ALERT MEMORANDUM

# District Court Reverses Bankruptcy Court in Wesco/Incora LME; Finds No Domino Effect in 2022 Uptier Transaction

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

New York

**Jane VanLare**
+1 212 225 22872
jvanlare@cgsh.com

**Thomas Kessler**
+1 212 225 2884
tkessler@cgsh.com

**Jack Massey**
+1 212 225 2314
jamassey@cgsh.com

**John Veraja**
+1 212 225 2854
jveraja@cgsh.com

*January 8, 2026*

Litigation has become a familiar consequence of liability management exercises ("**LME**" transactions), as non-participating creditors seek to vindicate rights they believe were compromised in the LME.  One closely watched example has been the uptier LME effectuated by Wesco Aircraft Holdings, Inc. ("**Wesco**") on March 28, 2022, which was premised on the company's ability to create a supermajority of creditors that could vote to authorize the LME.  After state-court litigation and a trial in the U.S. Bankruptcy Court for the Southern District of Texas (the "**Bankruptcy Court**"), which resulted in a victory for the minority holders, on December 8, 2025 the District Court for the Southern District of Texas (the "**District Court**") ruled that the Bankruptcy Court's analysis was incorrect, held that the LME transaction was permissible, and rejected the remedy that the Bankruptcy Court had fashioned following its holding that the transaction violated the Minority Group's rights.  The decision represents an important milestone in LME litigation in the wake of the Fifth Circuit's *Serta* decision (which held that another notable LME had violated the rights of minority holders), using the logic of that decision to support a holding in favor of a majority group.  The year 2026 and beyond are likely to see the continued use of LME transactions by companies looking to revitalize their capital structure and, following some transactions, litigation in bankruptcy courts and elsewhere.  Cases like *Wesco* will serve as an important guidepost for LME participants, practitioners, and observers.

***Background***

In January 2020, Wesco, one of the largest independent distribution and supply-chain services providers in the civilian and military aerospace industry, acquired Pattonair, Ltd, a leading aerospace services provider based in the United Kingdom. To finance the transaction, Wesco raised over $2 billion through three separate bond issuances: (i) $650 million in 8.5% senior secured bonds maturing in 2024 (the "**2024 Notes**"), (ii) $900 million in 9.0% senior secured bonds maturing in 2026 (the "**2026 Notes**") and (iii) $525 million in 13.125% unsecured bonds maturing in 2027 (the "**2027 Notes**") (collectively, the "**Existing Notes**"). The COVID-19 pandemic, which led to a sharp decline in global demand for aerospace services in the months after the acquisition and financing transactions, severely impacted Wesco's revenues and liquidity.

In 2021 and 2022, Wesco explored proposals from various lenders to provide the Company with much needed liquidity. Both a majority group of holders of 2024 Notes and 2026 Notes (the "**Majority Group**"), and a minority group of holders of the same notes (the "**Minority Group**"), pitched potential transactions to the Company.

The Majority Group, which held more than two-thirds of the 2024 Notes, approximately 60% of the 2026 Notes, and more than half of the 2027 Notes, offered to provide Wesco $250 million in new money and to reduce the cash interest expense and extend maturities on the existing debt. As part of the transaction, the Majority Group would exchange their 2024 Notes and 2026 Notes into new super-senior first-lien notes (the "**New 1L Notes**"), which would mature in late 2026. The transactions would also allow certain holders of the 2027 Notes to exchange their notes into new super-senior second-lien notes (the "**New 1.25L Notes**"), maturing in 2027.

Wesco concluded that the Majority Group's proposal was superior to the alternative transaction proposed by the Minority Group. In response, the Minority Group effectuated a defensive strategy designed to block Wesco from consummating the Majority Group proposal. It acquired a 33% position in each of the 2024, 2026 and 2027 Notes, which was enough to prevent the exercise of any actions requiring a two-thirds supermajority (including, critically, the release of liens on existing collateral).

Nevertheless, on March 28, 2022, Wesco and the Majority Group entered into and consummated their LME transaction (the "**2022 Transaction**"). The transaction involved a set of amendments to the existing notes indentures governing the relevant Existing Notes (the "**Existing Notes Indentures**"), in part to "unblock" the Majority Group's voting power:

- Permit the issuance of $250 million in additional 2026 Notes, to be acquired by the Majority Group and secured by the existing collateral. These amendments required only majority approval.

- Release the liens securing the 2024 and 2026 Notes and remove certain covenants that would have prevented the consummation of the 2022 Transaction. These amendments required consent from holders of two-thirds of the 2024 and 2026 Notes, which the company secured from the Majority Group, including its holdings of the minutes-old additional $250 million in 2026 Notes.

***Procedural Posture and Prior Litigation***

The net effect of the 2022 Transaction was to permit the Majority Group to exchange its existing holdings in the Existing Notes into priming debt, while stripping the liens and covenants supporting the Existing Debt, to the detriment of the excluded Minority Group. Several months after the 2022 Transactions, in October 2022, certain holders of 2024 Notes and 2026 Notes from the Minority Group sued Wesco in New York state court, seeking a judgment that the 2022 Transactions were "null and void and not enforceable" and an order avoiding and unwinding them, on the grounds that the transactions were impermissible under the terms of the Existing Notes Indentures. Despite the new money infusion, extended maturities, and lower cash-interest payments resulting from the 2022 Transactions, Wesco continued to face liquidity issues. In June 2023, Wesco and its related entities filed voluntary chapter 11 petitions in the Bankruptcy Court, which had the effect of automatically staying the New York state court lawsuit. On the same day, Wesco initiated an adversary proceeding seeking a judgment that the 2022 Transactions did not violate the Existing Notes Indentures. Certain Minority Group noteholders counterclaimed, seeking, *inter alia*, a judgment that the 2022 Transactions were in violation of the Existing Notes Indentures.

On January 17, 2025, the Bankruptcy Court issued a report and recommendation finding that the 2022 Transaction violated the Existing Notes Indentures.[1] The Bankruptcy Court determined that the 2022 Transaction was properly understood not as multiple, independent transactions, but instead as a row of dominos—once one fell, the rest of the dominos necessarily would follow. This was a critical finding, because the 2024 and 2026 Notes required two-thirds consent for any action that "ha[d] the effect of releasing all or substantially all" of the liens securing the 2024 and 2026 Notes. Under this framework, the Bankruptcy Court determined that, because the issuance of the additional $250 million in 2026 Notes (the first domino) led inexorably to the stripping of the liens (the second domino), the issuance of the $250 million in additional notes "ha[d] the effect of" releasing the liens, and therefore required two-thirds consent. Because the Majority Group did not hold two-thirds of the relevant Notes at the time the "first domino" fell, the Bankruptcy Court determined that the 2022 Transaction as a whole violated the Existing Notes Indentures. As a remedy, the Bankruptcy Court recommended (i) reinstatement of the purportedly released liens securing the 2026 Notes, and (ii) allowance of the Majority Group's $250 million new money investment as an unsecured claim rather than a claim under the New 1L Notes.

Wesco and the Majority Noteholders appealed to the District Court, and Wesco's plan of reorganization, premised on the Bankruptcy Court's decision approving the 2022 Transactions, was confirmed on the express understanding that it was subject to revision in the event the decision was rejected in whole or part.

***The District Court's Ruling***

After announcing at a status conference in September 2025 that he would reject the Bankruptcy Court's report and recommendation, on December 8, 2025, Chief District Judge Randy Crane issued an opinion holding that the 2022 Transactions were "proper, appropriate, lawful, and consistent with the terms of the 2024 and 2026 Indentures."

As basis for its ruling, the District Court rejected the Bankruptcy Court's "falling dominos" framework, instead finding that each of the individual amendments complied with the express terms of the applicable indentures at the time such amendments were executed. The District Court noted that the indentures were negotiated by sophisticated parties who chose their language carefully and, if the parties had wanted to bargain for additional protections and higher consent thresholds to issue additional notes (so-called "sacred rights"), they could have done so, and the District Court "refuse[d] to find any implied sacred rights." Judge Crane also rejected the Bankruptcy Court's finding that each step in the 2022 Transactions took place "automatically" and "inevitably" after the process was set into motion. On that basis, Judge Crane held that the issuance of the additional $250 million in 2026 Notes could not have "had the effect of" stripping the liens securing the 2024 and 2026 Notes, because each step required affirmative, additional actions on the part of the parties.

The District Court's decision noted that the Minority Group included sophisticated entities, and found, as a factual matter, that such entities were fully aware that the indentures allowed Wesco to dilute a minority group's voting power. Indeed, the District Court pointed out, some of those same sophisticated parties had previously employed a similar approach as a majority noteholders in comparable prior transactions.

The District Court also noted that its focus on the express language of an underlying agreement (and, implicitly, the structure of each amendment on its face, rather than the aggregate effect of a series of

[1] The Bankruptcy Court issued its decision in the form of a report and recommendation, rather than an order, because the Minority Group's contract claims were not a "core" bankruptcy proceeding in which a bankruptcy judge can issue a final judgment.

amendments) is consistent with the Fifth Circuit's recent decision in *In re Serta Simmons Bedding, L.L.C.,* 125 F.4th 555 (5th Cir. 2025).[2] The District Court characterized the *Serta* decision as "underscore[ing] the importance of adhering to the precise language of indenture agreements."

Although the District Court found that no damages were warranted, the District Court observed that even if Wesco had breached the 2026 Notes indenture, the proper remedy for any such breach would be to allow the Minority Group to seek monetary damages from Wesco as compensation for the breach (which would, given that Wesco was a debtor in Chapter 11, result in an unsecured claim against the Debtors) and not, as the Bankruptcy Court proposed, to reinstate the stripped liens supporting the 2026 Notes while invalidating the Majority Group's new liens. The District Court noted that under both New York and Texas law, the ordinary remedy for a breach of contract is monetary damages. Equitable remedies for breach of contract are only available if monetary damages are shown to be inadequate, and the fact of the defendant's bankruptcy (and the attendant likelihood that the plaintiff may not be able to recover its damages in full) does not render monetary damages an inadequate remedy. The District Court observed that "if insolvency were always sufficient to make an award of damages against a defendant legally inadequate, then any plaintiff with a breach-of-contract claim against a bankrupt defendant would always be able to seek specific performance or other equitable remedies as a matter of course." The District Court further noted that the Bankruptcy Court's proposed remedy would cost Wesco (the purported breaching party) nothing, and impose all of the costs on the Majority Group noteholders, stripping them of their newly-obtained senior liens and demoting their $250 million new investment to an unsecured claim.

Judge Crane's decision effectively limits the risk associated with LMEs even if one is challenged. In contrast to the Bankruptcy Court's rejected framework, the risk profile created by the District Court's decision limits the downside for majority noteholders who effectuate LMEs, even if those transactions are later rejected: The worst-case outcome, under the *Wesco* decision, is that the minority group would receive an unsecured claim for damages that may be partially or wholly out of the money, leaving the uptiering transaction effectively intact.

***Conclusion***

The District Court's decision represents an important signal that the Fifth Circuit's decision in *Serta* does not mean a death knell to the creative, aggressive LME, even in the Fifth Circuit. Additional positive news for majority noteholder groups seeking to improve their positions through LME transactions in 2025 came from the New York Appellate Division's decision in the *Mitel* case, upholding an uptier transaction in part based on a finding (similar to that in *Wesco*) that the relevant notes indentures represented an agreement among sophisticated parties that prohibited some types of uptiering transactions, but not others. 2026 will undoubtedly see further litigation over LME transactions in which courts will continue to grapple with competing interpretations of various permutations of debt document provisions.[3]

…

CLEARY GOTTLIEB

[2] In *Serta*, the debtor engaged in an "uptier" liability management transaction in which a majority group of lenders under Serta's syndicated loans exchanged their existing secured debt for new super-priority debt through use of the "open market purchase" provision in the underlying debt documents. The minority group argued that the transaction breached a sacred right in the debtor's loan agreement which required the company to allocate any payments with respect to its debt, or conversion of its debt, among the lenders on a pro-rata basis. The Fifth Circuit agreed with a minority group of lenders that the transaction did not fall within the "open market purchase" exception to the pro rata sharing provision because, among other things, the relevant exchange had not taken place on an open market.

[3] *See, e.g.*, CastleKnight Master Fund L.P.'s Preliminary Objection to First Day Relief, *In re United Site Services, Inc., et al.*, No. 25-23630-MBK, Docket No. 57 (Bankr. D. N.J. Dec. 29, 2025) (previewing objection to proposed plan, *inter alia*, on grounds that 2024 LME violated sacred rights in pre-existing credit agreements); Complaint, *Deltroit Directional Opportunities Master Fund Limited et al. v. Selecta Group B.V. et al.*, No. 1:25-cv-08956-JPO (S.D.N.Y. Oct. 28, 2025) (alleging that 2025 LME stripped non-participating lenders' rights and subordinated their debt, and challenging use of cooperation agreement to effectuate LME).