Cahill

Cash Only? Bankruptcy Courts Offer Divergent Interpretations of “Payment” in Connection with Exchange Mechanics

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INTRODUCTION

The *Serta* case has been widely followed by lenders, borrowers, and sponsors alike, with parties’ risk calculations shifting as the various courts opine on what were seen as customary pro rata sharing provisions, sacred rights, and assignment provisions. Judge Lopez’s latest ruling this month, finding that the participating lenders breached the credit agreement by accepting, without distributing, a non-pro rata cashless payment for their existing debt in the form of new priming loans, deviates from existing jurisprudence in the Third Circuit in *Del Monte* and offers a stricter textual approach to interpreting credit agreements than often espoused by other courts. Judge Lopez’s decision to award damages based on the underlying economics at the time of the breach, rather than at a later time after Serta benefited from the liquidity injection as part of the disputed transaction, may encourage excluded lender groups to pursue litigation, with large potential recoveries outweighing the cost, uncertainty, and potential relationship damage of litigating sponsor-backed liability management transactions.

BACKGROUND

In November 2016, Serta Simmons Bedding (“Serta”) borrowed $1.95 billion under a first lien term loan credit agreement (the “Serta Credit Agreement”) and $450 million under a second lien credit agreement.[1] By 2019, Serta needed new capital but already owed over $2 billion in secured debt and faced severe financial distress triggered in part by competition from direct-to-consumer companies and

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[1] Memorandum Opinion, AG Centre St. P'ship L.P. v. Serta Simmons Bedding, LLC (In re Serta Simmons Bedding, LLC), Adv. No. 23-09001, U.S. Bankr. Ct. S.D. Tex., ECF No. 742, at 1–2 (“*Serta 2026 Ruling*”).

COVID-19-related manufacturing shutdowns.[2] Two competing lender groups emerged with proposals to help Serta address its looming liquidity crisis and highly levered balance sheet: first, the so-called "Excluded Lenders", proposed a drop-down transaction, shifting assets to a subsidiary outside of the existing collateral group, allowing Excluded Lenders to lend into a structurally senior position; second, the "Participating Lenders", proposed a non-pro rata uptier transaction pursuant to which Serta would issue new superpriority term loans to the Participating Lenders, which became the basis of this legal saga.[3] The transaction with the Participating Lenders created $1.075 billion of "new" debt in two tranches—a $200 million "new-money" first-out tranche provided by the Participating Lenders, and an $875 million second-out tranche consisting of exchanged existing first lien term loans and existing second lien term loans of only the Participating Lenders, at approximately 74 cents on the dollar. The structure left the Excluded Lenders (who formerly held first priority and second priority liens in the capital structure) subordinated in a third-out position in the new waterfall (the "2020 Transaction").[4] Critically, in effecting the exchange, the Borrower offered to purchase the loans of only the Participating Lenders and not of the Excluded Lenders.

Central to the case was the pro rata sharing provision[5] of the Serta Credit Agreement, which required payments of the term loans under the Serta Credit Agreement to be made pro rata between term lenders absent an applicable exception. In order to avoid violating the Pro Rata Sharing Provisions under the Serta Credit Agreement (which could not be amended without the consent of each affected lender)[6], the Participating Lenders purported to structure the transaction as an "open market purchase"[7], one of

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[2] *Id.* at 2.
[3] *Id.* at 3–4.
[4] *Id.* at 7.
[5] *See* Section 2.18(c) of the Serta Credit Agreement (the "Pro Rata Sharing Provisions")

> If any Lender obtains payment (whether voluntary, involuntary, through the exercise of any right of set-off or otherwise) 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 in accordance with the aggregate

[6] As is typical, the Pro Rata Sharing Provisions were a "sacred right" under the Serta Credit Agreement. Whereas the Participating Lenders, constituting lenders holding a majority of the loans and unused commitments ("Required Lenders"), were allowed to amend most portions of the Serta Credit Agreement, all affected lenders had to consent to a change to the Pro Rata Sharing Provisions. Therefore, the Pro Rata Sharing Provisions could not be amended if the Excluded Lenders did not consent.

[7] *See* Section 9.05(g) of the Serta Credit Agreement, the "Open Market Purchase Provision":

the explicit carveouts to the Pro Rata Sharing Provisions[8], and which was then and is still a typical exception to pro rata sharing provisions in syndicated credit agreements. In short, Serta and the Participating Lenders attempted to use the undefined meaning of "open market purchase" to circumvent the broader lender group's rights to participate pro rata in Serta's repurchase of loans under the Pro Rata Sharing Provisions. Ordinarily, a lender's right to ratable treatment under such provision would require another lender receiving a disproportionately larger payment to make proportionate participation purchases from each lender to prevent the company from preferentially repaying certain lenders. The Excluded Lenders (among others), now subordinated by over a billion dollars in senior debt following the 2020 Transaction, argued that the private, exclusive negotiation of a debt-for-debt swap between Serta and the Participating Lenders could not possibly be considered an open market transaction.[9][10]

After Serta's bankruptcy filing, Serta and the Participating Lenders received a declaratory judgment that the 2020 Transaction constituted an "open market purchase".[11] However, the Fifth Circuit later reversed, holding that the 2020 Transaction was not a permissible "open market purchase" given it was privately negotiated, among other reasons, and remanding for further proceedings.[12] The case eventually proceeded to a trial on remand in March 2026 before Judge Christopher Lopez in the United States Bankruptcy Court for the Southern District of Texas.

COURT'S ANALYSIS ON BREACH

To determine whether the Participating Lenders breached the Serta Credit Agreement, Judge Lopez analyzed four criteria extracted from the Pro Rata Sharing Provisions: (i) whether the Participating Lenders received a "payment", (ii) whether such "payment" was received in respect of any principal or interest on the loans, (iii) whether the Participating Lenders received payment of a greater proportion of the total amount of loans than the Excluded Lenders and (iv) whether the Participating Lenders

> 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

[8] *Id.*
[9] Amended Adversary Complaint ¶¶ 267–69, Serta Simmons Bedding LLC v. AG Ctr. St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001 (Bankr. S.D. Tex. June 6, 2023), Dkt. No. 38.
[10] See *A Tale of Two Cases: Bankruptcy Courts Take Divergent Approaches on Non-Pro Rata Rollups*, CAHILL CLIENT ALERT (June 29, 2026) https://www.cahill.com/publications/client-alerts/2026-06-29-a-tale-of-two-cases-bankruptcy-courts-take-divergent-approaches-on-non-pro-rata-rollups for further detail on recent jurisprudence involving non-pro rata transactions in a DIP context.
[11] *Serta 2026 Ruling* at 12.
[12] *In re Serta Simmons Bedding, L.L.C.*, 125 F.4th 555, 579–81 (5th Cir. 2024).

purchased participations in loans from the Excluded Lenders "to the extent necessary so that the benefit of all such payments would be shared ratably".[13] Judge Lopez found in favor of the Excluded Lenders for each point listed above. An analysis of how Judge Lopez found that the Participating Lenders received a "payment" is set forth below.

WHAT IS "PAYMENT"

Judge Lopez found that "payment" under the Pro Rata Sharing Provisions is not limited to cash payments but encompasses any form of consideration received by a lender in respect of its principal.[14] Because the term "payment" is not defined in the Serta Credit Agreement, the court derived its meaning from the document's four corners, observing that the Pro Rata Sharing Provisions, unlike the borrower-payment mechanics, do not contain "Dollars" or "Cash" requirements, and instead include a broad parenthetical encompassing setoff rights, which are cashless, and a general catchall.[15] The court reinforced this reading by (i) noting that the applicable sacred right protecting the Pro Rata Sharing Provisions[16] carves out four specific non-cash debt-exchange provisions—carveouts that would be surplusage if cashless debt exchanges never triggered ratable sharing in the first place and (ii) observing that the drafters used the defined term "Cash" elsewhere in the agreement when they wanted to require it.[17] The court further rejected the Participating Lenders' reliance on LSTA industry custom as irrelevant under New York law when the contract's plain text includes its meaning.[18]

COMPARING TO DEL MONTE

The question before the Del Monte Foods Corporation II, Inc. ("Del Monte") court was whether a DIP credit agreement that included a roll-up of defendants' pre-petition loans constituted a payment or reduction of the defendants' loans under the pre-petition loan agreement's pro rata sharing provisions. In analyzing the definition of "payment", the *Del Monte* court diverged from *Serta* in three key ways: first, while *Serta* treats the Pro Rata Sharing Provisions as a separately and broadly drafted clause, *Del Monte*

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[13] *Id* at 19.
[14] *Id*. at 19-23.
[15] *Id*. at 20.
[16] *See* Section 9.02(b)(A)(6) of the Serta Credit Agreement:

> the consent of each Lender directly and adversely affected thereby (but not the consent of the Required Lenders) shall be required for any waiver, amendment or modification that: waives, amends or modifies the provisions of Sections 2.18(b) or (c) of this Agreement in a manner that would by its terms alter the pro rata sharing of payments required thereby (except in connection with any transaction permitted under Sections 2.22, 2.23, 9.02(c) and/or 9.05(g) or as otherwise provided in this Section 9.02)

[17] *Id*. at 21-22.
[18] *Id*. at 22.

read the general payment-mechanic provisions,[19] which require payments "in Dollars in the same day funds", as informing the meaning of "payment" throughout the agreement, including within the pro rata sharing provisions, concluding that the parties "understood 'payment' to require an exchange of dollars or cash equivalents."[20] Second, *Del Monte* affirmatively relied on the LSTA for the principle that "the term 'payment' is most sensibly construed to apply only to payments received in cash," whereas *Serta* explicitly rejected LSTA definitions as irrelevant industry custom that cannot override unambiguous contract text.[21] Third, where *Serta* reasoned that the deliberate inclusion of carveouts for non-cash transactions indicates the parties intended the Pro Rata Sharing Provisions to encompass cashless payments, *Del Monte* flipped this logic, reasoning that the absence of an express roll-up exception means sophisticated parties never intended roll-ups to trigger sharing—because "had the plaintiffs intended the agreement to prohibit a roll-up arrangement or to treat it as payment of the pre-petition debt, the parties could have stated so expressly."[22]

It is also worth noting that in *Del Monte*, the court emphasizes that the DIP financing included a roll-up which "did not discharge a single dollar of the Debtors' existing payment obligations," relying on the New York principle that "a mere promise to pay . . . does not discharge a preexisting debt".[23] In *Serta*, the original loans were retired and cancelled after being exchanged.[24] It is not clear whether the *Serta* fact pattern would have impacted the *Del Monte* court's overall assessment or analysis.

AMENDMENTS CANNOT RENDER SACRED RIGHTS ILLUSORY

The *Serta* court also rejected the Participating Lenders' argument that because they constituted Required Lenders, they could have amended the Open Market Purchase Provision to permit the 2020 Transaction and that by having the Required Lenders ratify the transaction, they implicitly and validly amended such provision. The court reasoned that because the Fifth Circuit held that the 2020 Transaction did not constitute an "open market purchase", an argument that Required Lenders could "ratify" an amendment to the Open Market Purchase Provision could not prevail. Judge Lopez notes: "If a majority of lenders could amend the carve-out under [the Open Market Purchase Provision], the protections under the [Pro Rata Sharing Provisions] are illusory."

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[19] *See* Section 2.16(a) of the Del Monte Foods Credit Agreement.
[20] Certain Members of the Ad Hoc Group of Minority Secured Lenders v. Members of the Ad Hoc Term Lender Group (In re Del Monte Foods Corporation II, Inc.), Adv. Case No. 26-01018 (MBK), U.S. Bankr. Ct. D.N.J., ECF No. 31, at 11–12.
[21] *Id.* at 11. *Serta*, ECF No. 742, at 22.
[22] *Id.* at 13. *Serta*, ECF No. 742, at 21-22.
[23] *Del Monte*, ECF No. 31, at 11–12.
[24] *Serta*, ECF No. 742, at 7.

COURT ANALYSIS ON DAMAGES[25]

The *Serta* court interpreted the Pro Rata Sharing Provisions to require that each lender in the syndicate share the benefit of the cashless exchange in the 2020 Transaction. In order to calculate damages, the court first determined that the "benefit" received by the lenders was received at the time of breach (i.e. the close of the 2020 Transaction).[26]

The court accepted that the "benefit" received by the Participating Lenders was $734 million—the face value of the first lien second out consideration they negotiated and accepted in exchange for their $992 million of first lien term loans under the Serta Credit Agreement (a 74-cent-on-the-dollar exchange ratio).[27] The court then divided the amount of "benefit" received ($734 million) by the total amount of the loan ($1.887 billion), to determine that the ratable benefit that every lender in the first-lien class was entitled to is $0.389 per dollar of their principal holdings.[28] Since the Participating Lenders received $0.74 per dollar (i.e. an amount above the calculated ratable benefit), the Participating Lenders were required to pay the difference of $734 million *minus* $386 million (i.e. the amount the Participating Lenders should have received for their ~$992 million holdings at $0.389 per dollar), which equals ~$348 million of excess payments received. [29]

The court then adopted the plaintiffs' "but-for world versus actual world" methodology, using the $0.25 market price for first lien term loans as of the closing date of the 2020 Transaction.[30] In the "but-for world," the plaintiffs would have received $348 million in cash (their pro rata share of the $734 million benefit) and retained $547 million first lien term loans (valued at $0.25, or $137 million), for a total value of $485 million.[31] In the "actual world," the plaintiffs retained all $895 million of their first lien term loans at $0.25, worth $224 million.[32] The difference, $261 million, is the damages figure the court arrived at.[33] The court then further found that the plaintiffs were entitled to pre-judgement interest under New York law beginning on the closing date of the 2020 Transaction.[34]

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[25] It is worth noting that the Excluded Lenders' claim for breach of contract was permitted on remand because the Fifth Circuit had held that the Participating Lenders' indemnification claims were properly disallowed under 11 U.S.C. § 502(e)(1)(B) as contingent claims for reimbursement by co-liable parties, and that the attempt to resurrect that indemnity through a 11 U.S.C. § 1123(b)(3)(A) "settlement" in the plan for Chapter 11 reorganization was an impermissible end-run around the Bankruptcy Code's disallowance provision. *In re Serta Simmons Bedding, LLC*, No. 23-20181 (5th Cir. Dec. 31, 2024).
[26] *Serta*, ECF No. 742, at 38.
[27] *Id.* at 37.
[28] *Id.* at 43.
[29] *Id.*
[30] *Id.* at 43–44.
[31] *Id.* at 43.
[32] *Id.*
[33] *Id* at 42.
[34] *Id* at 46-47.

TAKEAWAYS

Amidst a convoluted backdrop of jurisprudence, the latest from *Serta* will not decisively alter parties' behavior in pursuing sponsor-backed liability management transactions, but it will give them additional factors to weigh when structuring contentious transactions. Parties will likely now give greater attention to (i) whether pro rata sharing provisions are explicitly limited to cash transactions, (ii) whether a transaction requires an amendment to an existing carveout to a sacred right, considering Judge Lopez's dicta that amendments cannot render sacred rights illusory and (iii) the magnitude of potential damages should the court later find the lenders breached the credit agreement to implement the liability management transaction.

This latest decision will undoubtedly result in more precise wording of pro rata sharing provisions and related sacred rights. Parties should be mindful to specify whether "payments" and pro rata sharing provisions are meant to refer only to cash transactions or if they should also include cashless transactions such as refinancings, extensions, and assignments.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to email authors: Joel Moss (partner) at JMoss@cahill.com; Jordan Wishnew (partner) at JWishnew@cahill.com; Jenny Warshafsky (counsel) at JWarshafsky@cahill.com; Lacey Nemergut (counsel) at LNemergut@cahill.com; Matt Catone (associate) at MCatone@cahill.com; and Tanner Bowen (associate) at TBowen@cahill.com.