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The Insolvency Insider: Updates in Restructuring

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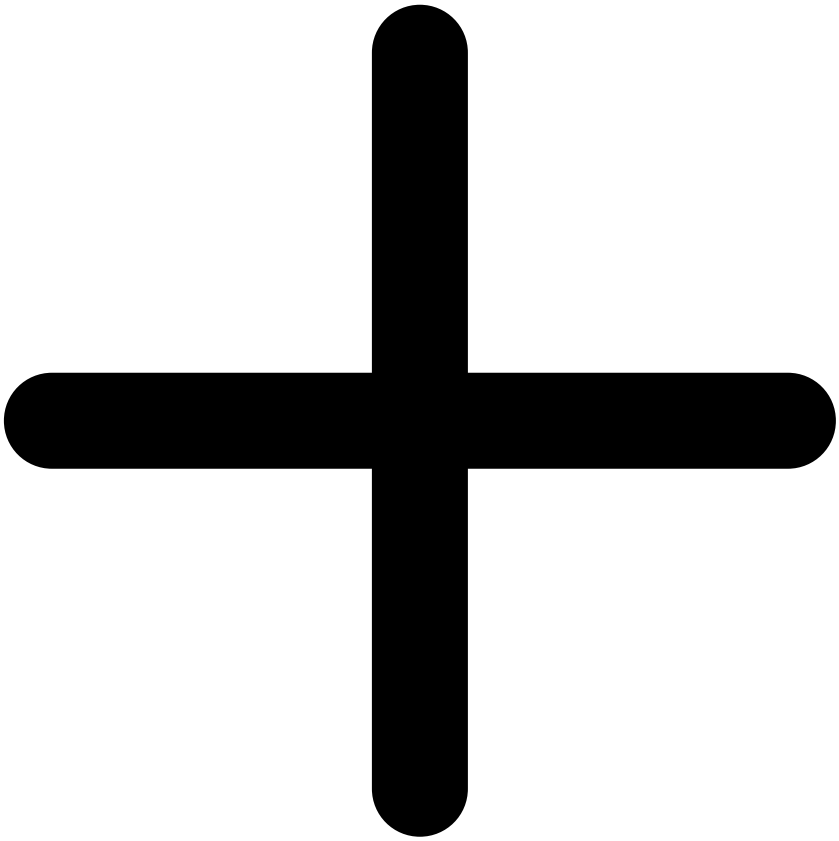
Early summer 2026 has produced several notable rulings from bankruptcy courts on the consequences of improper liability management transactions, committee-proposed liquidating plans, and the boundary between estate-owned and creditor-owned claims, along with a Supreme Court ruling addressing judicial estoppel. These decisions have meaningful implications for debtors and lenders navigating liability management exercises, chapter 11 plan classification, and post-confirmation litigation.

Serta Ruling Pulls Back the Covers on Uptier Liability Management Transactions



On July 7, 2026, Judge Christopher M. Lopez of the Bankruptcy Court for the Southern District of Texas, on remand from the Fifth Circuit, issued a long-awaited decision, holding that participating lenders in Serta's 2020 uptier liability management transaction breached the first-lien term loan agreement by taking non-pro rata payments on the first-lien term loan. The Court calculated the total damages to the excluded lenders at $261.13 million, plus mandatory 9% New York prejudgment interest dating back to the transaction's June 22, 2020 closing.

Serta's 2020 transaction has become one of the leading examples of an uptier liability management transaction (an "LMT"). By 2019 and early 2020, Serta was operating with more than $2 billion of secured debt while facing pressure from retail disruption, direct-to-consumer competition, and COVID-related manufacturing closures. In response, Serta retained Evercore and formed an independent committee to evaluate financing and deleveraging alternatives. Competing lender groups then proposed alternative LMTs, including drop-down and uptier structures, as Serta sought to raise new money, reduce debt, and capture the discount at which its loans were trading. The LMT that Serta ultimately chose closed on June 22, 2020. Under that transaction, participating lenders exchanged approximately $992 million of first-lien term loans for approximately $734 million of new first-lien second-out super priority loans, reflecting a 74% exchange ratio, with certain lenders providing $200 million of new first-out financing. The transaction was specifically structured as an "open market purchase" under section 9.05(g) of the credit agreement to avoid triggering section 2.18(c)'s pro rata payment-sharing provision. The resulting intercreditor waterfall ranked the new first-out debt first priority, the new second-out debt second priority, and the excluded lenders' legacy first-lien term loans behind both tranches.

The procedural history is extensive. The excluded lenders first sued in New York state court in June 2020 to enjoin the transaction, but preliminary relief was denied and the claims were later withdrawn. Additional litigation followed in both New York federal and state courts. After filing for chapter 11 protection in January 2023, Serta and the participating lenders commenced an adversary proceeding seeking a declaratory judgment that the transaction was a valid open market purchase that did not breach the implied covenant of good faith and fair dealing. The excluded lenders counterclaimed, asserting that the transaction violated the sacred rights protection of section 2.18—requiring pro rata sharing among lenders—and improperly amended those protections without unanimous lender consent. Former Bankruptcy Judge David R. Jones initially ruled for Serta and the participating lenders in March 2023, holding that the transaction qualified as an open-market purchase that did not violate the credit agreement or implied covenant. The Fifth Circuit reversed and remanded in December 2024, finding that the transaction was not a permissible open-market purchase under section 9.05(g). After the Supreme Court denied certiorari, Judge Lopez tried the remaining claims against the participating lenders.

On remand, the central issue was whether the debt exchange constituted a "payment" under section 2.18(c)'s pro rata payment-sharing provision. The participating lenders argued that "payment" meant cash, relying on references in section 2.18(a) to payments "in dollars" and common market understanding. Judge Lopez rejected that reading. Section 2.18(a), the Court held, governed borrower payment mechanics, while section 2.18(c) broadly protected ratable treatment whenever a lender receives consideration "whether voluntary, involuntary, through the exercise of any right of set-off or otherwise." Because set-off is non-cash, and because section 2.18(c) expressly carved out other non-cash transactions, limiting "payment" to cash would render key language superfluous. The Court also found that the payment was plainly "in respect of" principal on the participating lenders' first-lien term loans. Although undefined, the phrase was used broadly in the credit agreement to mean "concerning," "regarding," or "in connection with." The exchange agreement made the connection unmistakable, as the participating lenders sold, assigned, and transferred their "Purchased First-Lien Term Loans" to Serta in exchange for new first-lien second-out debt equal to 74% of the principal amount exchanged. That was consideration for—and in satisfaction of—their first-lien term loans, bringing the transaction squarely within the section 2.18(c) pro rata payment-sharing provision.

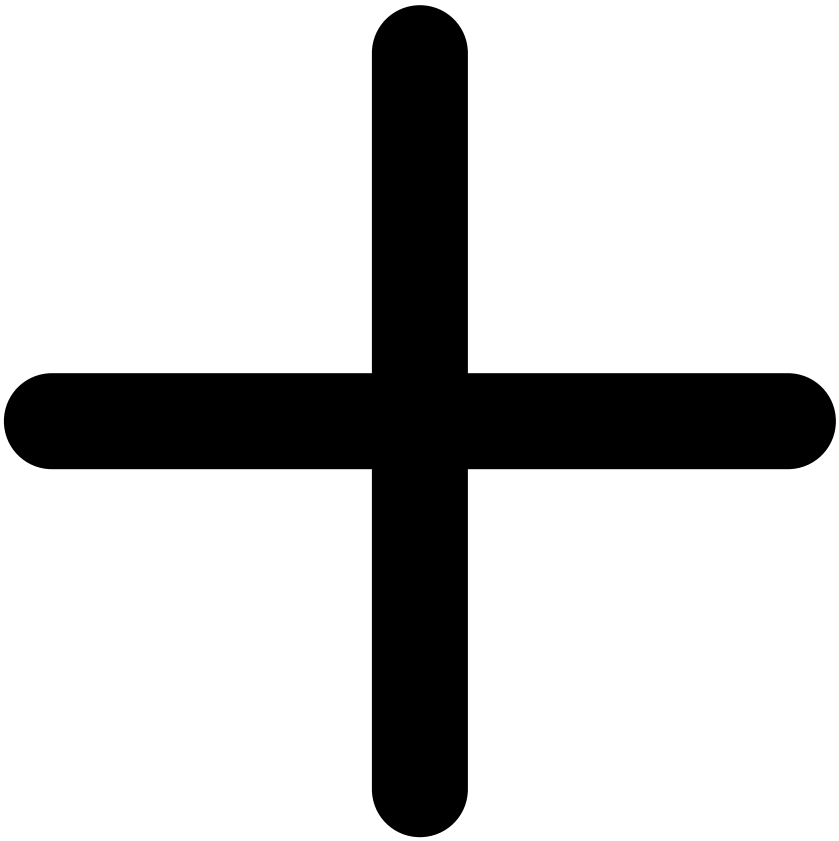
Judge Lopez also rejected the participating lenders' ratification theory, treating it as a repackaged version of the failed argument that majority lenders could validate the transaction as an "open market purchase." Allowing majority lenders to expand the open market exception to defeat pro rata sharing rights, the Court reasoned, would make the sacred right illusory. The participating lenders' equitable defenses fared no better. Although they relied on Judge Jones' prior statements suggesting that certain excluded lenders acted with an "objective lack of good faith," Judge Lopez held those statements as dicta and nonbinding. Moreover, the Court declined to apply the *in pari delicto* or unclean hands doctrines, finding that the excluded lenders' (i) competing drop-down proposal, (ii) participation in Serta's competitive process, and (iii) $30 million offer to stymie the transaction did not amount to intentional wrongdoing or unconscionable conduct. In the Court's view, Serta created the competitive process, and lender efforts to maximize recovery or pursue a pro rata deal did not defeat a claim for contract damages. Finally, the participating lenders' mitigation defense failed as they did not establish a realistic path for the excluded lenders to sell their legacy first-lien loans after the transaction, particularly given the thin and illiquid market relative to plaintiffs' position in excess of $700 million.

For damages, the Court measured the excluded lenders' loss as of the June 22, 2020 closing date, rejecting a chapter 11 emergence-date methodology as too dependent on later market developments and Serta-specific events. The Court found that the participating lenders received $734 million in first-lien second-out consideration, with the excluded lenders' ratable share valued at approximately $348 million. Using the closing-date market price of $0.25 for the legacy first-lien loans, the Court accepted a "time of breach" damages calculation of $261.13 million. The Court rejected the participating lenders' effort to reduce or eliminate damages based on the broader economic benefits of the transaction, including new money, deleveraging, and potential improvements in recovery prospects, noting that section 2.18(c)'s pro rata payment-sharing provision required sharing the benefit of the non-pro rata payment itself, not a broader after-the-fact assessment of whether the transaction benefitted Serta or creditors generally. The Court further awarded mandatory prejudgment interest under New York law at 9% per annum from the June 22, 2020 closing through July 7, 2026.

This decision is a significant conclusion to one of the market's most closely watched LMT disputes. While the Fifth Circuit had already narrowed the use of "open market purchase" provisions to support non-pro rata uptiers, Judge Lopez's opinion makes the

consequences concrete. If an LMT does not fit within a valid exception to a contractual provision requiring pro rata sharing, participating lenders may be required to share the benefit of the exchange under the precise written language of the credit agreement, regardless of the resulting economic treatment of creditors. More broadly, this ruling underscores the risk of aggressive LMT structures, confirming that violations can still result in meaningful damages even years after a transaction closes.

Committee Plan Confirmed Over Parent, Secured Lender, DIP Lender Objections



On June 16, 2026, Judge Brendan L. Shannon of the Bankruptcy Court for the District of Delaware confirmed the chapter 11 liquidating plan proposed by the Official Committee of Unsecured Creditors for US Magnesium LLC. In confirming that plan, the Court overruled objections from the debtor's parent, The Renco Group, Inc., and the DIP lender and prepetition secured creditor, Wells Fargo. The Court held that the plan was proposed in the creditors' best interests, would likely yield superior recoveries to a chapter 7 liquidation, and properly classified Renco's and Wells Fargo's claims for voting and distribution purposes.

US Magnesium filed chapter 11 in September 2025 in response to prolonged operational, environmental, and liquidity pressures at its Utah magnesium production facility. The case initially focused on a going-concern sale process anchored by a stalking horse bid from a Renco affiliate. After the Court approved the bidding procedures in December 2025, the parties moved to a competitive auction that produced a higher and better bid from the Utah Division of Forestry, Fire and State Lands. The winning bidder acquired substantially all the debtor's real property and related assets for approximately $30 million. The Committee actively litigated throughout this phase of the case, objecting to the DIP facility, challenging the stalking horse bid, moving to convert the case, and ultimately obtaining derivative standing to pursue estate claims against Renco and Wells Fargo.

After the Utah sale closed, the case pivoted to an orderly wind-down of the remaining estate assets, including inventory and equipment. The Committee, the Debtor, Renco, and Wells Fargo reached a partial settlement that allowed the liquidation process to move forward while resolving a subset of the Committee's asserted claims. The Court authorized continued use of cash collateral and later approved debtor-in-possession financing in the form of "liquidation advances" provided by Wells Fargo to fund the monetization of its prepetition collateral at the Utah facility. Those advances were subject to a termination trigger if the chapter 11

case converted to chapter 7 or if the Court appointed a trustee outside of a confirmed plan. The Committee relied heavily on this termination feature to support its argument that a chapter 11 liquidating structure would preserve more value than a chapter 7 proceeding.

The Debtor never filed its own plan. After exclusivity expired, the Committee proposed a chapter 11 plan built around a dual-track liquidation architecture. Under the plan, a collateral liquidation manager would oversee the disposition of encumbered assets for the benefit of secured creditors, while a separate liquidating trustee would administer unencumbered assets, prosecute preserved causes of action (including those against Renco and Wells Fargo), reconcile claims, and make distributions through a liquidating trust. General unsecured creditors strongly supported the plan, with 52 creditors holding approximately $87.7 million in claims voting to accept. Only three creditors voted to reject it.

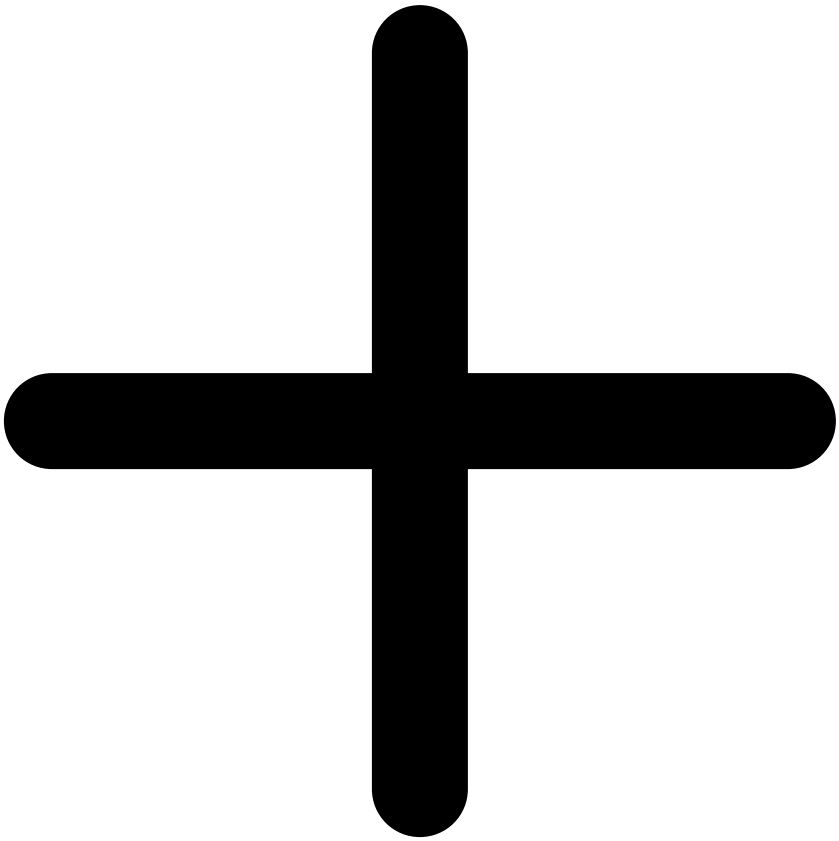
Renco objected on the basis that the plan improperly classified substantially similar unsecured claims into three impaired voting classes—(1) deficiency claims, (2) insider unsecured claims, and (3) general unsecured claims—despite broadly comparable treatment. Renco argued that this structure was designed to isolate Renco's vote and manufacture an impaired accepting class. Wells Fargo separately objected that the plan improperly classified claims under its revolving credit facility and term loan together into a single senior secured class. Wells Fargo also objected to the plan because it failed to provide sufficient release and exculpation protections in light of Wells Fargo's post-petition financing and cooperative posture.

The Committee defended its classification scheme as reflecting legitimate legal, factual, and economic distinctions among creditor groups. It argued that: (i) general unsecured claims was an appropriate residual class for most general unsecured claims; (ii) deficiency claims were properly segregated from general unsecured claims because they arose from funded debt and were contingent or unliquidated; and (iii) insider unsecured claims were properly segregated from general unsecured claims because they warranted separate classification due to potential recharacterization or equitable subordination and non-creditor incentives tied to equity ownership and litigation exposure.

Judge Shannon overruled both sets of objections. The Court held that the Committee's plan appropriately classified insider claims and funded-debt deficiency claims separately from other general unsecured claims, and that Renco and Wells Fargo failed to demonstrate impermissible gerrymandering with respect to voting on the plan. The Court also rejected Renco's best-interests challenge, concluding that the plan would likely produce higher aggregate recoveries than a chapter 7 conversion by preserving the existing liquidation framework, avoiding the disruption and cost of a chapter 7 trustee-led process, and enabling continued monetization of assets under established financing, access, and management arrangements.

The decision reinforces that a committee-proposed liquidating plan can withstand insider and secured lender classification attacks where the proponent demonstrates genuine differences in creditor rights, incentives, and risk profiles and ties those differences to a coherent liquidation strategy. It also underscores that insider status, funded-debt characteristics (including contingent deficiency exposure), and litigation risk may justify separate classification when those features meaningfully affect creditor behavior or potential recoveries.

Supreme Court Signals Skepticism Toward Judicial Estoppel in Bankruptcy



Although decided in the chapter 13 context, the Supreme Court's June 11, 2026 decision regarding the proper application of judicial estoppel may have significant implications for debtors and other parties in interest. In *Keathley v. Buddy Ayers Construction, Inc.*, the Court resolved a circuit split on the standard for applying judicial estoppel while signaling broader skepticism about the doctrine's role.

Judicial estoppel is an equitable doctrine designed to "protect the integrity of the judicial process" by preventing parties from taking inconsistent positions. The issue arose when an individual debtor was injured in an automobile accident after confirming his chapter 13 plan but did not amend his schedules or otherwise disclose the personal injury claim. He later filed suit in federal district court, where the defendant moved for summary judgment based on judicial estoppel.

Before the Supreme Court's decision in *Keathley*, the circuits were split as to how to determine whether a debtor's omission was "inadvertent." The Fifth and Tenth Circuits applied an objective test, under which an omission is inadvertent only if: (1) the debtor lacked knowledge of the claim, or (2) the debtor had no hypothetical motive to conceal the claim. Other circuits had adopted a subjective test requiring evidence that the debtor intended to mislead the court.

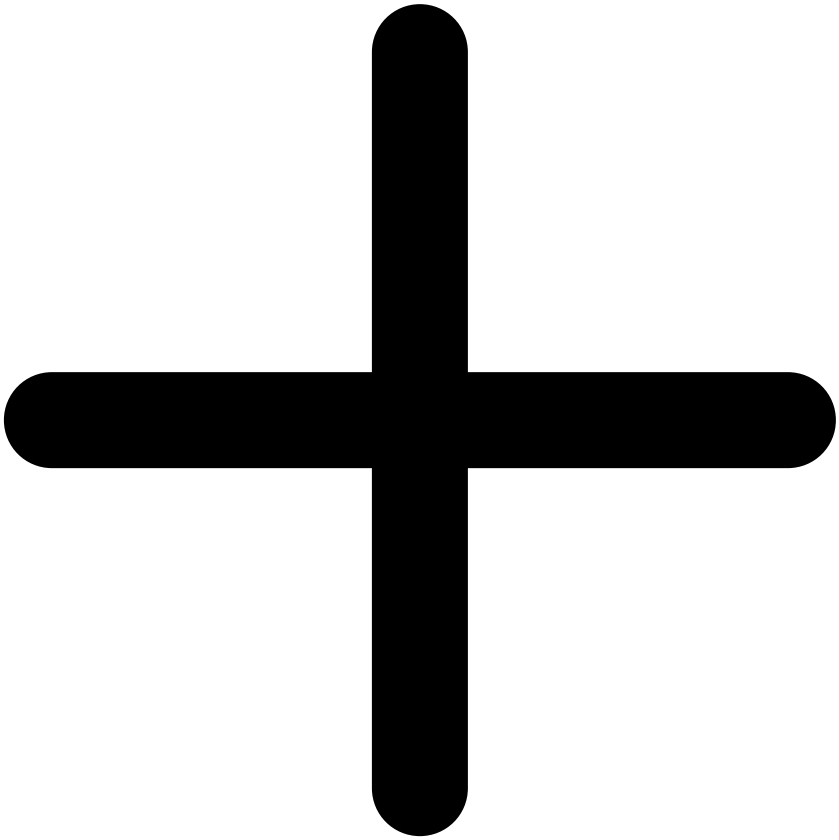
Because the debtor here knew of the facts underlying the claim and hypothetically had a motive to conceal them, the Fifth Circuit, applying the objective test, held that judicial estoppel barred the debtor from asserting its undisclosed tort claim. The Fifth Circuit thus dismissed the debtor's personal injury case. The Supreme Court vacated and remanded, holding that courts must evaluate

inadvertence under a totality of the circumstances standard. The Supreme Court concluded that the Fifth Circuit's approach was too rigid and limiting.

Although the majority assumed without deciding that judicial estoppel may apply in bankruptcy cases and that "inadvertence or mistake" can function as an exception to the doctrine's application, Justices Thomas and Gorsuch wrote separately to "express doubt about the foundation of the doctrine of judicial estoppel" and suggest that it should be reexamined wholesale in a future case. Justice Sotomayor also wrote separately to question the doctrine's continued utility in the bankruptcy context, suggesting that "it may not ever make sense to apply judicial estoppel when bankruptcy proceedings are pending." She emphasized that bankruptcy courts are well positioned to mitigate harm to the integrity of the bankruptcy system and that parties benefiting from judicial estoppel in the bankruptcy context are often unrelated third parties rather than creditors.

After *Keathley*, judicial estoppel remains available but must be applied under a fact intensive, totality of the circumstances analysis to determine whether the disclosure failure or inconsistent representation was truly a mistake. However, parties (and courts) should exercise caution when relying on this defense given the Court's suggestion that it would be willing to consider a doctrinal overhaul, potentially in the near future. Related doctrines such as equitable estoppel, collateral estoppel, and res judicata may provide more reliable avenues for relief.

Reliance-Based Claims Escape Sale Order Bar



On June 11, 2026, Judge Craig T. Goldblatt of the Bankruptcy Court for the District of Delaware issued a memorandum opinion denying the Wind-Down Debtors' effort to bar certain vendor claims against former officers of Joann Inc. The decision addresses whether creditor claims for fraud and negligent misrepresentation against non-debtor former officers belonged to the bankruptcy estate and were sold to a buyer of the estate's assets pursuant to the Court's sale order or, instead, remained direct claims held by individual creditors. The Court held that the claims belonged to the creditors individually and were not barred by the sale order.

Joann filed its second chapter 11 case in January 2025, less than nine months after emerging from a brief, fully consensual prepackaged case in 2024. In the second case, Joann sold substantially all its assets to a liquidator. Several vendors that had supplied goods to Joann after the first bankruptcy case but before the second later sued former officers of the Company in Ohio state court. The vendors alleged that the officers had made false statements about Joann's financial condition that induced the vendors to extend credit. The vendors asserted claims for common law fraud and negligent misrepresentation.

The Wind-Down Debtors commenced an adversary proceeding in Delaware seeking to enforce the sale order. They argued that the vendors' claims were estate claims that had been sold to the buyer and therefore could not be pursued by the vendors. Separately, the former officers removed the Ohio action to federal court, and the case was ultimately transferred to Delaware and referred to the Bankruptcy Court. The vendors sought remand or abstention, while the Wind-Down Debtors sought judgment on the pleadings.

Before reaching the merits, Judge Goldblatt addressed whether the Wind-Down Debtors had standing to enforce the sale order. The

Court rejected the argument raised by the Wind-Down Debtors that Article III standing principles do not apply in bankruptcy adversary proceedings. Nevertheless, the Court concluded that the Wind-Down Debtors had alleged sufficient injury to seek enforcement of the sale order. In particular, the Court found that the vendors' claims could potentially erode available D&O insurance or generate indemnity claims against the Wind-Down Debtors, which was adequate to establish a concrete stake in the dispute.

On the merits, the Court applied the Third Circuit's recent decision in *Whittaker Clark & Daniels*, which addressed when creditor claims against third parties become property of the bankruptcy estate. Judge Goldblatt recognized that *Whittaker Clark & Daniels* may have expanded the universe of claims that qualify as estate property but held that the vendors' claims remained direct even under that broader framework. The Court emphasized that the vendors' fraud and negligent misrepresentation claims required each vendor to prove individualized reliance on alleged misstatements by the former officers. Because liability depended on particularized injury directly traceable to the defendants' alleged conduct, the claims were personal to the vendors rather than derivative of an injury to Joann or its creditor body as a whole.

The Court also denied the vendors' motions to remand and abstain. Because the Ohio action was filed before Joann's plan became effective, the Court applied the Third Circuit's broad pre-confirmation "conceivable effect" test related to jurisdiction and found subject matter jurisdiction because the litigation could erode insurance policies in which the debtors had an interest. The Court further held that mandatory abstention did not apply and declined to exercise permissive abstention or equitable remand given the action's relationship to the bankruptcy case and sale order.

This opinion provides valuable guidance to debtors and potential purchasers on the boundary between estate claims and creditor-owned claims after a bankruptcy sale. Even where a sale order transfers the estate's causes of action broadly, creditors may retain direct claims against non-debtors where the claims require individualized proof of reliance or injury. Moreover, bankruptcy courts may retain jurisdiction over such disputes when the litigation could affect estate assets, or if it implicates the interpretation of a bankruptcy court's prior order.

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