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Bankruptcy Court Awards Serta Simmons' Excluded Lenders $261 Million

July 9, 2026

Six years after Serta Simmons Bedding ("SSB") executed its famous, non-ratable uptier liability management transaction, Judge Christopher Lopez of the United States Bankruptcy Court for the Southern District of Texas ruled that the majority, participating lenders breached the Credit Agreement's pro rata sharing provision and awarded $261 million in damages (plus interest from the transaction date) to the excluded minority lenders.

Background

In June 2020, SSB and lenders holding a majority of its first lien term loans (the "Participating Lenders") executed a transaction in which, among other things, the Participating Lenders exchanged $992 million of existing first lien term loans for $734 million in new super-priority term loans, priming the minority lenders who were not invited to participate (the "Excluded Lenders"). The exchange was described by SSB and the Participating Lenders as SSB's "open market purchase" of the Participating Lenders' term loans to take advantage of an exception to the pro rata sharing provision of SSB's credit agreement, which was protected by a sacred right and could not be modified without the consent of the Excluded Lenders.

The Excluded Lenders challenged the transaction, and the case wound through New York state court, bankruptcy court, and, ultimately, the Fifth Circuit, which ruled in December 2024 that the exchange did not constitute an "open market purchase." We previously wrote about the initial bankruptcy court decision and the Fifth Circuit's ruling. The Fifth Circuit remanded to the bankruptcy court with a single remaining question: given that the open market purchase exception did not apply, did the Participating Lenders breach the credit agreement's pro rata sharing provision? On July 7, 2026, following a trial held in March 2026, the court answered yes.

I. The Debt Exchange Was a "Payment"

The threshold question on remand was whether the exchange of first lien term loans for new super-priority term loans constituted a "payment" under the pro rata sharing provision of SSB's credit agreement. The Participating Lenders argued that "payment" in this context meant *cash* payment and that the receipt of exchange debt was outside the scope of this provision. However, pro rata sharing provisions are typically drafted broadly — with the intention and expectation that they will apply to cash payments, exchanges, and other consideration received in respect of the subject debt — and the court held that such was the case in the SSB credit agreement.

The court also noted for further contextual evidence of intent that the more limited term "cash payment" was used in other specific instances in the credit agreement (in contrast to the pro rata sharing provision), and that the pro rata sharing provision included several express (but inapplicable) carve-outs for certain non-cash payments (including open market purchases), which would be unnecessary and irrelevant if the entire provision were only intended to apply to cash payments.

II. The Pro Rata Sharing Provision Was Breached

Because the exchange constituted a payment in respect of the first lien term loans— and because, per the Fifth Circuit's prior ruling, it did not qualify for the "open market purchase exception" — the Participating Lenders were required to comply with the pro rata sharing provision. This provision states in relevant part:

> If any Lender obtains payment . . . in respect of any principal of or interest on any of its Loans of any Class held by it resulting in such Lender receiving payment of a greater proportion of the aggregate amount of its Loans of such Class and accrued interest thereon than the proportion received by any other Lender with Loans of such Class, then the Lender receiving such greater proportion shall purchase (for Cash at face value) participations in the Loans of other Lenders of such Class at such time outstanding to the extent necessary so that the benefit of all such payments shall be shared by the Lenders of such Class ratably…

The court held that the Participating Lenders received greater than their pro rata share of the exchange loans and then failed to purchase participations from the Excluded Lenders, in breach of this provision.

III. Equitable Defenses Rejected

The Participating Lenders urged the court to bar or reduce damages based on the equitable principles of *in pari delicto* and unclean hands, essentially placing fault with the Excluded Lenders for providing an earlier proposal of a competing drop-down transaction and a $30 million offer to SSB to terminate the deal. The court declined to apply either doctrine, finding no fraud, illegality, or misconduct in the Excluded Lenders' actions, and generally striking an unsympathetic tone to arguments by the sophisticated parties that sought to limit the applicability or effect of the express contractual provisions to which they agreed. As Judge Lopez put it, SSB and the Participating Lenders "structured a transaction that always had a risk of not complying with [the pro rata sharing provision]" and "sophisticated parties accepted the litigation risk that came with it."

IV. Damages

The court measured damages at the date of breach and the credit agreement's pro rata sharing provision in accordance with its terms: the $734 million in new super-priority debt received by the Participating Lenders was required to be shared ratably across the $1.887 billion first lien class. This resulted in an aggregate liability of approximately $261 million. In addition, the court also awarded prejudgment interest at nine percent per annum dating from the breach, as required by New York law. Liability is several, not joint: each Participating Lender owes its proportionate share based on its individual holdings as of the 2020 transaction closing.

Takeaways

The court sent a clear message: loan documents will be interpreted strictly in accordance with their terms and applicable law. Judge Lopez brushed aside every equitable argument — *in pari delicto*, unclean hands, that the damages "defy economic reality," and that New York's statutory prejudgment interest rate is "exorbitant" — and addressed the dispute as a straightforward breach of contract claim governed by the plain language of the agreement. Opinions as to the fairness of the result — of the court, the parties, and the broader finance markets — were deemed irrelevant.

Accordingly, in drafting, reviewing, and utilizing terms relevant to liability management transactions or modification of loan documents more generally, the utmost care should be given to accurately reflect and implement the intent of the parties, with the expectation that the words on the page will control any dispute.

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