Linklaters

Serta Simmons: Court Awards $400 Million to Excluded Lenders in Disputed LME Saga

August 2026



Key Takeaways:

- On July 7, 2026, following the Fifth Circuit Court of Appeals' 2024 remand and a March 2026 trial, Judge Christopher Lopez of the U.S. Bankruptcy Court for the Southern District of Texas ruled that the lenders who participated in Serta Simmons Bedding's 2020 uptier liability management exercise ("LME") had breached the credit agreement's pro rata sharing provision and initially awarded the excluded lenders $261.13 million plus mandatory 9% prejudgment interest, for a total exceeding $400 million in the aggregate (subsequently reduced to approximately $105 million plus $57 million in prejudgment interest, after taking into account settlements entered into by certain participating lenders).
- The court flatly rejected the participating lenders' core argument that a cashless debt-for-debt exchange does not constitute a "payment" under the pro rata sharing provision, which the court found to be "drafted broadly" to govern any consideration received "*in any form and from any source*" in respect of principal or interest (emphasis added).
- Coming after the Fifth Circuit's reversal of the original ruling that the Serta uptier qualified as an "open market purchase," the decision is the most definitive ruling to date on the scope of pro rata sharing protections, and highlights the substantial damages exposure lenders face when those protections are violated. Although certain non-settling excluded lenders have appealed the judgment, for now the ruling significantly raises the stakes for non-pro rata LMEs.

I. Introduction

Judge Lopez's July 7 opinion provided an answer to the central question the Fifth Circuit left open on remand: did the cashless debt-for-debt exchange constitute a "payment" under the credit agreement's pro rata sharing provision? Setting aside equitable arguments and appeals to industry custom and economic reasonableness, the court applied a rigorous, text-driven analysis and concluded that the participating lenders breached the credit agreement, with substantial financial consequences. As the court put it, "[s]trict textual analysis was required to determine whether the 2020 Transaction complied with the Credit Agreement as an open market purchase without triggering any sacred rights. Now the text must be strictly applied when assessing damages."

II. Background: The Fifth Circuit's "Open Market Purchase" Decision

In June 2020, Serta executed a so-called "uptier" transaction with support from a slim majority of its first lien lenders. These participating lenders exchanged approximately $992 million of existing first lien term loans for roughly $734 million of new super-priority "first lien, second-out" debt, while Serta also raised $200 million of new "first lien, first-out" money, thereby subordinating the excluded (non-participating) lenders' legacy positions to both new tranches. To avoid triggering the ratable sharing requirement under Section 2.18(c) of the credit agreement, the parties to the transaction sought to structure it as an "open market purchase." Excluded lenders challenged this characterization, arguing that a privately negotiated, non-pro rata debt exchange could not qualify.

Bankruptcy Judge David Jones, the original judge overseeing the Serta chapter 11 cases, ruled in favor of Serta, without extensive analysis, finding the transaction qualified as an open market purchase. On December 31, 2024, the Fifth Circuit unanimously reversed, holding that an "open market purchase" must occur on the secondary market for syndicated loans and cannot encompass a privately negotiated side deal with a select group of lenders. The Fifth Circuit remanded for reconsideration of the excluded lenders' breach of contract claims, observing that they had "a strong case." Serta's petition for certiorari was denied, and the case was reassigned to Bankruptcy Judge Lopez.

III. The July 7, 2026 Opinion: A Deep Dive

The parties' disputes culminated in a five-day trial in March 2026 between the excluded lenders challenging the transactions (collectively, the "Plaintiffs") and the participating lenders. Judge Lopez rendered a thoughtful 48-page opinion methodically addressing the breach of contract claim, each of the participating lenders' defenses, and the damages calculation resulting from breach.

A. A Cashless Debt-for-Debt Exchange Is a "Payment" Under Section 2.18(c)

The central issue on remand was whether the cashless debt-for-debt exchange at the heart of the Serta uptier LME constituted a "payment" triggering pro rata sharing under

Section 2.18(c). The participating lenders pointed to Section 2.18(a)'s requirement that borrower payments be made in "Dollars" (defined as the lawful money of the United States), which they contended implied a cash-only limitation to the word "payment" that should be read into Section 2.18(c) as well. Judge Lopez rejected the participating lenders' argument through a careful textual analysis. He observed that Section 2.18(a) governs the mechanics of borrower-to-lender payments through the administrative agent, while Section 2.18(c) is "drafted broadly" to protect ratable treatment between lenders in the same class, *regardless of the form of consideration received*.

The court identified several other textual indicators:

- Section 2.18(c) itself refers to payments obtained "whether voluntary, involuntary, through the exercise of any right of set-off or otherwise." A set-off is a non-cash exchange, and the "or otherwise" catch-all is open-ended.
- Section 2.18(c) contains express carve-outs for certain categories of non-cash transactions. If debt exchanges were categorically excluded from Section 2.18(c), the court reasoned these carve-outs would be surplusage.
- The credit agreement uses the defined term "Cash" elsewhere when the parties intended to limit a provision to cash consideration. No such limitation appears in Section 2.18(c).
- The credit agreement elsewhere provides that a cashless rollover is deemed to comply with requirements that payment be made "in Dollars," "in Cash," or similar, which further confirms that payments "in Dollars" and payments "in Cash" are not always the same thing, and that the parties knew how to specify each when they wished to.

The court also rejected the participating lenders' attempt to invoke the Loan Syndications and Trading Association's (LSTA) industry understanding of "payment" as limited to cash, noting that "payment" is not a technical term and that, under New York law, industry custom cannot override the plain meaning found within the four corners of the contract.

B. The Payment Was "In Respect of" Principal on First Lien Term Loans

The court next found that the new First Lien Second Out debt received by the participating lenders was "in respect of" their First Lien Term Loan principal. The court read "in respect of" broadly, as it is used hundreds of times throughout the credit agreement, to mean "concerning," "regarding," or "in connection with." The Exchange Agreement's signature pages made the connection unmistakable: each participating lender received new debt equal to 74% of the "Principal amount of Purchased First Lien Loans" it had surrendered. Serta then retired and cancelled the exchanged loans of the participating lenders.

C. Equitable and Procedural Defenses Rejected

The participating lenders raised several defenses, each of which the court rejected:

- **Prior judge's statements are not law of the case.** The participating lenders argued that Judge Jones' prior characterization of the excluded lenders' "objective lack of good faith" in the earlier trial was binding. The court disagreed, finding those statements were dicta that could be "removed without affecting any ruling." Because the statement was not a ruling, the excluded lenders could not have waived their right to challenge it.
- **Ratification fails.** The lenders argued they had ratified the transaction by amending the "open market purchase" exception in Section 9.05(g) with majority consent. The court called this "the same argument that lost before the Fifth Circuit in new packaging," since the ratification theory depended on Section 9.05(g) having validly authorized the transaction in the first place, which the Fifth Circuit held it did not. Section 9.02(b)(A) also barred a majority from amending the carve-out in a way that would render the pro rata sharing protections of Section 2.18(c) "illusory."
- **In *pari delicto* and unclean hands do not bar recovery**. The participating lenders pointed to the excluded lenders' competing drop-down proposal and $30 million offer to derail the uptier. The court found this conduct fell short of either the *in pari delicto* or unclean hands doctrine: the drop-down proposal was never accepted, a participating lender had made its own drop-down proposal, and Serta itself had orchestrated the competitive bidding process. Unclean hands was also unavailable because the action was exclusively for damages.
- **Failure to mitigate rejected.** The participating lenders argued the excluded lenders should have sold their first lien term loans after the 2020 Transaction to mitigate damages. The court found there was no meaningful market: only $162 million in aggregate face amount traded in the 18 months after the transaction, at an average trade size of $2.3 million, against the excluded lenders' aggregate position of over $700 million. Exiting their position would also have required the excluded lenders to surrender their breach of contract claims, which New York law did not require.

D. Damages: Face Value, Strictly Applied

Section 2.18(c) provides a specific remedy: a lender receiving a disproportionate payment "shall purchase (for Cash at face value) participations in the Loans of other Lenders" to ensure ratable sharing. Judge Lopez applied this remedy as written. The Plaintiffs' ratable share of the $734 million in First Lien Second Out consideration was approximately 47.43% (reflecting their $895 million holdings out of $1.887 billion total), or $348 million.

The court then adopted the Plaintiffs' expert's "time of breach" methodology, using the closing-date market price ($0.25 on the dollar) of the First Lien Term Loans. The calculation compared the Plaintiffs' position in a "but-for world" (where they received their ratable $348 million cash payout under Section 2.18(c) and retained the remaining ~$547 million of their loans at market value) to their actual position (retaining $895 million of loans at the same market value). The resulting aggregate damages figure was approximately $261 million.[1]

The court rejected the participating lenders' expert's alternative approaches, which sought to measure the "benefit" of the transaction by reference to changes in expected recovery values or to net the economic value of the new-money injection and deleveraging. Judge Lopez found these methodologies "a-textual" and untethered to the specific payment-sharing mechanics of Section 2.18(c): "Section 2.18(c) focuses on the benefit of the payment, not benefits of the 2020 Transaction." More broadly, Judge Lopez agreed with the excluded lenders that Section 2.18(c) functions as a true lender pro rata treatment mandate, not a mechanism to evaluate the economics of a transaction after the fact.

The participating lenders also argued on equitable grounds that the result "defied economic reality" by requiring them to pay $348 million for participations worth roughly $87 million at closing-date prices. The court rejected this argument as well, holding that the text of the agreement controlled and required payment at face value for participations in the distressed First Lien Term Loan. The court reasoned that the requirement to pay face value for participations in the distressed First Lien Term Loan was always a possibility known by the parties, who were sophisticated and accepted the litigation risk.

[1] The court set forth a detailed calculation in its opinion. The court arrived at $261 million by subtracting the $224 million in real-world value held by the excluded lenders (the market value of the excluded lenders' $895 million of First Lien Term Loans) from the $485 million that they should have held in a "but-for" world (the sum of the $348 million cash payment that the excluded lenders should have received from selling participations to the participating lenders and the $137 million in market value of the remaining $547 million in First Lien Term Loans the excluded lenders would have retained).

E. Prejudgment Interest: 9% Per Annum, No Exceptions

The credit agreement is governed by New York law, and New York's prejudgment interest rate on breach of contract claims is a mandatory 9% per annum by statute. The court applied prejudgment interest starting from the closing date of the transaction (June 22, 2020)—the time of breach—rather than the date of Serta's emergence from chapter 11, as proposed by the participating lenders. Compounded through the date of the opinion (July 7, 2026), the resulting interest amount was estimated at roughly $142 million.

The participating lenders argued that awarding 9% interest over six years on a multi-hundred-million-dollar damages claim was inequitable, particularly given that they initially prevailed in the bankruptcy court and were only reversed on appeal. The court acknowledged the scale of the interest award but found no basis to deviate: "This Court will not substitute the parties' decision to have New York law govern disputes about the Credit Agreement without any applicable exceptions."

F. Several (Not Joint) Liability

Consistent with the credit agreement, the court held that lender liability is several, not joint. Each remaining participating lender was liable only for its own proportionate share of the adjusted damages total, calculated by reference to its individual First Lien Term Loan holdings as of June 22, 2020. A defendant's liability does not increase because other participating lenders settle, are dismissed, or are otherwise no longer parties.

Following the decision, several participating lenders settled or satisfied their share of the liability which reduced the total outstanding damages to approximately $105 million and prejudgment interest to approximately $57 million by the time the court entered a judgment on July 20.

IV. Outlook and Market Implications

The non-settling participating lenders filed a notice of appeal of Judge Lopez's decision to the U.S. District Court for the Southern District of Texas on July 30.[2] For now, Judge Lopez's opinion represents one of the strongest judicial statements to date that pro rata sharing provisions may extend to non-cash consideration, including debt-for-debt exchanges. If upheld, the ruling would significantly narrow a potential path by which non-pro rata LMEs structured as cashless exchanges could be executed without implicating pro rata sharing protections. Given that these features are common across broadly syndicated term loan agreements, the risk calculus for non-pro rata transactions of all kinds should account for this result and the potential for significant damages measured at par value, compounded by years of mandatory prejudgment interest.

Further, by applying Section 2.18(c)'s "for Cash at face value" remedy on its terms without regard to the market value of the participations at the time of breach, awarding New York's mandatory 9% prejudgment interest, and dismissing the participating lenders' appeals to fairness and other equitable arguments, the court reinforced that it will look to the plain language of the contract to resolve disputes arising under a credit agreement, and not extrinsic considerations of commercial purpose, economic reasonableness, or market practice.

Practitioners drafting or negotiating LME-related provisions (and loan document modifications more broadly) must ensure that the contractual language precisely captures the parties' commercial intent, as the decision serves as a reminder that courts may treat the text as the definitive expression of that intent. We expect the following considerations to come into play when drafting syndicated credit agreements:

- Continued importance of enshrining pro rata sharing provisions and any carve-outs as sacred rights;
- Continued focus on so-called "Serta blockers" (provisions designed to prevent lien and payment subordination through uptiering) and any carve-outs that sophisticated parties may seek to exploit;
- Efforts to expand exceptions to pro rata sharing such as through "privately negotiated purchase" options, or carve-outs for DIP rollups; and
- Explicit inclusion or exclusion of specified cashless transactions in the meaning of "payment" for purposes of pro rata sharing provisions.

The decision is also relevant for collateralized loan obligation ("CLO") vehicles, a number of which were among the participating lender group. For any participating lender CLOs that had not previously settled their liability but have by now reached stated maturity and terminated the CLO vehicle, enforcing a several-liability judgment raises practical questions around the availability of clawback remedies against a liquidated entity. Going forward, CLO investors may take a closer look at the type of LME transactions CLO managers are entering into, which may limit a CLO manager's ability to enter into uptier priming transactions involving excluded and participating lender groups.

The *Serta* decision may also shift the competitive landscape for financing to a degree. First, the market may move further toward consensual approaches to LMEs, since extending pro rata participation to the full lender group remains a fairly reliable way to insulate a transaction from challenge. The Plaintiffs in Serta were largely excluded from participating in the First Lien Second Out debt, and the outcome of the case could embolden minority lenders in other transactions who were similarly excluded from aggressive non-pro rata transactions to pursue litigation. In addition, as non-pro rata exchanges with incumbent lenders become more difficult to structure within recognized contractual safe harbors, at least under the typical terms of existing credit documents, third-party financing sources may find themselves in a relatively stronger competitive position in the market for alternative transactions.

The *Serta* decision arguably stands in tension with a May 2026 ruling by Judge Michael Kaplan in the *Del Monte Foods* bankruptcy case in the District of New Jersey. In *Del Monte*, minority lenders challenged a non-pro rata DIP rollup under a pro rata sharing provision comparable to Serta's Section 2.18(c). Judge Kaplan took the opposite view from Judge Lopez on the key question, concluding that a cashless rollup was not a "payment or reduction" triggering pro rata sharing because the term "payment," in the context of a credit agreement, is generally understood to mean a cash payment. Although the two cases involved different factual and procedural contexts and different credit agreements, they represent conflicting judicial guidance on the same fundamental question: whether the term "payment," as used in a pro rata sharing provision, includes cashless exchanges when the contract language is not explicit on the point. Both cases will be important to follow as they continue to unfold.

[2] The excluded lenders also filed a cross-appeal on August 3, challenging the judgment's denial of "all other relief" requested by the excluded lenders and the incorporated order denying the excluded lenders' motion for leave to file a second amended answer, counterclaims, and third-party claims. Beyond alleging breach of the pro rata sharing provision, the excluded lenders' pleadings had (i) sought a declaratory judgment that the 2020 Transaction was invalid; (ii) alleged that the credit agreement amendments permitting the non-pro rata senior financing violated Section 9.02, which required unanimous lender consent to amend the pro rata sharing requirement; and (iii) alleged a breach of the implied covenant of good faith and fair dealing, which Judge Lopez did not address in his opinion. The reason for this appeal is not clear; however, to the extent the excluded lenders are seeking to invalidate and rescind the 2020 Transaction and the related amendments themselves, the implications could extend beyond the damages awarded under Section 2.18(c) .

Key contacts

New York



Michael H. Torkin
Partner, New York
Tel: +1 212 903 9150
michael.torkin@linklaters.com



Daniel Guyder
Partner, New York
Tel: +1 212 903 9110
daniel.guyder@linklaters.com



Penelope Jensen
Partner, New York
Tel: +1 212 903 9087
penelope.jensen@linklaters.com



Christopher Hunker
Partner, New York
Tel: +1 212 903 9267
christopher.hunker@linklaters.com

Paris



François Kopf
Partner, Paris
Tel: +33 156432777
francois.kopf@linklaters.com



Mathieu Dell Vittoria
Partner, Paris
Tel: +33 156432771
mathieu.dellavittoria@linklaters.com

London



Richard Hodgson
Partner, London
Tel: +44 20 7456 3797
richard.hodgson@linklaters.com



Nick Le Masurier
Partner, London
Tel: +44 20 7456 3767
nicholas.le_masurier@linklaters.com



Juliana Leite de Barros
Partner, London
Tel: +44 20 7456 2519
juliana.leite_de_barros@linklaters.com



Julia Matthews
Partner, London
Tel: +44 20 7456 3572
julia.matthews@linklaters.com



Liam Robinson
Partner, London
Tel: +44 20 7456 2274t
liam.robinson@linklaters.com



James Warboys
Partner (Linklaters LLP, England & Wales), Registered Foreign Lawyer (England & Wales), London
Tel: +44 20 7456 5111
james.warboys@linklaters.com

London (continued)



Max Krasner
Partner, London
Tel: +44 20 7456 4862
max.krasner@linklaters.com



Damien Gomez
Partner, London
Tel: +44 20 7456 3416
damien.gomez@linklaters.com

Madrid



Ben Crosse
Global co-Head of Banking, Madrid
Tel: +34 913996176
ben.crosse@linklaters.com



Francisco Sainz-Trapaga
Partner, Madrid
Tel: +34 913996033
francisco.sainz-trapaga@linklaters.com

Hong Kong



Richard Woodworth
Partner, Hong Kong SAR
Tel: +852 29015285
richard.woodworth@linklaters.com



Roberta Cheung
Partner, Hong Kong SAR
Tel: +852 29015526
roberta.cheung@linklaters.com

Milan



Francesco Faldi
Partner, Milan
Tel: +39 02883935242
francesco.faldi@linklaters.com



Ettore Consalvi
Partner, Milan
Tel: +39 02883935263
ettore.consalvi@linklaters.com

Frankfurt



Riaz Janjuah
Partner, Frankfurt
Tel: +49 40303343712
riaz.janjuah@linklaters.com



Sabine Vorwerk
Partner, Frankfurt
Tel: +49 6971003308
sabine.vorwerk@linklaters.com



Band 1
Restructuring/Insolvency
Chambers Global 2026

linklaters.com

This content is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here, please get in touch. © 2026 Linklaters.

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. It is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of the LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP and of the non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, 20 Ropemaker Street, London, EC2Y 9AR, England or on www.linklaters.com and such persons are either solicitors or registered foreign lawyers. Please refer to www.linklaters.com/regulatory for important information on our regulatory position.

CD655_F/08.26