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“Upside Down” – Value Transfers Through Uptiering Exercises

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In our April edition, we explored how value transfers – strategic shifts of economic value within a capital structure – have become a defining feature of modern liability management exercises (LMEs). These tools often favor a select group of creditors, challenging traditional notions of pari passu treatment and introducing new risks for investors.

This month, we focus on one of the most aggressive and controversial LME tactics: the uptiering transaction.

Also known as a Priming Exchange Transaction (PET), an uptiering involves offering a subset of lenders the opportunity to exchange their existing debt for new, super-priority instruments. These deals often include exit consents that strip protections from non-participating debt, leaving holdouts subordinated – without broader consensus.

We break down how these transactions work, why they are legally possible, and their real-world impact – highlighting the pivotal Serta Simmons case, its recent court reversal in 2025, and the role of governing law in determining creditor outcomes. Finally, we outline key considerations for investors navigating this increasingly complex and fragmented credit landscape.

What Is An Uptiering?

Most LME transactions exploit flexibility or loopholes in credit documentation to reallocate value – often through collateral, priority, or covenant shifts – in ways that benefit some creditors at the expense of others.

An uptiering is a liability management strategy in which a financially distressed borrower offers a select group of existing lenders the opportunity to exchange their current debt for new, super-priority debt – effectively placing them at the top of the capital structure. This is typically achieved through amendments approved by a majority vote and may involve exit consents, where participating lenders agree to strip covenants from the existing debt as a condition of the exchange.

Because the offer is made only to a subset of creditors, the transaction is non-pro rata: participating lenders receive enhanced rights, while non-participating creditors are subordinated, often without any additional compensation. In a restructuring or insolvency, this shift in priority can significantly reduce the recovery prospects of the subordinated creditors – hence the term uptiering, as one group is effectively moved "up" in priority over others.

Why Are Uptierings Possible?

Uptiering transactions are possible because of flexibilities and gaps in many modern credit agreements, especially in covenant-lite structures. To execute an uptier successfully, two conditions typically need to be met:

- The ability to amend the credit agreement to permit the issuance of new, senior-ranking debt.
- The ability to selectively repurchase or exchange debt, leaving non-participating creditors structurally behind.

Here's how those conditions are often met in practice:

Amendment Thresholds: Many agreements allow material changes (such as lien subordination or permitting new senior debt) with approval from a simple majority of lenders – often just over 50% – rather than requiring unanimous consent. This enables one group of lenders to change the rules to their advantage, even if others oppose it.

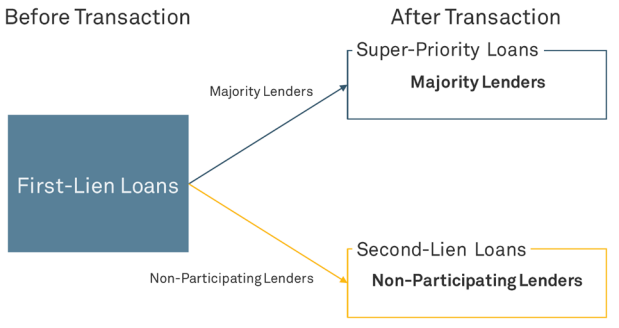
"Open Market Purchase" Language: Some contracts allow the borrower to repurchase existing debt "in the open market." While this might suggest purchases at prevailing market prices, it has often been interpreted broadly to justify private exchange offers – where only a select group of lenders receives favorable new debt, leaving others with the original, now subordinated, instruments.

Lack of Explicit Restrictions: Older or loosely drafted documents often lack protective clauses, such as "Serta blockers" or pro-rata sharing requirements, that could otherwise prevent one group of creditors from receiving better repayment terms than others. These clauses are now more common – but not always present or enforceable, depending on how they are drafted.

How Do Uptierings Work?

Uptierings are typically executed through selective exchange offers paired with exit consents. Participating lenders agree not only to receive new super-senior debt, but also to vote to strip covenants and protections from the existing debt. The transaction is not made pro rata – only those who join receive the improved terms.

FIGURE 1: DEBT IS SPLIT IN UPTIERINGS
Uptier transaction structure



Source: XAIA Investment GmbH

Step-by-step mechanics:

Issuer Proposes an Exchange Offer: The company invites a select group of lenders to exchange their existing debt for new, senior-ranking debt, typically secured and with better economics.

Consenting Majority Approves Amendments: Participating lenders (often just over 50%) vote to amend the credit agreement, using exit consents to remove restrictive covenants, default triggers, or other protections from the remaining legacy debt.

Non-Participating Lenders Are Subordinated: Lenders who decline or left out of the exchange remain in the original facility – but now rank below the new super-senior debt, and no longer benefit from key protections or collateral access.

Transaction Closes: The new debt is issued, the exchange completes, and the capital structure is permanently reshaped, typically in favor of participating lenders who now enjoy elevated recovery prospects.

What Is an Exit Consent?
An **exit consent** is a restructuring tactic where participating lenders **vote to strip protections** (like covenants or collateral rights) from the old debt **as a condition of exiting** into new, senior debt.
This leaves **non-participating creditors** holding weakened claims, making it harder to resist the deal. Often legal – but highly **coercive**.

Uptiering vs. Drop-Down: What's The Difference?

In our most recent Perspectives letter, we introduced drop-downs. In a drop-down, assets are physically moved out of the restricted group (where existing lenders have claims) to an unrestricted subsidiary. New debt is raised at the unrestricted level, secured by those assets. Non-participating creditors lose access to collateral and are subordinated because they no longer have a claim on key assets.

The main difference between a drop-down transaction and an uptiering lies in the mechanism of subordination:

- Uptiering: Contractual subordination
- Drop-down: Structural subordination

In short:

- Drop-down = move assets away from legacy creditors.
- Uptiering = give better priority to new/exchanged debt

And yes – they can be combined.

Case Study: Serta Simmons – The Mother of All Uptiering

In 2020, Serta Simmons executed a highly contentious uptiering transaction, where it offered a select group of existing lenders the opportunity to exchange their debt for new super-senior loans with priming liens – ranking ahead of the debt held by non-participating creditors. Using flexibility in its loan documents, Serta obtained majority consent (just over 50%) to amend the credit agreement and permit the new priming structure, despite strong opposition from other lenders.

Notably, there were two competing creditor proposals. One group – including Serta's ultimate transaction counterparties – supported the uptiering transaction. Another group, led by Apollo and Angelo Gordon, proposed an alternative transaction involving a drop-down, where valuable assets would have been moved to an unrestricted subsidiary and used to raise new senior debt.

Serta ultimately chose the uptiering over the drop-down alternative, a decision that effectively subordinated the non-participating creditors and triggered multiple lawsuits, challenging the legality of reprioritizing claims by simple majority. Despite the legal backlash, courts initially upheld the move as contractually permissible under the credit agreement, reinforcing the importance of careful lender protections and precise drafting.
The case became a landmark in modern LME strategy and spurred widespread adoption of "Serta blockers" in new loan documentation to prevent similar creditor-on-creditor maneuvers.

It needs to be noted, that in April 2025, the U.S. Court of Appeals for the Fifth Circuit struck down Serta Simmons' 2020 uptiering transaction, ruling it violated the credit agreement by misusing the "open market purchase" provision and breaching pro rata sharing requirements. The decision challenges the legal basis of uptierings and may limit the use of similar majority-led restructurings going forward.

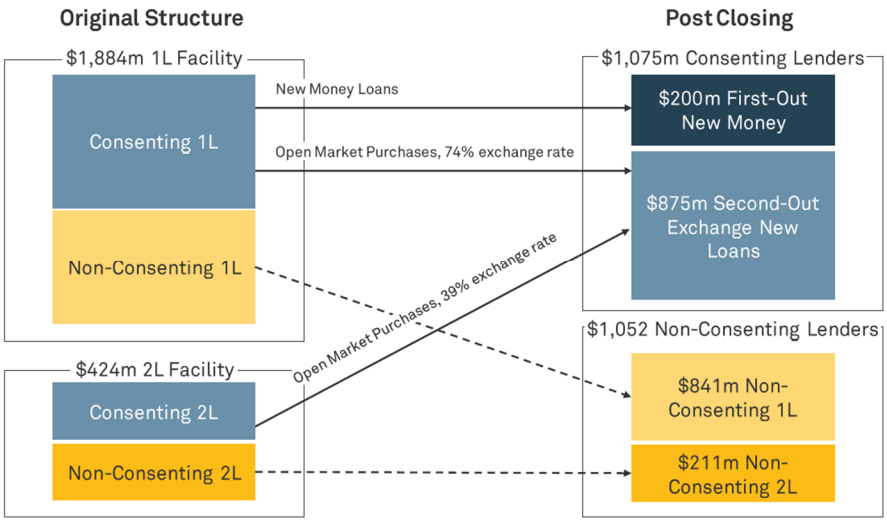
Serta – The Mechanics

In June 2020, Serta Simmons executed the mentioned uptiering transaction in which select lenders – like Eaton Vance and Invesco—provided $200 million in new super-priority "first-out" debt and exchanged roughly $1 billion of first-lien loans (at 74%) and $300 million of second-lien loans (at 39%) into a new $875 million "second-out" super-priority tranche. A third-out tranche was created but left unused.

The controversy arose because the deal was non-pro rata – not offered to all lenders. Those excluded, including Apollo and Angelo Gordon, saw their remaining $895 million of first-lien and $128 million of second-lien debt pushed down in priority, effectively becoming third- and fourth-lien claims.

This transaction was facilitated by amendments to Serta's 2016 credit agreement, which allowed for non-pro rata debt exchanges under certain conditions. The participating lenders' new positions were structured to have priority over the non-participating lenders, leading to legal challenges and significant implications for the syndicated loan market.

FIGURE 2: UPTIERINGS SPLIT PARI PASSU DEBT
Visualization of the Serta uptiering transaction (2020)



Source: Company reports, XAIA Investment GmbH

Governing Law Defines The Playbook: Why Uptierings Work In Some Jurisdictions – And Not Others

The viability of an Uptiering depends less on the borrower's domicile and more fundamentally on the governing law of its debt instruments.

While a corporate issuer may be based in Europe, the restructuring tools it can deploy – especially in distressed situations – are shaped by whether its bonds or loans are governed by New York law or English law.

Under New York law, which governs most U.S. leveraged loans and many high-yield bonds, uptierings and similar liability management exercises can often be implemented with just a simple majority of lender consent (typically 50.1%) – at least for amendments to non-core terms, such as collateral rights or ranking provisions. This relatively low threshold creates a powerful incentive: a bare majority can authorize amendments that elevate their own claims into a super-senior position, leaving non-consenting creditors behind in the priority waterfall. In the bond context, the Trust Indenture Act (TIA) Section 316(b) limits amendments to fundamental terms – such as principal, maturity, and payment rights – unless unanimous consent is obtained. However, uptierings are often structured carefully to avoid changing those protected elements, allowing the transaction to proceed with less than full creditor support.

This framework enabled transactions like Serta Simmons, where a majority group of lenders exchanged their loans for new super-priority debt, subordinating the remaining lenders – despite all lenders holding pari passu claims at origination. U.S. courts, favoring contractual freedom, have largely upheld such deals when executed within the terms of the credit agreement or indenture – even if the outcome is asymmetric.

By contrast, English law imposes stricter procedural and substantive constraints. While certain amendments can pass with 66⅔% or 75% of bondholders under trust deed structures, others – particularly those affecting core terms or disproportionately harming a subset of creditors – may require unanimous consent. More importantly, the "abuse of majority" principle – established in Assenagon v. IBRC (2012) – holds that creditor decisions must be made in good faith and for the benefit of the class as a whole. This limits the use of coercive tactics, such as stripping protections from non-consenting creditors through exit consents or selective amendments. Although later cases like Redwood v. TD Bank recognized that unequal outcomes may still be permissible, the emphasis remains on fairness of process and the collective interest.

The structural implication is clear: in U.S. loan markets, a slim majority can execute a value-reallocating transaction, making uptierings economically attractive for opportunistic lenders and sponsors. In UK/EU bond frameworks, by contrast, the higher voting thresholds and judicial oversight make similar tactics both harder to execute and less rewarding – as the economics must be shared across a larger creditor base.

Still, the line between jurisdictions is increasingly blurred. Many European borrowers – particularly in sponsor-backed, cross-border, or USD-denominated financings – now issue debt governed by New York law, regardless of their home base. This shift allows them to access U.S.-style restructuring flexibility, including uptierings, drop-downs, and majority-approved exchanges, while marketing to global investors. However, it also introduces significant legal and structural risk for creditors accustomed to more protective European regimes – effectively moving the battleground from local courts to New York law documentation.

Market Repricing After Uptierings

Uptiering announcements often cause immediate and sharp price dislocations across a company's debt instruments. Participating lenders – who exchange into newly issued, super-senior debt – tend to see price appreciation as their claims move up the capital structure. In contrast, non-participating creditors face price declines, reflecting their effective subordination and reduced recovery prospects.

This asymmetry disproportionately affects passive or smaller investors, especially in the syndicated loan market. Collateralized Loan Obligations (CLOs) – major holders of leveraged loans – are particularly vulnerable, as their rigid structures and inability to actively participate in exchange offers can leave them stuck with devalued, non-uptiered debt.

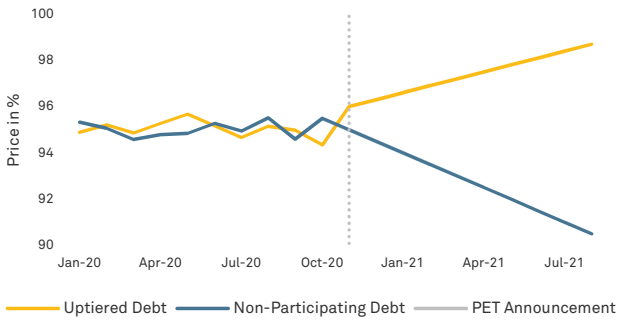
Meanwhile, the primary beneficiaries are sponsors and debtors, who use uptierings to avoid insolvency proceedings, extend control, and sometimes create value by reducing nominal debt obligations – even without broader creditor consent.

This repricing dynamic has played out in high-profile cases such as Serta, Incora, and Boardriders, where secondary prices of non-participating tranches dropped significantly, while uptiered debt traded at a premium. These dislocations can offer distressed trading or arbitrage opportunities for investors – either by entering at discounted levels in subordinated paper or by backing the newly issued senior instruments.

While uptierings are more common in loan structures – owing to lower amendment thresholds and more flexible terms – they are increasingly appearing in bond transactions as well, particularly when governed by New York law. The 2023 restructuring of Hunkemöller is one such example.

Below is a simplified illustration of how market prices typically evolve post-uptiering: initially aligned, debt instruments diverge sharply after the transaction, with uptiered debt gaining and subordinated debt falling – mirroring their revised recovery expectations.

FIGURE 3: UPTIERINGS BIFURCATE BOND (PRICES)
Simplified example for price development of uptiered and non-participating debt



Source: Bloomberg, XAIA Investment

Hotspots Where Credit "Raiders" Exploit Weaknesses

Cross-border use of New York law documentation to bypass European restructuring standards (Example: Hunkemöller, 2023): By issuing New York law governed debt, issuers can sidestep UK/EU legal protections like the "abuse of majority" rule and execute selective exchanges or uptiers that wouldn't survive under local law.

Simple majority voting thresholds and lack of Serta blockers in loan agreements (Examples: Serta Simmons, 2020; Boardriders, 2023): Covenant-lite credit agreements often permit material amendments with just 50.1% consent, allowing a narrow majority to push through uptierings or drop-downs at the expense of the minority.

Outdated documentation lacking pro rata sharing and sacred rights protections (Example: Incora, 2024): Older credit agreements frequently miss critical guardrails – like pro rata enforcement rights or high voting thresholds – making them easy targets for unbalanced restructurings.

Multi-entity structuring and documentation fragmentation across jurisdictions (Example: Mitel, 2024): Complex, layered capital structures with different governing laws enable selective priming and isolate creditors from coordinated pushback.

Considerations For Investors

As uptierings and other LME tactics become increasingly accepted in the U.S. restructuring landscape, creditors need to reassess how they approach documentation, risk, and pricing.

Know the governing law and COMI: A bond's governing law – and the issuer's center of main interest (COMI) – determines which restructuring tools may be used and which courts will have jurisdiction in a default scenario.

Review docs proactively: Understand amendment rights, collateral baskets, and restrictions.

Coordinate early: Disorganized lenders are more easily outvoted or sidelined.

Negotiate upfront: Push for "blockers" and tighter consent thresholds in new financings.

Monitor sponsor behavior: Aggressive sponsors are more likely to test uptiering strategies, especially in U.S.-style deals.

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Philipp Graxenberger and Josef Pschorn oversee Alternative Credit Strategies at XAIA Investment, specializing in identifying inefficiencies in the credit market, particularly within complex capital structures and special situations. Their expertise spans credit arbitrage, relative value, special situations, and restructurings.

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