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WHITE PAPER

March 2025

Uptiers in 2025: Impact of the Serta and Mitel Decisions on Liability Management Exercises

Late last year, the U.S. Court of Appeals for the Fifth Circuit and the Appellate Division of the Supreme Court of the State of New York issued important rulings regarding the validity of uptier "liability management exercises" ("LMEs"). The Fifth Circuit held that a 2020 uptier transaction involving notes issued by Serta Simmons Bedding did not fall within an "open market purchase" exception to the requirement under the governing credit agreement that payments be shared ratably among lenders. It also excised indemnity protections from Serta's confirmed chapter 11 plan, finding that such protections violated the Bankruptcy Code. The Appellate Division dismissed claims that challenged a 2020 uptier transaction entered into by Mitel Networks and majority lenders, ruling that none of the amendments required additional consent in order to be effective under the governing credit agreement. These are landmark decisions that will have repercussions for future LMEs.

INTRODUCTION

On December 31, 2024, the United States Court of Appeals for the Fifth Circuit issued an opinion addressing several appeals arising out of the Serta Simmons Bedding chapter 11 cases. Reversing the Southern District of Texas Bankruptcy Court, the Fifth Circuit held that Serta's 2020 uptier transaction did not fall within an "open market purchase" exception to the requirement under the governing credit agreement that payments be shared ratably among lenders, and remanded the case for consideration of breach of contract counterclaims. The Fifth Circuit also excised indemnity protections from Serta's confirmed chapter 11 plan, finding that such protections were an "end-run" around section 502(e)(1)(B) of the Bankruptcy Code and violated the requirement of equal treatment under section 1123(a)(4) of the Code.

On the same day, the Appellate Division of the Supreme Court of the State of New York issued an opinion dismissing claims that challenged a 2020 uptier transaction entered into by Mitel Networks (International) Limited and its affiliates and majority lenders. The court in *Mitel* determined that none of the amendments consented to by the majority lenders required additional consents in order to be effective under the governing credit agreement.

These are undoubtedly landmark decisions that will have repercussions for future liability management transactions. As discussed in more detail below, however, it remains to be seen whether their impact can be circumvented by drafting, how they will impact types of debt other than broadly syndicated loans, and how relevant they will be to future liability management exercises.

SERTA

Background

In June 2020, Serta and lenders holding a majority of Serta's senior secured term loans entered into an "uptier" transaction in which the majority lenders: (i) provided Serta with a $200 million new-money first-out, super-priority term loan; and (ii) exchanged $1.2 billion of their existing first-lien and second-lien term loans for approximately $875 million of new second-out, super-priority debt. Serta's other lenders were not offered the opportunity to participate in the 2020 transaction. As part of the uptier transaction, Serta agreed to indemnify the participating majority lenders for any losses, claims, or damages that might result from their participation.

Certain of Serta's excluded minority lenders sought unsuccessfully to enjoin the 2020 transaction in New York State Court. Other excluded lenders subsequently sued Serta in the United States District Court for the Southern District of New York. After the District Court denied Serta's motion to dismiss (in an opinion that included a finding that the term "open market purchase" was ambiguous and that "[o]n a plain reading of the term, the transaction did not take place in what is conventionally understood as an open market'"), Serta and its affiliates filed for chapter 11 in the United States Bankruptcy Court for the Southern District of Texas in January 2023.

The majority lenders commenced an adversary proceeding in the bankruptcy case seeking a declaratory judgment that the 2020 transaction did not violate the credit documents and did not violate the implied covenant of good faith and fair dealing. The bankruptcy court ruled in favor of the majority lenders on these issues and on various counterclaims and third-party claims asserted by the excluded lenders.

The majority lenders also filed proofs of claim for indemnification and contribution in the chapter 11 cases, which they later conceded should be disallowed as contingent claims for reimbursement pursuant to 11 U.S.C. § 502(e)(1)(B). Nevertheless, Serta and the majority lenders sought and obtained approval from the bankruptcy court of a plan settlement under 11 U.S.C. § 1123(b)(3) that afforded indemnity to any person or entity holding super-priority debt.

Opinion

Open Market Purchase

Serta's credit agreement contained typical pro-rata sharing provisions requiring that any payments to lenders be made ratably. These provisions were protected in the credit agreement by a so-called "sacred right" amendment provision requiring that the pro-rata provisions could not be waived, amended, or modified without the consent of each affected lender except if a non-pro rata payment is "(A) through Dutch Actions open to all Lenders holding the relevant Term Loans on a pro-rata basis or (B) through open market purchases . . . ."

In the 2020 transaction, Serta relied on the exception for "open market purchases" to exchange the majority lenders' existing loans for new super-priority loans on a non-pro-rata basis. On summary judgment in the adversary proceeding, the bankruptcy court held that the meaning of "open market purchase" was not ambiguous and that the 2020 transaction fit within the open market purchase exception.

The Fifth Circuit disagreed. Looking to dictionary definitions, case law, and other sources of authority, the court concluded that "an open market purchase is a purchase of corporate debt that occurs on the secondary market for syndicated loans." The court rejected the argument that an "open market" exists whenever private parties engage in competitive negotiations, holding instead that the term refers to a specific and designated market; and that the relevant market for syndicated first-lien debt is the secondary market for syndicated loans. The court explained: "if [Serta] wished to make [an] . . . open market purchase and thereby circumvent the sacred right of ratable treatment, it should have purchased its loans on the secondary market. Having chosen to privately engage individual lenders outside of this market, [Serta] lost the protection of [the open market purchase exception]."

The Fifth Circuit further reasoned that, if an open market purchase meant any competitive purchase it would render the Dutch Auction exception surplusage because a Dutch Auction is itself an acquisition for value in competition among participants.

Serta and the majority lenders made counterarguments that were rejected by the Fifth Circuit. First, Serta and the majority lenders argued that the credit agreement expressly required a Dutch Auction to be "open to all lenders," whereas the same language did not appear in the exception for "open market purchases." The Fifth Circuit rejected this argument as "very weak," given that the term "open market purchase" itself contains the word "open," and thus it would be unnecessary to specify that an open market purchase needs to be open to all lenders.

Second, Serta and the majority lenders argued that the excluded lenders had themselves proposed a similar type of debt swap transaction that would also have made use of the open market purchase exception, and that this should be taken as course-of-performance evidence that the parties understood the open market purchase exception to allow uptiers. The Fifth Circuit found this argument to be flawed since an action on a single occasion does not constitute a course of performance, and in any event the prior proposal had not been made on behalf of all of the objecting lenders and so could not bind them.

Thus, the Fifth Circuit reversed the bankruptcy court's declaratory judgment approving the transaction and remanded the excluded lenders' counterclaims to the bankruptcy court, noting that the excluded lenders would "have a strong case" that Serta and the majority lenders violated the Credit Agreement.

On February 20, 2025, the Fifth Circuit denied requests by the majority lenders for reconsideration and for certification of the meaning of the phrase "open market purchase" under New York law to the New York Court of Appeals.

Indemnity

The Fifth Circuit also excised the settlement indemnity from Serta's chapter 11 plan. The Fifth Circuit first held that review of the indemnity provisions was not barred by the doctrine of equitable mootness because excision would neither impact the rights of any party not before the court nor undermine the confirmed plan.

The Fifth Circuit held that excision of the indemnification provisions was appropriate because contingent claims for reimbursement where the claiming entity is co-liable with the debtor are disallowed under Section 502(e)(1)(B) of the Bankruptcy Code. The Fifth Circuit characterized the settlement indemnity as a "resurrected" pre-petition indemnity because it was on essentially the same terms and intended to protect the same group of lenders as the pre-petition indemnity, and was thus "an impermissible end-run around the Bankruptcy Code." The Fifth Circuit explained that 11 U.S.C. § 1123(b)(3)(A), which permits a plan to "provide for the settlement or adjustment of any claim or interest belonging to the debtor or the estate," does not "affirmatively provide for the back-end resurrection of claims already disallowed on the front end" and is therefore "too weak a reed" to support the settlement indemnity.

The Fifth Circuit further held that, even if the settlement indemnity were justifiable under Section 1123(b)(3)(A), it nevertheless

violated 11 U.S.C. § 1123(a)(4), which requires that a plan "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest." While declining to delineate the exact scope of Section 1123(a)(4), the Fifth Circuit held that where the expected value of the indemnity "varied dramatically" between class members depending on whether they had participated in the 2020 transaction, the settlement indemnity violated the Code's requirement of equal treatment.

MITEL

Background

The *Mitel* case also arose from a 2020 uptier transaction, in which Mitel's majority senior secured term and revolving lenders provided $150 million of new super-priority debt and exchanged their existing debt for new second-out and third-out loans that were senior to the existing loans pursuant to the terms of an amended intercreditor agreement.

The excluded lenders sued to challenge the transaction in New York state court. The trial court granted motions to dismiss by Mitel, its sponsor, the majority lenders, and the agent on certain causes of action. The Appellate Division dismissed all causes of action on appeal.

Opinion

The Appellate Division held that the uptier transaction did not violate the sacred rights in Mitel's credit agreements because: (i) any effect that the transaction had on Mitel's loans was indirect; and (ii) no provisions of the credit agreement protected by sacred rights had been subject to an actual waiver, amendment, or modification as part of the transaction.

The Appellate Division further held that the pro rata sharing provisions of the credit agreement were not breached because they were subject to an express exception that authorized Mitel, as borrower, to "purchase by way of assignment and become an Assignee with respect to Term Loans at any time." The court found that there was no indication that a "purchase" for purposes of this exception could not include a refinancing or exchange not offered on a pro rata basis to the lenders. Importantly, the relevant exception to the pro rata sharing provisions did not require an "open market purchase," but any "purchase by way of assignment."

The excluded lenders sought to appeal the decision to the New York Court of Appeals, but the parties reached a settlement to resolve the litigation shortly before Mitel filed a pre-negotiated chapter 11 case on March 10, 2025, in the Southern District of Texas to implement the uptier restructuring.

ANALYSIS

Both the *Serta* and *Mitel* decisions have a significant impact on the future of liability management exercises ("LMEs"). In the case of *Serta*, parties can no longer rely on courts in the Fifth Circuit to sanction non-pro-rata uptiers involving the private, bilateral purchase or exchange of syndicated term loans based solely upon an "open market purchase" exception. Beyond that, however, the rulings raise further questions, including potential drafting considerations. A few thoughts:

- As the *Mitel* ruling demonstrates, even a seemingly small difference in language, such as the omission of the words "open market" before "purchase," can have a consequential result. For loans governed by credit documents with language more akin to that in *Mitel* than in *Serta*, non-pro rata uptier transactions may still be viable.
- Provisions and terms in credit documents that are not explicitly "sacred rights" can themselves be amended by required lenders rather than all lenders. Consider, for example, whether an amendment could alter the definition of "open market purchase" to facilitate Serta-like transactions. Certainly, some term loans expressly include "privately negotiated" transactions as exceptions to pro rata requirements.
- The *Serta* decision applies to syndicated term loans. It may provide less guidance for other types of debt. For example:
  - *Bonds*: *Serta*'s impact on uptiers involving bonds may be limited, as bond indentures rarely, if ever, contain an "open market purchase" exception. In the *Wesco/Incora* matter, however, the Bankruptcy Court for the Southern District of Texas last year held that a non-pro rata uptier transaction was not permitted by certain provisions in a bond indenture requiring that notes be selected for purchase in a pro-rata manner.

- *Private credit*: The Fifth Circuit in *Serta* identified the relevant "open market" as the secondary market for syndicated loans. This raises the question of what the appropriate market would be if an uptier transaction were consummated in a private credit deal.

- Many recent LMEs have not taken such an overtly non-pro rata approach as *Serta*, instead offering participation to all lenders, but on differing economic terms. In evaluating whether to participate consensually in such transactions, lenders since 2023 have generally assumed that they faced an uphill battle in contesting whether an "open market purchase" is a permitted exception to pro-rata sharing. Those assumptions have now changed. This may alter the dynamics of how consensual LMEs are negotiated and structured.
- The Fifth Circuit's holding puts indemnities at risk in certain circumstances, which could influence lenders' willingness to participate in LMEs. That being said, the Fifth Circuit's decision applies only where indemnities are included in a plan settlement. It does not affect indemnities relating to LMEs that are litigated outside of bankruptcy court. This might impact whether lender proponents of an LME would be supportive of a borrower filing for chapter 11.
- From a larger perspective, the Fifth Circuit's holdings on equitable mootness and excision might be taken as a signal that the court is willing to step in and modify bankruptcy court rulings and even confirmed plans. This too could have an impact on the willingness of borrowers to seek adjudication of LMEs in bankruptcy court rather than in other fora.
- The Fifth Circuit's holding with respect to 11 U.S.C. § 1123(a)(4) will likely generate many questions as to what constitutes equal value. Indeed, on January 7, excluded lenders in the *ConvergeOne Holdings* chapter 11 cases filed a notice of supplemental authority arguing that the plan in that case offers majority lenders a "valuable and exclusive investment opportunity to secure their votes" and thereby caused the majority lenders to receive more on account of their claims than the other lenders. The ConvergeOne debtors responded on January 14 that the consideration given to the majority lenders did not violate Section 1123(a)(4) because it did not constitute plan treatment of prepetition claims, but was instead "market compensation for a new money commitment."

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