FEATURE STORY

The Saga of Serta:

The Next Chapter—Subordination of "Non-Participating" Lenders Upheld by Bankruptcy Court

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"Liability Management Transactions" continue to grab headlines. Companies in distress are turning to the out-of-court restructuring of their debt in ways that leave lenders who made loans on the basis of a senior secured position either with certain assets no longer available as collateral pursuant to a "drop down financing" or subordinate to new tranches of debt pursuant to an "uptiering transaction." This article takes a look at the arguments being made in some of the litigation that has often followed on such uptiering transactions and in particular the June 2023 decision of the Bankruptcy Court in the Serta case.

Although there were some earlier cases, "liability management exercises" surfaced in a conspicuously notorious way with the headlines of 2017 on the "drop down financings" in J. Crew, Chewy and Neiman Marcus. In 2020, the earlier wave of "drop down financings" were joined by Travelport, Revlon and Cirque de Soleil along with another category of liability management exercises now known as "uptiering" in the cases of Serta, Trimark and Boardriders. With each year since, more cases have surfaced continuing to confound the expectations of lenders who thought the loans owing to them held a first priority position in the borrower's capital structure.

Just as J. Crew has become the watchword for "drop down financings," so the Serta case has become the catch phrase for "uptiering." Given its prominence, the decision by the Bankruptcy Court in the Southern District of Texas in connection with the exit of Serta from Chapter 11 in June of 2023 takes on even greater significance.

The consistent theme in all of these cases is the use by distressed borrowers of interpretations of credit agreement terms to engage in out-of-court restructurings of their debt that results in lenders who made loans with the understanding that they had a senior position on the borrower's assets either

- ending up without critical assets as collateral that were the basis for the financing in the case of the "drop down" exercise, or
- only with recourse to such assets on a subordinate basis in the case of the "uptiering" exercise.

In each of these cases, the fundamental expectation of senior secured lenders is defeated by specific interpretations of credit agreement terms that the borrowers, and certain of the original lenders, assert permit the debt restructuring without the consent of the lenders adversely affected and all outside of a bankruptcy case.

The Fitch Ratings Study of the Effect of Liability Management Exercises: Do They Really Work for the Distressed Borrower or Just Make the Lenders Worse Off?

There is significant irony in the use of these "exercises" by companies in financial distress as captured by a 2023 study by Fitch Ratings. As reported by Fitch, most liability management transactions only delayed default, rather than avoided it and at the same time resulted in significantly less recovery for those lenders that did not have the opportunity to participate in the new financings that are part of the drop down financing or uptiering.

Fitch examined 29 companies that had engaged in 30 liability management transactions that were publicly disclosed (Revlon engaged in two) between 2014 and February of 2023 and found that seventeen of the transactions were deemed distressed debt exchanges and treated as a default by at least one of the three major rating agencies and of the remaining thirteen that did not constitute a default on the basis of being a distressed debt exchange at the time of the announcement, seven companies subsequently filed for Chapter 11 or engaged in distressed debt exchanges deemed a default by the rating agencies or both.

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The LSTA Issues (and Re-Issues) its Market Advisory on Liability Management Exercises

A lot has happened in this area since 2020 as cases have progressed, including the issuance by the Loan Syndications and Trading Association (LSTA) of a market advisory on "Liability Management Transactions: Drafting Fixes" on March 29, 2021, which the LSTA then reissued and updated on July 24, 2023, as such transactions continue to defeat the expectations of lenders as to their senior secured position on the assets of a borrower.

Implicit in the LSTA's market advisories, and the need for them, is the recognition that the leveraged loan market, in general, is to be a "senior" secured debt product. If the holder of debt can be subordinated or lose critical collateral, then the foundation on which the lender's expectations of recovery that is the basis for the making of the loan or the purchase of the debt is adversely affected and the additional risks of the loss of priority pursuant to such transactions needs to be considered in the making or purchase of a loan.

While the asset-based lending market may be generally immune from some actions, with the approach of borrowers in the interpretation of credit agreement terms, nothing can be taken for granted.

The Lead-Up to the Serta Bankruptcy Court Decision

The Other Cases to Note

Before we get to the Bankruptcy Court decision in the Serta Chapter 11 case in June, there are four other cases that bear mentioning. In each of them the courts addressed some of the same issues. The cases are:

- the "Trimark case" in New York State Supreme Court--Audax Credit Opportunities Offshore Ltd. v TMK Hawk Parent, Corp., No. 565123/2020 (JMC), 150 N.Y.S.3d 894 (Sup. Ct. N.Y. Cty. Aug. 19, 2021),
- the "Serta Southern District case" in the U.S. District Court for the Southern District of New York --LCM XXII Ltd. v. Serta

Simmons Bedding, LLC, No. 21-CV-3987, 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022),

- the "TPC case" in the United States Bankruptcy Court for the District of Delaware --Bayside Capital Inc. v. TPC Group Inc, No. 22-5072 (CTG) (Bankr. D. Del. July 6, 2022, and
- the "Boardriders case" also in New York State Supreme Court--ICG Global Loan Fund 1 DAC v. Boardriders Inc., Index No. 655175/202, 2022 WL 10085886 (Sup. Ct. N.Y. Cnty. October 17, 2022).

While a detailed analysis of these cases is for another time, as in the Serta bankruptcy case, each of the cases involves an "uptiering" transaction. In each case, the group of lenders that were excluded from participating in the newly created classes of priming senior debt (the "non-participating lenders") started an action against the borrower and those lenders that acquired the priming senior debt (the "participating lenders").

When the participating lenders made motions to dismiss the cases brought against them by the non-participating lenders in the New York State courts in Trimark and Boardriders, both New York State courts did not grant the motions to dismiss. Similarly, the Federal court in the Southern District of New York did not dismiss the non-participating lenders' case in the Serta action in response to the motion to dismiss by the participating lenders in that case. In doing so, the courts found that contrary to the arguments of the participating lenders, the relevant provisions of the credit documents could be interpreted in a way that required the company to get the consent of the non-participating lenders to being primed. So, the decisions were not on the merits, but still helpful to the non-participating lenders. The Trimark litigation was ultimately settled and the Boardriders decision is stayed on appeal in New York State court, so we may not get further insights on the issues from these cases. Meanwhile, the Serta case in the Southern District of New York was taken over by the Bankruptcy Court with the results described below.

Similarly, the Federal court in the Southern District of New York did not dismiss the non-participating lenders' case in the Serta action in response to the motion to dismiss by the participating lenders in that case.

The TPC case was decided in the Bankruptcy Court in Delaware. Unlike either the Trimark case or the Boardriders case (as well as the Serta decision by the Southern District of New York), the Bankruptcy Court in granting a motion for summary judgment in favor of the company and participating lenders found, among other things, that the consent of the non-participating lenders to being subordinated was not required under the applicable agreement. In so finding, the Bankruptcy Court relied on the absence of an express "anti-subordination" provision in the credit document which would have said that the consent of a lender to being subordinated was required, together with some other conclusions based on unique features of the indenture that governed the notes at issue in the case.

The similar results in the two State court cases (and the Federal court case in Serta) and the similar results in the two Bankruptcy Court cases may be somewhat attributable to the different places procedurally in which the decisions occurred (a motion to dismiss versus a judgment on the merits), as well as the predisposition of Bankruptcy Courts to support and facilitate the reorganization of the Chapter 11 debtor.

Pro Rata Sharing

Most credit agreements include a provision that payments to the lenders under a credit agreement are to be shared "pro rata" among the lenders, with each lender's pro rata share determined based on the amount of its commitment relative to the commitments of all lenders in the facility. There are some variations and twists in this basic concept, when there may be other tranches of debt included in the same credit agreement—like a first-in-last-out tranche or "FILO", which as the name suggests means payments are only applied to debt in that tranche after payments on the other tranches.

The general rule in most credit agreements is that an amendment requires the approval of the holders of commitments equal to more than 50% of the total commitments. However, there are usually a series of exceptions to the general rule. Some terms of the credit facility are so significant that to amend those terms requires the approval of all lenders or at least each lender adversely affected by an amendment to such provision. When an

amendment to a provision requires the approval of all lenders or all lenders adversely affected by the amendment, it is now commonly referred to as a “sacred right.”

Needless to say, the right to be paid at a certain level of priority among the debt that may be subject to a credit agreement is critical to a lender. The lender determines to make a loan on the basis of the priority of its place in the company’s capital structure. That place determines the risk of repayment. Consequently, most credit agreements provide that any amendment to the credit agreement that would change the right of a lender to receive payments pro rata with other debt subject to the same credit agreement requires the approval of each lender that would be adversely affected by such an amendment. Any amendment that reduces the amount of a payment that such lender receives relative to other lenders requires its approval--whether payments made by the borrower or payments from the proceeds of collateral. The requirement that a lender approve a change to its right to a pro rata share of a payment therefore is one of the “sacred rights” of a lender.

So, for example, if a lender has provided a commitment of $25 million as part of a $100 million credit facility, for every dollar of payments, the lender would expect to receive 25%. If the credit agreement is amended to create a new “class” of loans, and those loans are to be repaid before the lender’s original $25 million, then if a payment comes in, instead of receiving 25% of such payment, the lender will receive nothing (0%), at least until the new class of loans are repaid. The lender will not receive its pro rata share of such payment as it had expected. Consequently, it is adversely affected and its risk increased from its original bargain.

One of the key issues that is litigated in the “uptiering” cases is whether an amendment that creates a new “class” of debt that is entitled to be paid before the existing debt is a change to the provision that requires the pro rata sharing of payments and therefore requires the approval of each lender adversely affected by such change.

Each of these cases starts out with a group of lenders, all with the same level of priority in right of payment, each entitled to its pro rata share of payments based on the amount of its commitment.

Then, a borrower confronted with financial struggles looks for ways to avoid bankruptcy and perhaps even liquidation, by generating more liquidity. Putting aside the question as to whether a company in such distress should in fact use the bankruptcy court for its intended purpose to restructure its debt or liquidate as may be most appropriate given its circumstances, the company seeks out additional loans to address its needs for more cash to continue to operate. In seeking additional funds, the distressed borrowers find that lenders are more likely to provide additional loans if given a right to payment ahead of the existing debt owing by the company—which leads to the creation of the new class of priming debt.

To achieve this goal, the company looks at the existing credit agreement to see what additional debt it is permitted to incur and with what priority. Since such amounts are usually insufficient or do not address the issue of priority, the company seeks out lenders willing to approve amending the credit agreement to allow new debt with a higher priority than the existing debt.

The participating lenders in the super-priority debt argue that such amendments only require 50.1% because the amendments do not affect the requirement that payments be shared pro rata among the lenders. The argument is that such requirement only applies to payments among the same class of debt and by creating a new class of super senior debt, the amendment does not impact the sharing among the same class.

The participating lenders also argue that the section of the credit agreement that provides for pro rata sharing is not changed, so there is, in fact, no amendment that requires any approval. And when the subordination of the non-participating lenders occurs as a result of a new tranche of “super-priority” debt subject to a new separate credit agreement, there in fact is no change to the pro rata sharing provision in the original credit agreement. In such circumstances, there may be an amendment to authorize the new intercreditor agreement between the lenders under the existing credit facility and the lenders under the new super-priority debt—but not necessarily any amendment to any provisions of the credit agreement relating to the priority of application of payments.

The non-participating lenders say that before the amendments they would have received a pro rata share of the payment. After the amendments, they don’t. Therefore, it is an amendment to the pro rata sharing of payments. The New York Supreme Court in Boardriders expressly concluded that a sacred right requiring approval by a lender to being subordinated could be implicit in the pro rata sharing provisions.

While the New York State courts in both Trimark and Boardriders accepted the possibility of the non-participating lenders’ interpretation and so would not dismiss the litigation, the Bankruptcy Court in TPC granted summary judgment in favor of the company and participating lenders on the basis, among other things, that the pro rata sharing provision would more naturally apply to distributions within a class and not prohibit subordination of an entire class to another. The absence of an express reference to subordination requiring each lender’s consent was significant in the TPC decision.

Open Market Purchases

In some of these cases the credit agreement includes an exception to the requirement that an amendment to the pro rata sharing provision requires the approval of each lender affected by the amendment. The credit agreements say that a lender may assign all of its rights and obligations in respect

of its loans "on a non-pro rata basis" through "open market purchases." And the amendment provisions say that each lender's consent to a change to the pro rata sharing provision is required, except in the case of an assignment transaction in an "open market purchase."

So, the issue becomes whether this "open market purchase" exception to the general rule requiring all lender approval for an amendment to the pro rata sharing provision is applicable to the uptiering transaction. Is the "uptiering" an open market purchase? Since the term "open market purchases" is not defined, not surprisingly, the participating lenders and the non-participating lenders offer different interpretations.

The position of the participating lenders in the cases is that this exchange is an "open market purchase." The participating lenders assert that the term refers to a situation where the borrower or its affiliates and the lenders are the buyer and seller and leads to a price that a willing buyer and a willing seller may obtain in a privately negotiated arm's-length negotiation.

In uptiering transactions, besides making new money loans that prime the existing loans of the non-participating lenders, there is also usually an "exchange" of the existing debt held by the participating lenders for a new class of higher priority debt (although interestingly this was not one of the features of the uptiering in the TPC case). In this exchange, the participating lender assigns its original debt back to the borrower and in exchange gets debt with a higher priority in right of payment.

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The non-participating lenders say that an "open market purchase" requires an "open" market in which any buyer or seller may trade (including all of the lenders, not just a few selected by the borrower to be the participating lenders) and in which prices and product availability are determined by free competition and that a typical open-market purchase is one accomplished through a broker or agent and requiring the purchaser to pay a set market price.

In the Boardriders case, the New York Supreme Court was unwilling to accept the position of the company and the participating lenders. The court particularly pointed to the non-participating lenders' arguments that the transactions were not open market purchases because: it was not available to all buyers and sellers in the marketplace; free competition did not determine the market price; no third-party advisor or broker was hired to canvass the market; and the company did not purchase the loans at market value but exchanged the loans at par value despite trading value at 40-50% discount to par.

In the Serta Southern District case, the court also said that it could not agree that the participating lender's interpretation of the term "open market purchases" was the only interpretation, noting that the transaction did not take place in what is conventionally understood as an "open market."

Breach of Implied Covenant of Good Faith and Fair Dealing

All contracts, at least under New York law, include an implied covenant of good faith and fair dealing in the course of contract performance. It does not have to be written in the contract, including, in this, case a credit agreement, but is imputed into the terms of the contract by operation of law. Given the impact of the amendments in each of these cases on the position of the non-participating lenders, the causes of action brought by the non-participating lenders against the company and the participating lender usually include a claim for the breach of this implied covenant.

One of the ways that a claim for a breach of this implied covenant works is that it cannot be duplicative of a breach of contract claim. In the Trimark case, the Court concluded that was, in fact, the case, and so granted the motion of the participating lenders to dismiss that claim against the company and participating lenders.

By contrast, the Boardriders decision found that the

allegations that the participating lenders worked in concert and in secret to deprive the non-participating lenders of the benefit of their bargain, i.e. pro rata distribution of loan repayments, could constitute bad faith and therefore the court did not grant the motion of the participating lenders to dismiss this cause of action finding that the claim based on the breach of the implied covenant of good faith and fair dealing was not exactly duplicative of the breach of contract claim.

In the Serta Southern District case, the Court allowed the participating lenders' claim for breach of the implied covenant of good faith to proceed as an alternative theory of recovery to their breach of contract claim. The Court said that the pursuit of the claim of breach of the implied covenant of good faith was contingent on the Court's determination the uptiering transaction and amendments to the credit agreements did not violate the express terms of the agreements. And more substantively noted that the participating lenders bargained for first lien priority, pro rata rights, which rights were subverted by the participating lenders creation of a new tranche of debt with priority rights senior to those of the non-participating lenders.

Other Arguments

The participating lenders make other arguments some to support their claims and others to respond to arguments from the company and the participating lenders.

For example, there are claims by the non-participating lenders for tortious interference with contracts against Oaktree, the sponsor in Boardriders, or against Centerbridge and Blackstone, the sponsors in Trimark, for orchestrating the uptiering transactions.

There is also the claim that the effect of the subordination of the debt of the non-participating lenders violates the "waterfall" provision in the credit agreement and effectively is an amendment to release all or substantially all of the collateral, which constitutes another category of "sacred right" requiring the approval of each lender. The reasoning is that since there will be no collateral left over for the non-participating lenders after it is applied to pay the new super-priority debt, the amendments to allow the new super-priority debt should be treated as a release of all of the collateral.

The decisions do not seem particularly receptive to either of these arguments. In the case of the argument that the subordination is a release of collateral, there in fact is no release of collateral, so the non-participating lenders are straying very far from the terms of the agreement.

On the other side, the participating lenders argue that the non-participating lenders are not entitled to bring the claims in the first place because as part of the uptiering transactions the credit agreement is amended to expand the typical "no action" provision. Most credit agreements limit the ability of an individual lender to exercise remedies against the borrower or the collateral independently of the agent or the approval of a majority of the lenders. But such provisions do not limit claims against other lenders. In anticipation of the litigation that will likely ensue, in an uptiering transaction the credit agreement is amended to expand the limitations on the ability of a lender to take action against the borrower or collateral so as to also prohibit a lender from bringing claims against the agent or another lender or at least adds other requirements to any action by an individual lender against the agent or any other lender so as to make those more difficult to bring.

Serta Case Recap

On November 8, 2016, Serta entered into three credit facilities:

- a $1.95 billion first lien term loan credit agreement,
- a $450 million second lien term loan credit agreement, and
- a $225 million asset-based revolving credit facility.

In 2020, Serta's business, which had already been struggling as a result of online and foreign competitors, was further impacted by mandated closures of over half of its manufacturing facilities as a result of the government's response to COVID-19, leading it to look at refinancing alternatives. The company engaged Evercore who contacted eleven different lending groups regarding financing opportunities. One group of lenders, led by Apollo, Angelo Gordon and Gamut Capital, offered the sponsor, Advent, new debt secured by the intellectual property, in a "drop down financing" not unlike J. Crew and Travelport.

However, after some negotiations with different groups, on June 8, 2020, Serta announced in a press release that it had entered into a transaction support agreement with the holders of the majority of its first lien and second lien term loans (the "participating lenders") to recapitalize the company—not Apollo and the others who had proposed the loan based on the intellectual property (the "non-participating lenders"). According to the press release, the transaction was expected to reduce net debt by approximately $400 million, and provide for $200 million in new capital.

The company opted for an "uptiering" transaction rather than a "drop down financing". To do so, the term loan documents were amended to permit the following:

- $200 million of newly funded super-priority "first out" debt ranking ahead of the existing first lien term loans (the "priority term loan").
- $875 million of super-priority "second out" debt ranking ahead of the existing first lien term loans in exchange for certain existing first lien term loans and existing second lien term loans.

This left approximately $862 million of the existing first lien and second lien debt from the term loans of the non-participating lenders.

Three days after the uptiering transaction was announced,

on June 11, 2020, Apollo, Angelo Gordon and Gamut, as the non-participating lenders, initiated an action in the Supreme Court of New York for a preliminary injunction and temporary restraining order to prevent the recapitalization. See N. Star Debt Holdings L.P. v. Serta Simmons Bedding LLC, No. 652243/2020, 2020 WL3411267 (N.Y. Sup. Ct. June 19, 2020). These term lenders held approximately 30% of the existing first lien term loans which would be subordinated under the refinancing, while the lenders that had entered into the transaction support agreement for the recapitalization held more than 50.1%.

In addition, the collateral agent for the first lien term loan lenders sought to intervene in the North Star action on behalf of the non-participating lenders and separately filed its own action in New York state court challenging the transaction.

In a decision on June 19, 2020, the judge presiding over the North Star action denied the non-participating lenders' request for a preliminary injunction and allowed the transaction to close.

On July 2, 2020, the non-participating lenders brought suit in Federal court in the Southern District of New York asserting claims against the company and a number of the participating lenders. See LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 20 Civ. 5090 (GBD), 2021 WL 918705 (S.D.N.Y. Mar. 10, 2021). This action was dismissed by an order dated March 10, 2021, due to a lack of subject matter jurisdiction, because the parties were not completely diverse.

Then, on May 4, 2021, the non-participating lenders (or "plaintiff "lenders) commenced an action in the Federal court in the Southern District of New York against Serta. In response, the participating lenders (or "defendant" lenders) filed a motion to dismiss the action.

In a decision on March 29, 2022, the court in the case in the Southern District of New York declined to dismiss the action—in the same way that the courts in Trimark and Boardriders did not grant the motions to dismiss the actions by the non-participating lenders against the borrower and participating lenders in the face of similar arguments. LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 21 CIV. 3987 (KPF), 2022 WL 953109 (S.D.N.Y. Mar. 29, 2022).

In addition, the collateral agent for the first lien term loan lenders sought to intervene in the North Star action on behalf of the non-participating lenders and separately filed its own action in New York state court challenging the transaction.

The Main Event—Serta in Chapter 11

With that long wind-up, we come to the commencement by Serta of a Chapter 11 case in the Southern District of Texas.

On January 23, 2023, Serta filed for Chapter 11 in the Southern District of Texas referring not only to its financial difficulties but the impact of the pending litigation concerning the 2020 uptiering transaction on its strategic position as the basis for the filing. The Bankruptcy Court determined that the disputes subject to the litigation in New York (which were still ongoing since the participating lenders' motion to dismiss the litigation was not granted as noted above) were better determined in Serta's bankruptcy case and therefore the litigation in the Southern District of New York were stayed.

On January 24, 2023, Serta commenced an action in the Bankruptcy Court seeking a determination that the 2020 uptiering transaction was permitted under the 2016 credit agreements and the participating lenders did not violate the implied covenant of good faith and fair dealing under the 2016 credit agreements by entering into the uptiering transaction (referred to in the Chapter 11 case as the "Adversary Proceeding"). The non-participating lenders responded on February 23, 2023 and on February 24, 2023, the company filed a motion for summary judgment and on February 24, 2023, the non-participating lenders filed their own motion for summary judgment.

On March 28, 2023, the Bankruptcy Court conducted a hearing on the summary judgment motions. At the conclusion of the hearing, the Bankruptcy Court granted partial summary judgment in favor of the participating lenders.

The Bankruptcy Court found that the change to the priority of the original term loans from 2016 to subordinate them to the new tranches did not require the consent of the non-participating lenders. The 2016 Serta credit agreement required the consent of each lender in the case of any change to the pro rata sharing provision, except in the case of an "open market purchase" which was permitted under Section 9.05(g) of the credit agreement. In the view of the

Serta Bankruptcy Court, the term “open market purchase” in Section 9.05(g) of the 2016 credit agreement was “clear and unambiguous” and the 2020 transactions constituted an “open market purchase.” Therefore, the exception to the rule requiring each lender to approve a change to the pro rata sharing provision of the 2016 credit agreement did not apply, since an “open market purchase” was excluded from such requirement. The summary judgment order is currently on appeal with the Fifth Circuit.

On May 15, 2023, the Bankruptcy Court started a trial to consider confirmation of the company’s plan of reorganization and to resolve the remaining claims in the “Adversary Proceeding”. After addressing the objections to the plan of reorganization and confirming the plan subject to a stay of seven days to allow parties to appeal the decision, the Bankruptcy Court turned to the matters in the Adversary Proceeding.

The principal remaining claim of the non-participating lenders was that the subordination of their liens constituted a breach of the implied covenant of good faith and fair dealing. The Bankruptcy Court concluded based on the evidence at trial that the parties “were keenly aware that the 2016 Credit Agreement was a “loose document” and understood the implications of that looseness.” The Bankruptcy Court found that the non-participating lenders who had offered a drop down financing that the company did not accept, were trying to do to the other lenders what was done to them. The Bankruptcy Court found that rather than a defensive measure to avoid being subordinated, this was evidence that the non-participating lenders knew that the documents were intended to allow priming debt and therefore could not argue that they were unfairly deprived of the benefit of their bargain. The Court in fact turned the reasoning around, saying that it was the non-participating lenders, rather than the participating lenders, who did not act in good faith.

In its decision the Bankruptcy Court said: “The parties could have easily avoided this entire situation with the addition of a sentence or two to the 2016 Credit Agreement. They did not. And this litigation ends with each party receiving the bargain they struck—not the one they hoped to get.”

And with that, pending any decisions from the Fifth Circuit based on the appeals, is where matters stand in the Serta case.

Conclusion

In considering all of the above, a few key conclusions seem to surface:

- No matter how obvious it may be to a lender making loans based on an understanding that it will be in a “senior” secured position as to the assets of the borrower, lenders cannot count on the courts to interpret credit agreement terms in a way that appreciates how significant this expectation is for such lender.
- These cases raise the question of why companies are not turning to the Bankruptcy Court for its intended purpose, which is to provide a forum and a set of rules for the negotiation of the rights of borrowers and lenders designed to maximize fairness and balance the interests of the parties in the restructuring of debt, but instead are engaged in the same exercise but outside the haven of such forum.
- These transactions and the cases that they spawn are a symptom of a larger issue in the terms of credit documents. It may be characterized as a function of “unintended consequences,” but certainly the repeated references in the Serta decision by the Bankruptcy Judge to the “looseness” of the documents dramatically underscores the need for lenders to very carefully and thoughtfully consider the nature of the flexibility that the documents provide to the borrowers. Borrowers need the ability to run their businesses and make important business decisions, but the basis on which the lenders are making their loans and taking risk needs to be specifically addressed in allowing transactions and amendments to the documents.

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