" in its amendment provisions. They required the consent of each affected lender to certain amendments of the credit agreement, a higher consent threshold than regular-way amendments that normally only require the consent of lenders holding a majority of the facility.[4] One of the most common sacred rights, and of relevance in *American Tire*, is a prohibition against amendments to a credit agreement that would alter the *pro rata* treatment of lenders with respect to repayments of loans — a fundamental tenet of syndicated lending.

In more modern credit agreements, sacred-right protections often include "Serta blockers," specific protections that prevent amendments to the credit agreement that would facilitate the refinancing of majority lenders' loans with senior indebtedness while leaving minority lenders with junior loans. The term "Serta blocker" is a reference to Serta Simmons' 2020 transaction in which a majority group of lenders consummated an uptier exchange of their loans for senior debt while in effect subordinating the nonparticipating lenders' loans.[5]

In the *American Tire* term facility, the Serta blocker required that all lenders be given the opportunity to participate as a consenting lender in any amendment or consent that would subordinate the term loans or their liens to any indebtedness not already permitted under the credit agreement. The credit agreement also included the more traditional sacred-right protection against non-*pro rata* loan repayments. However, it had an exception in the Serta blocker that permitted a simple majority of lenders to consent to or provide DIP financing that primed the term loans.

The debtors and majority lenders sought to rely on the DIP-financing exception to exclude minority lenders from participation in the DIP financing and authorize non-*pro rata* payment of the term loans. The relevant provision of the credit agreement (§ 10.01(h)) read as follows:

> (h)(i) except to the extent the opportunity to participate as a consenting Lender in any applicable amendment pursuant to which such provisions are so modified has been offered on an equal and ratable basis to all existing Lenders, amend Section 2.12(a), 2.13 or 8.04 in a manner that would alter the *pro rata* sharing of payments thereunder or (ii) except to the extent an opportunity to participate in the applicable "priming" debt has been offered to all existing Lenders on a *pro rata* basis, modifications that subordinating any of the Obligations to

1 *In re Am. Tire Distribs. Inc.*, No. 24-12391 (CTG), Bienias Decl., Dkt. No. 15, ¶ 41 (Bankr. D. Del. Oct. 23, 2024).
2 *Id.* at ¶ 11.
3 *See, e.g., Am. Tire*, No. 24-12391 (CTG), Interim DIP Order, Dkt. No. 16, Ex. A, ¶¶ H(h)-(k), ¶ 26 (Bankr. D. Del. Oct. 23, 2024).
4 Because these provisions afford each lender a veto over certain types of transactions, they are commonly referred to as "sacred rights." They typically extend to, among other things, changes to the fundamental economic terms (maturity, amount or timing of payments of principal or interest, currency, etc.), increases in a lender's loan commitments and releases of substantially all of the collateral of a secured loan.
5 *See In re Serta Simmons Bedding LLC*, No. 23-90020 (DRJ), 2023 WL 3855820, at *14 (Bankr. S.D. Tex. June 6, 2023), *appeal dismissed sub nom., Matter of Serta Simmons Bedding LLC*, No. 23-20410, 2024 WL 4708974 (5th Cir. Nov. 7, 2024), *rev'd in part sub nom., In re Serta Simmons Bedding LLC*, 125 F.4th 555 (5th Cir. 2025), *as revised* (Jan. 21, 2025).

any other Indebtedness or subordinating the Liens securing the Obligations to the Liens securing any other Indebtedness (in each case of the foregoing, except (x) Indebtedness that is permitted under this Agreement (as in effect on the Closing Date) to be senior in right of payment to the Obligations and/or be secured by a Lien on the Collateral that is senior to the Lien securing the Obligations, as applicable or *(y) in connection with any [DIP] facility (or similar financing under applicable law))*, in each case without the written consent of each Lender directly and adversely affected thereby.[6]

Under the debtors' and the majority lenders' interpretation of the clause, the DIP-financing exemption contained in the parenthetical at the end of subclause (ii) should have applied equally to subclause (i). This interpretation would exempt DIP financings from both the requirement that all lenders be permitted the opportunity to participate in priming indebtedness (*i.e.*, § 10.01(h)(ii)) *and* the requirement that all lenders be permitted to participate in any amendment to the *pro rata* payment requirements under the credit agreement (§ 10.01(h)(i)).

The Court's Ruling

In a bench ruling, Hon. **Craig Goldblatt** sided with the objecting minority lenders. He found that the credit agreement's DIP-financing exception did not extend to the requirement that repayments of loans be made *pro rata* to all lenders. He noted that the credit agreement contained the prohibition on non-*pro rata* repayments in multiple provisions in addition to a Serta blocker. He explained that the DIP financing exception in the Serta blocker only permitted a priming DIP financing to be incurred without offering participation to all lenders.

The exception did not extend to the term loans' *pro rata* prepayment requirement. Because the DIP financing proposed to roll up (*i.e.*, repay) a portion of the pre-petition term loans, the roll-up would be subject to the credit agreement's requirement that repayments of loans be shared *pro rata*. As he explained,

> [I]t seems to me what the rollup is, is a draw on the DIP to pay down the pre-petition credit agreement, and it seems to me that nothing in saying that you can have a priming DIP with some, but not all, means that when you pay down the pre-petition debt you don't have to pay down the pre-petition debt in accordance with the pre-petition agreement, including its *pro rata* sharing agreement, and that's just from the language.[7]

Judge Goldblatt buttressed his contractual analysis by noting that allowing a DIP-financing carve-out to circumvent a loan's *pro rata* sharing requirements would be commercially irrational.[8] He then refused to release the DIP lenders from suit by the minority for breach of contract.

After making his remarks, Judge Goldblatt adjourned the hearing to allow the debtors and DIP lenders to deliberate on a path forward. In response to the judge's comments, the DIP lenders and the debtors elected to eliminate the roll-up entirely.

American Tire's Impact

American Tire will no doubt set legal minds off to the races drafting enhancements to the latest model of Serta blocker to be included in their credit agreements. Viewed properly, however, Judge Goldblatt's comments are in line with prior decisions by bankruptcy courts addressing intercreditor conflicts. Where these conflicts arise, the specific contractual terms governing the relationships between creditors should dictate the outcome.

For example, in *TPC*, Judge Goldblatt examined the terms of a bond indenture to deny the objecting bondholders' challenge to a majority bondholder-led uptiering transaction. In this case, the question turned on whether the transaction's subordination of the bonds at issue violated a "sacred right" against modifications that would make "any change in the provisions in the Intercreditor Agreement or this Indenture dealing with the application of proceeds of Collateral that would adversely affect the Holders."[9] After a close analysis of the indenture's terms, Judge Goldblatt determined that this "sacred right" protected bondholders' rights to receive *pro rata* distribution of collateral but did not impose a unanimous consent requirement to subordinate the bonds.[10]

In *Wesco Aircraft*, Hon. **Marvin Isgur** of the U.S. Bankruptcy Court for the Southern District of Texas presided over a 30-day trial before issuing a bench ruling holding that the debtor's 2022 uptiering transaction violated the terms of the indenture governing certain of its secured notes.[11] He concluded that the series of pre-planned automatic transactions (conducted with only the support of a bare majority of the outstanding notes) effectively constituted a single "domino agreement" that "had the effect" of stripping the secured notes' liens (for which a two-thirds majority was required under the indenture).[12] In his comments, Judge Isgur made clear that his ruling was not based on any equitable "collapsing doctrine" but instead focused on the actual contractual provisions that prohibited any amendments that "had the effect" of stripping the notes' liens.[13] Against this backdrop, the *American Tire* ruling might just be another road sign reminding the market that future non-*pro rata* uptiering transactions will be closely scrutinized.[14]

---

6 Emphasis added.

7 *In re Am. Tire Distribs. Inc.*, No. 24-12391 (CTG), Nov. 19, 2024, Hearing Transcript at 116:2-9 (Bankr. D. Del. Nov. 19, 2024).

8 *Id.* at 116:9-25.

9 *In re TPC Grp. Inc.*, No. 22-10493 (CTG), 2022 WL 2498751, at *3 (Bankr. D. Del. July 6, 2022).

10 *Id.* at *12.

11 *Wesco Aircraft Holdings Inc. v. SSD Invs. Ltd.*, No. 23-03091 (MI), July 10, 2024, Hearing Transcript at 3:8-24 (Bankr. S.D. Tex. July 10, 2024). On Jan. 17, 2025, Judge Isgur issued a written opinion memorializing his prior ruling. *See Wesco Aircraft Holdings Inc. v. SSD Invs. Ltd.*, No. 23-03091 (MI), Dkt. No. 1520 (Bankr. S.D. Tex. Jan. 17, 2025).

12 *Wesco Aircraft Holdings Inc. v. SSD Invs. Ltd.*, No. 23-03091 (MI), July 10, 2024, Hearing Transcript at 14:1-18 (Bankr. S.D. Tex. July 10, 2024).

13 *Id.*

14 In an even more recent decision, the Fifth Circuit in *Serta* analyzed whether an uptiering transaction constituted an "open market purchase" — a common exception to the sacred right of ratable payments in credit agreements — and concluded that the uptier transaction in that case did not qualify as an "open-market purchase" exception. *See In re Serta Simmons Bedding LLC*, No. 23-20181, (5th Cir. Dec. 31, 2024). This article does not examine the *Serta* decision given the decision's focus on the definition of "open-market purchase," which was not relevant in the *American Tire* ruling. However, the observation stands that careful examination of a credit agreement's sacred rights and contractual provisions will remain an important factor in structuring future liability-management transactions (or challenging them) in the future.

continued on page 63

Don't Tread on Me! Minority Lenders Score a Victory in American Tire

from page 13

It remains to be seen whether the market will heed these warnings, and a new wave of drafting updates to syndicated loan documentation will provide the necessary safety features to avoid these types of collisions in the future. Whether or not that is the case, everyone in the market — whether they are burning rubber in pursuit of ever more aggressive uptiering transactions or trying to pump the brakes on what they view as an alarming trend — would do well to ensure that they fully understand the potential risks (including drafting ambiguities) in their credit documents. Such an understanding may put transaction proponents in the fast lane to approval, while minority lenders can use such information to avoid being left on the side of the road. abi