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Litigators of the Week: A $400M Win for Excluded Serta Lenders in Landmark 'Creditor-on-Creditor Violence' Trial

By Ross Todd
July 10, 2026

Our Litigators of the Week are **Susheel Kirpalani**, **Zachary Russell** and **Ken Hershey** of **Quinn Emanuel Urquhart & Sullivan**.

They represent a group of lenders, including Apollo and Angelo Gordon, who were excluded from a 2020 uptier transaction with mattress company Serta Simmons Bedding and a majority of its lenders restructuring the company's debt.

This week, U.S. Bankruptcy Judge Christopher Lopez in Houston awarded the excluded lenders $261 million in base damages, plus more than $140 million in prejudgment interest, after finding the lenders who participated in the liability management transaction breached the credit agreement by receiving payments on their first-lien debt without buying out the excluded first lien lenders represented by the Quinn team.

Courtesy photos

L-R: Zachary Russell, Susheel Kirpalani, and Kenneth B. Hershey of Quinn Emanuel .

Litigation Daily: Who were your clients and what was at stake here?

Zach Russell: Our client is an ad hoc group of lenders who formerly held first lien loans issued by Serta Simmons Bedding LLC. The group is led by TPG Angelo Gordon, Apollo Global Management and Gamut Capital Management. In June 2020, a group holding a majority of the first lien loans announced their intent to enter into the first-ever "uptier" liability management transaction, in which they would provide a new money loan to Serta on a superpriority basis and also exchange their existing first lien loans into a superpriority exchange debt tranche with priority payment rights over all left-behind first lien term loans. Our clients sued almost immediately in state court to enjoin the transaction, but that effort failed. Needless to say, this significantly decreased the value of our clients' loans, and when Serta subsequently filed for bankruptcy in 2023, our group received almost no consideration under the plan of reorganization; virtually all of the value of the company was given to the majority group. This lawsuit, in which we were pursuing damages from the majority lenders for breach of the ratable sharing provision of the credit agreement, represented our clients' only remaining avenue to receive any compensation whatsoever from the harm done to them when they were left out of the uptier transaction—a harm in the form of non-ratable payments to the majority group that we believed (and the court agreed) violated the syndicated loan agreement that governed the loans.

How did this matter come to you and the firm after the Fifth Circuit decision reviving your clients' case?

Ken Hershey: The Fifth Circuit ruled that the debt-for-debt exchange at the heart of this dispute did not satisfy the Credit Agreement's "open market purchase" exception to the agreements' ratable sharing provision. But the Fifth Circuit left open the dispositive question of what part of the transaction, if any, breached the Credit Agreement and remanded to the bankruptcy court to consider that question and the appropriate remedy. Several months following remand, prior counsel sought an injunction to prevent the defendants (many of which were CLOs) from winding down or dissolving, as some had done while the case was pending on appeal. The court declined to issue an injunction, expressing skepticism as to both irreparable harm and as to whether plaintiffs had shown a likelihood of success on the merits on the breach claim because the case was not so clear-cut. With just four months left until trial, and the close of discovery fast approaching, we got the call.

Who was on your team and how did you divide the work?

Russell: The team was led by partner Susheel Kirpalani and the team members included partner **Matt Scheck**, me (I'm counsel) and associates Ken Hershey, **Cameron Kelly**, **Ankitha Mandava**, **Maeve Lentricchia** and former associate **John Murray**. When we first received the mandate, we had only weeks to complete fact discovery on the new issues that arose after the case was remanded by the Fifth Circuit. The fact discovery process (finalizing document discovery, taking depositions, motion practice, etc.) was largely handled by me and the associate team. Matt Scheck took the lead on all things related to the other side's mitigation defense (including third party and expert discovery). Ken Hershey worked closely with our damages expert in preparing his report and also took the lead on drafting our pretrial brief. And Susheel took the lead on defending all of our clients at their depositions. Once we reached trial, everyone was working on everything. Of course, some people continued to handle specific issues that they had become the most knowledgeable on during the pretrial process, but it was truly an all-hands-on-deck strategy in which everyone became an expert on every facet of the case.

How did you get up to speed on the factual record in the run-up to trial? Did any complications arise from not having handled much of the underlying discovery?

Russell: Getting up to speed in such a short period of time was a huge lift.The procedural record for this case had been extensive (several state court lawsuits, an adversary proceeding that included summary judgment and a prior trial, and bankruptcy confirmation), and discovery had been ongoing for years. But what made matters especially tricky was that the issues had shifted a bit since the Fifth Circuit remanded the case, because the defendants were advancing entirely new theories on why the transaction did not breach the agreement and pursuing affirmative defenses (like mitigation and equitable defenses) that had not been the focus of the prior discovery. And there were elements of our affirmative case that we needed to prove up that had similarly not been the parties' focus until remand. As a result, there were massive holes in the discovery record that the team had to work extremely quickly to plug, including a wide-ranging exercise to ascertain the depth of the market for trading Serta's first lien loans after the transaction, an issue that was central to the defendants' mitigation defense.

This case has become one of the flagship disputes in the creditor-on-creditor violence era. Did you view it as a broader market case from the beginning, or primarily a contract case on the remanded issues?

Susheel Kirpalani: We were excited to take on this case because it was the first liability management exercise (LME) of the pandemic era, and it worked, initially, paving the way for a trend unlike any I have seen in over 30 years in restructuring. So many LMEs have been done since 2020 because of Serta's initially successful structure. We viewed the revived challenge as a shot that would be heard around the restructuring world. And far from being primarily a contract case, the case really became a law school exam on how a court should remedy a breach like this. Of course, there was a big contract element—construing a syndicated credit agreement and trying to understand what promises were actually made and broken. But isolating the damage done to lenders by the transaction back in 2020 and developing the appropriate methodology for ratable payments as among lenders was something no other court had yet done in the syndicated loan context.

How much of your trial strategy was built around the contract text versus custom-and-practice evidence from the syndicated-loan market?

Hershey: We focused overwhelmingly on the language of the credit agreement, which we argued in our opening and closing statements unambiguously favored our breach claim—a position that the court ultimately adopted. We opted not to introduce affirmative evidence of custom and usage but instead highlighted evidence from the record suggesting that the defendants understood our construction of the credit agreement to be correct. For their part, the defendants relied heavily on a passage from a trade publication that superficially favored their position. We elicited extensive testimony from our clients and the defense witnesses that cast doubt on whether that publication's position could be treated as reflecting an established industry custom-and-practice, and we further argued that the position taken by the trade publication cannot trump the plain language of the credit agreement.

What do you think Judge Lopez's ruling means for other disputes involving uptier and other liability-management transactions?

Kirpalani: The one thing we have learned litigating LMEs is that, despite the common features of many bonds and syndicated loans, no two cases are exactly alike. I think Judge Lopez's ruling is significant despite being tied to the specific contract and surrounding facts before him. In terms of its broader meaning, it shows that creditors can face actual lender liability (a term often used but hardly ever applied) if they do not abide by their own obligations under a credit agreement. It also proves that individual creditor rights—if meritorious—can be vindicated and remedies can be fashioned long after an out-of-court restructuring is completed and even after a Chapter 11 case is over. That's not something you see every day and certainly not something anyone in the distressed community has seen after an LME is blessed by a bankruptcy court as part of a Chapter 11 plan and the plan is fully consummated. Not every case will involve true lender-on-lender claims—many are merely claims against the debtor or are derivative of the estate's avoidance powers—but in the rare case where a creditor has direct meritorious claims against another creditor, Judge Lopez's decision stands for those individual rights being protected and vindicated (even six years later).

What lessons should credit investors take from the outcome?

Kirpalani: Sophisticated credit investors have a solid foundation of U.S. bankruptcy law. Indeed, our bankruptcy laws are the bedrock of the country's renowned capital markets. That's because the Bankruptcy Code has clearly defined rules that were developed and fine-tuned over five decades (and many of its principles go back over 100 years); these rules have been battle-tested in court to maximize consistency in investor expectations. In contrast, while the world of LMEs may seem well-trodden by now, it's really only been six years. How many of those LMEs have actually gone to trial? (I am aware of just two—Wesco Aircraft and Serta— both of which we handled.) There is much we still don't know about how contracts or the common law will be interpreted to apply to evolving financing techniques. While corporate finance lawyers may think they know how a provision works due to years of dealmaking, that is not the same thing as having a body of case law behind it. If you are a creditor exploring a potential restructuring out-of-court, you should seek advice from healthy skeptics who litigate for a living in addition to the talented lawyers who negotiate deals. I think this is already happening broadly given the amounts at stake in contemplated LMEs, but I think the Serta decision underscores how important it is to evaluate competing views before making investments.

What will you remember most about this matter?

Kirpalani: Two things. I will definitely remember honing my process for trial (a technique I have likened to sitting in a "reading room" for the TV show "Friends"). Every member sits together in the war room about two weeks before trial, a week before trial, and again the night before trial, and we rehearse the flow slide by slide, every attempt at humor, every metaphor, every facial expression. The whole team leans in critically—striving to get every phrase right, every image right, and to anticipate the counter—and this has become our approach to trying cases. It is exhausting but also a lot of fun. It has the unexpected benefit of ensuring I will not need any notes when it is game day. Second, I will never forget receiving that inbound email last fall, on a no-names basis, asking if I might have time for something interesting but urgent. I had no idea what the call would be about and, as someone who had followed the progression of the case from afar, I had a feeling of exhilaration when I learned it was Serta. That's to say that I will always remember with gratitude being given the opportunity to represent such prominent institutions in vindicating their most important rights as credit investors.

Russell: When I think back on this case, I am always struck by how smoothly things went once trial began. That was not a happy accident or mistake—that is what we strive for, as it only occurs as a result of months of hard work, determination and focus by the entire team.We had poured countless hours into developing and mining the record, developing our legal theories and strategies, ensuring each piece of evidence we needed would get into the record and making sure we had the best retorts possible for every challenge the other side would throw at our case. At trial, the defense was constantly throwing curveballs and trying to muddy the waters to detract attention from what this case was actually about. But we knew this would happen. And by the time we got to trial, we knew exactly what tactics the other side would use, and we had developed what turned out to be the perfect response to each attempt.

Hershey: There were so many twists and turns in this case. We quickly learned that notwithstanding the decision from the Fifth Circuit, establishing a breach and damages would be a challenge requiring an intensive effort from all team members. I will most remember the many late nights I spent on the phone with various team members hashing out our theories of breach and damages, and how everyone on the team worked so tirelessly toward achieving this phenomenal outcome.