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Final Ruling in Serta Reaches Decision on “Open Market Purchase”

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Background

In November 2016, Serta Simmons Bedding, LLC and certain affiliates (collectively, the “Debtors”) entered into credit facilities which provided for (i) $1.95 billion in first lien term loans (the “2016 Credit Agreement”), (ii) $450 million in second lien term loans (the “Second Lien Term Loan Agreement”) and (iii) a $225 million asset-based revolving loan. [1]

In 2020, with the Debtors facing liquidity and other financial difficulties, the Debtors and a group of lenders making up a majority of the lenders under both the 2016 Credit Agreement and the Second Lien Term Loan Agreement (the “PTL Lenders”) effected an up-tiering transaction whereby, among other things, the PTL Lenders created new priority tranches of debt consisting of a new money loan and loans exchanged at a discount with the loans made pursuant to the 2016 Credit Agreement and the Second Lien Term Loan Agreement (the “2020 Transaction”).[2] The exchanged loans replaced debt that had been owing to the PTL Lenders and the loans were not exchanged on a pro rata basis with all lenders or offered to all lenders.

Issue and Summary of Decision

Arguing that it violated the terms of the 2016 Credit Agreement, a group of lenders that did not participate in the up-tiering transaction (the “Objecting Lenders”) objected to the transaction. On June 6, 2023, the U.S. Bankruptcy Court for the Southern District of Texas found that the 2020 Transaction was permitted under the terms of the 2016 Credit Agreement and approved confirmation of the Chapter 11 plan of the Debtors.[3]

Open Market Purchases

The primary point of contention with respect to the 2020 Transaction was whether or not the exchange of loans satisfied the requirements of an "open market purchase" under the 2016 Credit Agreement.

Section 9.05(g) of the 2016 Credit Agreement states, in relevant part, that:

> Notwithstanding anything to the contrary contained herein, any Lender may, at any time, assign all or a portion of its rights and obligations under this Agreement in respect of its Term Loans to any Affiliated Lender on **a non-pro rata basis** (A) through Dutch Auctions **open to all Lenders holding the relevant Term Loans on a pro rata basis** or (B) **through open market purchases**, in each case with respect to clauses (A) and (B), without the consent of the Administrative Agent.[4]

In determining whether the 2020 Transaction satisfied the requirements of an "open market purchase" under the 2016 Credit Agreement, the court compared the requirements of a "Dutch Auction" to what was required for "open market purchases" under the 2016 Credit Agreement. The 2016 Credit Agreement included pages of implementation rules with respect to Dutch Auctions and required Dutch Auctions to be "open to ***all*** Lenders…on a pro rata basis."[5] By comparison, the 2016 Credit Agreement did not require that open market purchases be open to all lenders. As a rule of contract interpretation, the court noted that if the parties to an agreement omit terms in one place of a contract and not in others, the omission should be deemed to be intentional.[6] Therefore, the inclusion of the requirement that Dutch Auctions be open to ***all*** lenders and the comparative omission of this requirement with respect to open market purchases meant that open market purchases did not have to be made available to all lenders.

In determining what requirements did need to be satisfied in order for a transaction to qualify as an "open market purchase" under the 2016 Credit Agreement, the court looked at the plain meaning of the terms, noting that Merriam-Webster defines "open market" as "an economic market in which prices are based on competition among private businesses and not controlled by a government."[7] Based on this definition - and noting that in the process of negotiating the 2020 Transaction a number of lending groups had been contacted and made competing proposals, including the Objecting Lenders - the court found that an open market purchase took place because the purchase was obtained for value, in competition among private parties.

Good Faith and Fair Dealing

New York law, which governed the 2016 Credit Agreement, implies a covenant of good faith and fair dealing in the performance of every contract. In determining that the 2020 Transaction did not violate the covenant of good faith and fair dealing, the court noted that conduct expressly permitted under an agreement does not violate the implied covenant, and that actions taken for legitimate business purposes, even if self-interested, do not violate the covenant of good faith and fair dealing.[8] Finding no evidence of improper motive on behalf of either the Debtors or PTL Lenders and that the 2020 Transaction was permitted under the 2016 Credit Agreement, the court also ruled that the implied covenant of good faith and fair dealing was not breached.[9]

Key Take-Away

The U.S. Bankruptcy Court for the Southern District of Texas is the first court to issue a final ruling in a high-profile case involving a position enhancing transaction that interprets the meaning of "open market purchase" under New York law, and found that the up-tiering transaction effected by Serta and the PTL Lenders complies with such provision because – though the exchange was not offered to all lenders – it "was the result of good-faith, arm's length negotiations by economic actors acting in accordance with the duties owed to their respective creditors, investors and owners"[10] and was thus permitted by the 2016 Credit Agreement.

[1] Memorandum Opinion, *In re Serta Simmons Bedding, LLC*, No. 23-90020 (Bankr. S.D. Tex. June 6, 2023), ECF No. 1045; *see also N. Star Debt Holdings L.P. v. Serta Simmons Bedding LLC*, No. 652243/2020, 2020 WL3411267 (N.Y. Sup. Ct. June 19, 2020).

[2] *N. Star Debt Holdings L.P. v. Serta Simmons Bedding LLC*, No. 652243/2020, 2020 WL3411267 (N.Y. Sup. Ct. June 19, 2020).

[3] Memorandum Opinion, *In re Serta Simmons Bedding, LLC*, No. 23-90020 (Bankr. S.D. Tex. June 6, 2023), ECF No. 1045.

[4] *Id*. (emphasis added)

[5] *Id*.

[6] *Id*.

[7] *Id*.

[8] *Id*.

[9] *Id*.

[10] *Id*.

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