Simpson Thacher

Simpson Thacher's Liability Management *Expresso*

A "quick taste" of the latest trends from the world of creative leveraged finance transactions

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Welcome to the next edition of *Simpson Thacher's Liability Management Expresso*, which offers a concise yet substantial look at emerging trends, financing strategies, and tactical innovations in the liability management arena. As the landscape of creative capital solutions continues to evolve, this bulletin returns with fresh insights and analysis on the latest market developments shaping strategies in the U.S., Europe and beyond. Whether you are actively navigating these transactions or simply seeking to stay informed, our Liability Management and Special Situations Team is committed to keeping you current and prepared.

In This Edition

Serta Blockers: How Can They Impact DIP Financing?

Remind me, what is a Serta blocker?

As many of you know, or in case you forgot, in its simplest form, a Serta blocker requires a 100% lender vote on amendments or waivers that would subordinate their loans or payment priority. According to Covenant Review, a majority of loans in the JPMorgan Leverage Loan index now include some form of Serta protection.

There are a few forms of these blockers that provide varying levels of protection for minority lenders. The strictest version makes any subordination a 100% lender vote—no exceptions. Looser forms permit subordination with a "Required Lender" (usually defined as a majority in amount) vote, but only if all lenders are offered a chance to ratably participate in the transaction (though arrangement or backstop fees may be excepted).

What is DIP financing and why is it so important?

Debtor-in-possession ("DIP") financing is provided to a debtor in a chapter 11 case to fund operations and the administrative expenses of the case (which can be substantial). DIP financing is very important to the recovery of prepetition lenders. The DIP lenders can dictate the milestones and structure of the case through covenants, and often the DIP converts into exit financing and/or equity of the reorganized company on very favorable terms.

DIP financing almost always primes existing debt on both a lien and payment priority basis. To do so, the debtor must either have consent to the priming from the holder(s) of the prepetition lien or have the bankruptcy court approve a non-consensual priming, which is never easy and something debtors try to avoid.

Do Serta blockers prevent lenders from providing or consenting to priming DIPs without 100% lender support?

In the absence of a Serta blocker, the collateral agent (who technically holds the lien in favor of all lenders) would give its consent to a priming DIP financing if directed to do so by the Required Lenders. The Required Lenders will give this consent if the existing lenders, or a subgroup of them, are providing the DIP financing.

With the rise of Serta blockers, however, it has become a little more complicated. A strict blocker *could* require 100% lender consent, depending on the specific language. In a large syndicate, achieving that level of consensus can be hard, if not impossible, so many, but not all, blockers expressly carve DIP financings out from the Serta protections, thereby putting it back to a Required Lender vote. These carve-outs may have certain restrictions and parameters, for example a cap on the amount of DIP financing.

So, if there is no DIP carve-out, does that mean lenders necessarily need 100% support to consent to a priming DIP facility?

Not necessarily.

For one, many Serta blockers have an exception for priming facilities offered to all lenders ratably. So, as long as all lenders are given the opportunity to participate in the DIP, the Required Lenders can provide the necessary consent. In many cases, the ad hoc group of lenders that are proposing the DIP financing are more than happy to open up the DIP to all of their fellow lenders, particularly if the members of the ad hoc group do not have to share their backstop or arrangement fees.

> [...] consenting to a priming DIP financing may not trigger a Serta vote at all.

Second, consenting to a priming DIP financing may not trigger a Serta vote at all. Recall that a typical Serta blocker is a "sacred right" exception to the general rule that *amendments or waivers* to the credit documents only need a Required Lender vote. But does a consent to priming in a chapter 11 case require an *amendment or waiver* to the credit document? That's debatable, although it is worth noting that some amendment sections also cover any *consents* under the credit document. In that case, there is a stronger argument that the Serta blocker applies.

Finally, even if the Serta blocker applies and requires a 100% vote, a debtor can always propose a non-consensual priming DIP. The Serta protection does not limit what a chapter 11 debtor can do in bankruptcy, and a bankruptcy court might be more lenient in approving a non-consensual priming DIP that has overwhelming but not unanimous support of the lenders, particularly if the alternative is to leave the debtor with no viable financing.

What about DIP "roll-ups"?

For the uninitiated, a "roll-up" is when existing lenders that provide DIP financing convert (or "roll") or are deemed to convert all or a portion of their pre-bankruptcy debt into loans under the DIP. This has the effect of giving such prepetition debt "superpriority" and priming lien status and the benefit of enhanced treatment in chapter 11, where DIPs must be paid in full, in cash under a plan, unless they agree to alternate treatment.

But how does that relate to Serta blockers?

Well, in a recent case, *American Tire Distributors*, a priming DIP financing with a roll-up feature was proposed by an ad hoc group representing about 90% of the lenders; the remaining lenders were not invited to participate. The Serta blocker included a DIP carve-out, such that minority lenders' consent was not needed in order to permit a priming lien. However, the minority lender group challenged the roll-up, arguing that the ad hoc group lenders were breaching the credit agreement because the roll-up constituted a non-pro rata payment and therefore should not be approved unless it was open to all lenders.

The bankruptcy judge—Judge Goldblatt of Delaware—implied from the bench that he agreed with the minority lenders. And while he would nonetheless approve the DIP, he made it clear that the minority lenders' right to sue the ad hoc lenders would not be prejudiced by the DIP. As a result, and rather than invite the minority group into the DIP, the contested DIP roll-up was removed, and the resulting DIP package approved by the court (although it seems that the excluded lenders would have preferred to be rolled-up themselves).

American Tire is a good lesson that even if the Serta blocker has a DIP carve-out, a DIP financing may nonetheless implicate another sacred right if it includes a non-pro-rata roll-up.

Restructuring Tales Inked Beyond the Chapter (11)

The Supreme Court's decision in *Purdue* has received a lot of attention. Has chapter 11 practice changed since that decision?

The Supreme Court's decision in *Purdue* gave the global restructuring market pause for thought in situations where non-consensual third-party releases are an important part of the restructuring solution.

> [...] choice of forum, alongside careful structuring of the releases, is front of mind post-*Purdue*.

Post-*Purdue*, different U.S. Bankruptcy Courts, noticeably in Delaware, Texas, New York and New Jersey, have come to different conclusions as to what is and what is not a permitted release under chapter 11. As a result, choice of forum, alongside careful structuring of the releases, is front of mind post-*Purdue*.

Has the resulting patchwork approach of different U.S. Bankruptcy Courts led to debtors looking to other forums to restructure?

There's no doubt that chapter 11 remains a versatile and effective tool for many debtors with a connection to the United States. But, alternative and viable restructuring options are available for international groups with a U.S. nexus. The debate triggered by *Purdue* is an opportunity for the U.S. market to reflect on how debtors and their supportive stakeholders can consider all of their options when pursuing a restructuring solution. Their options analysis can include the possibility of going outside the U.S. for a restructuring process, with the solution then imported into the U.S. (typically, via chapter 15).

What types of restructuring procedures outside the U.S. are you talking about?

Put simply, there are a variety of options. Whether they are available or appropriate will depend on the circumstances of a particular debtor's situation. Some jurisdictions have mature and precise surgical tools that have been used for decades to restructure complex capital structures of international debtor groups. An example is the UK scheme of arrangement. Staying in the region, both the UK and Europe have recently adopted restructuring procedures that include a mechanism for binding in entire dissenting stakeholder classes—similar to the cross-class cramdown power in chapter 11. Beyond Europe, many other jurisdictions (Hong Kong, Singapore, Cayman, to name a few) have their own tools to execute large cross-border restructuring transactions, which can be used in conjunction with and parallel to other global restructuring processes to achieve robust cross-border implementation of a restructuring solution.

Are there any examples of groups with a strong U.S. nexus managing their liabilities in a formal process outside of chapter 11?

Yes, and this practice pre-dates the recent market noise caused by *Purdue*.

In 2019, Simpson Thacher acted for the sponsors of *syncreon*, the Michigan-HQ'd specialist logistics supply chain solutions group, in what was reported as perhaps the first-ever use of a UK scheme of arrangement to restructure debt issued by a U.S.-based global group.

More recently:

- *Light SA*, a Brazilian power company, faced default on $600 million of New York law bonds. While Light underwent a domestic solution—a Brazilian judicial restructuring (or *recuperação judicial*)—there were concerns around the international effectiveness of that domestic plan. Rather than file for chapter 11, Light changed the governing law of the bonds to English law and proposed an English scheme of arrangement. The solution was then imported into the U.S. via chapter 15 recognition.

- *Grupo Financiero Mega*, a Mexican financial services group with no prior connection to the UK, incorporated a new English subsidiary that assumed liabilities under the group's New York law notes. The group then proposed an English scheme of arrangement to compromise those notes, with the restructuring imported into the U.S. via chapter 15 recognition.

- *Crédito Real*, one of the largest non-bank lending institutions in Mexico, negotiated a solution that is effective in the U.S.—despite that solution having broad non-consensual third-party releases. The debtor filed for a Mexican restructuring procedure (a *concurso mercantil*). The resulting creditor and court approved plan contained broadly drafted releases granted in favor of third parties (including the debtor's shareholders, directors and officers). That plan, including the broad non-consensual third-party releases, was then imported into the U.S. via chapter 15 recognition. The U.S. International Development Finance Corporation objected, on the basis that the releases were precisely the type of provision that the Supreme Court held in *Purdue* are not available in chapter 11. In granting chapter 15 recognition, the U.S. Bankruptcy Court for the District of Delaware held that the *Purdue* issue does not extend to chapter 15 recognition.

So, overseas restructuring procedures are a viable option for debtors?

Yes. Good forum shopping—choosing the court and process for a debtor's restructuring for good commercial reason—has been, and remains, an important tool in any debtor's cross-border restructuring armory.

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* *In April 2025, Simpson Thacher announced plans to expand its Bay Area presence with an office in San Francisco.*