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Houston We Have (Another) Problem: District Court Reverses Confirmation Over Unequal Treatment in *ConvergeOne*

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In this article, the author examines a court ruling that offers potential clarity regarding equal treatment requirements under Section 1123(a)(4) of the Bankruptcy Code and that provides important guidance on the structuring of backstopping and equity rights offerings in bankruptcy plans.

The U.S. District Court for the Southern District of Texas (the Court) recently issued a significant decision reversing the bankruptcy court's confirmation of the Chapter 11 plan of ConvergeOne Holdings, Inc. and certain of its affiliates (collectively, ConvergeOne).[1] The ruling offers potential clarity regarding equal treatment requirements under 11 U.S.C. § 1123(a)(4) and provides important guidance on the structuring of backstopping and equity rights offerings in bankruptcy plans. The potential scope of the decision and its impact on other exclusive opportunities offered to creditors in Chapter 11 cases, including, for example, with respect to DIP financing fees, remains unclear.

BACKGROUND

ConvergeOne, an information technology services provider, filed for Chapter 11 relief in the Southern District of Texas after negotiating a restructuring support agreement (the RSA) with approximately 81% of its first and second lien holders (the Majority Lenders).[2] The RSA was the product of extensive, months-long negotiations between ConvergeOne, its equity sponsor, and the Majority Lenders, but notably excluded certain other lenders (such excluded lenders, collectively, the Minority Lenders) from any participation in the process.[3] The RSA was finalized immediately before the bankruptcy filing and formed the basis of a prepackaged Chapter 11 plan (the Plan) that significantly

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1 ConvergeOne Dist. Ct. Order, Case No. 4:24-cv-02001 (S.D. Tex. Sept. 25, 2025), Dkt. No. 54.

2 Id. at 1-2.

3 Id. at 2-3.

deleveraged ConvergeOne's balance sheet while ceding control of the reorganized equity to ConvergeOne's prepetition secured lenders.[4]

Pursuant to the RSA and the Plan, the Majority Lenders received the exclusive right to purchase equity in the reorganized company through an equity rights offering at a significant discount to Plan value.[5] The Majority Lenders also committed to backstop the rights offering, receiving a 10% premium on their claims through the discounted equity purchases.[6] The backstopping arrangement required the Majority Lenders to reserve capital and meet certain milestones, but the opportunity to participate in the backstop, and thus to receive enhanced recoveries under the Plan, was not offered to all class members.[7] Minority Lenders, by contrast, were excluded from both the negotiations and the opportunity to participate in the backstopping arrangement, despite them actively seeking to be included.[8]

The Minority Lenders objected to the confirmation of the Plan, arguing that their exclusion from the backstopping and equity purchase opportunity violated the equal treatment mandate of Section 1123(a)(4).[9] Judge Lopez overruled the Minority Lenders' objection and confirmed the Plan, finding the backstop necessary and reasonable, holding that the additional recoveries were consideration for new financial commitments and that no market test was required.[10] The Minority Lenders subsequently appealed the order confirming the Plan.[11]

DISTRICT COURT'S ANALYSIS

On appeal, the Court (applying a de novo standard of review) focused on whether the Plan's exclusive backstopping opportunity constituted unequal treatment under Section 1123(a)(4).[12] The Court's analysis was guided by U.S. Supreme Court precedent in *Bank of America National Trust & Savings Association v. 203 N. LaSalle St. Partnership* (LaSalle),[13] as well as recent

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[4] Id.

[5] Id. at 3.

[6] Id.

[7] Id.

[8] Id. at 13.

[9] Id. at 4.

[10] Id.

[11] Notice of Appeal, Case No. 4:24-cv-02001 (S.D. Tex. May 28, 2024), Dkt. No. 1.

[12] ConvergeOne Dist. Ct. Order.

[13] Bank of America National Trust & Savings Association v. 203 N. LaSalle St. Partnership, 526 U.S. 434 (1999).

authority from the U.S. Court of Appeals for the Fifth Circuit in *In re Serta Simmons Bedding, LLC* (Serta).[14] The Court noted that while the Bankruptcy Code does not define "equal treatment," both *LaSalle* and *Serta* provide important guidance.[15] In *LaSalle*, the Supreme Court held that exclusive investment opportunities tied to prepetition claims or interests, absent market testing, constitute impermissible unequal treatment.[16] *Serta* further clarified that equal treatment under Section 1123(a)(4) requires both equality of value and opportunity, and prohibits disparate treatment with respect to value among class members.[17]

The Court found that the backstopping opportunity was exclusive to the Majority Lenders, constituted treatment on account of a claim, and provided disparate recoveries across similarly situated claims in the same Plan class.[18] The Court emphasized that the opportunity to participate in the backstop (and to receive enhanced recoveries) was itself a valuable right that was not made available to all similarly situated creditors and no consideration was paid for the exclusivity.[19] The Court also addressed the argument that the Minority Lenders had a meaningful opportunity to propose alternative plans after the RSA and Plan were finalized, finding that, given the prepackaged nature of the case and the overwhelming creditor support for the Plan, proposed alternatives were effectively futile.[20] The Court described the opportunity to propose alternatives as "illusory at best," since the Plan was already locked in by the time the bankruptcy was filed.[21]

Additionally, the Court devoted significant attention to the question of whether a sufficient "market test" had been conducted for the backstop opportunity.[22] The opinion noted that, unlike in other cases where all creditors had the chance to participate or where alternative capital-raising options were considered, the ConvergeOne backstop was not subjected to any open-market process or subjected to a fair-market valuation test.[23] The Court cited the

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[14] In re Serta Simmons Bedding, LLC, 125 F.4th 555 (5th Cir. 2024).

[15] Id. at 12.

[16] Id. at 9-11.

[17] Id. at 12-13.

[18] Id. at 13.

[19] Id. at 13-14.

[20] Id. at 16-17.

[21] Id. at 17.

[22] Id. at 14-19.

[23] Id. at 18.

Seventh Circuit's *Castleton Plaza* decision[24] as persuasive for requiring some form of competitive bidding or auction in certain circumstances.[25] Ultimately, the Court found the absence of any meaningful market check or opportunity for all similarly situated creditors to participate in the backstop to be a critical flaw, but did not provide clarity regarding what might satisfy the "market test" requirement in future cases.[26]

The Court also addressed the issue of equitable mootness, an argument raised by the Majority Lenders on appeal in their motion to dismiss.[27] Dismissal of an appeal as equitably moot requires the appellee to establish three elements:

(1) The plan of reorganization has not been stayed;

(2) The plan has been substantially consummated; and

(3) The relief requested by the appellant would either affect the rights of third parties or the success of the plan.[28]

The Minority Lenders focused on the third element, asserting that the Court could fashion complete relief by ordering the Majority Lenders to transfer certain of the reorganized equity distributed under the Plan on account of the exclusive backstop opportunity to the Minority Lenders, thereby achieving the same treatment on account of the same claims.[29] The Court agreed with the Minority Lenders, denying the Majority Lenders' motion to dismiss.[30]

The Court's Key Findings

1. *Exclusive Opportunity as Unequal Treatment*: The Court found that the Plan's backstopping arrangement provided an exclusive and valuable

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[24] In re Castleton Plaza, LP, 707 F.3d 821 (7th Cir. 2013). In Castleton Plaza, the Seventh Circuit held that "new value" plans – i.e., Chapter 11 plans pursuant to which existing shareholders receive the right to contribute new value to retain or receive ownership in exchange for consideration – must be subjected to market testing.

[25] ConvergeOne Dist. Ct. Order at 17-18.

[26] Id. at 19.

[27] Order Denying Motion to Dismiss, Case No. 4:24-cv-02001 (S.D. Tex. Oct. 23, 2024), Dkt. No. 43. To succeed on the dismissal of an appeal on grounds of equitable mootness, the appellee must show (1) the plan of reorganization has not been stayed, (2) the plan has been substantially consummated, and (3) the relief requested by the appellant would either affect the rights of third parties or the success of the plan. The Court noted that the Plan had not been stayed and had been substantially consummated, and focused on determining if the requested relief would harm third parties or threaten the success of the Plan, finding that it did not.

[28] Id. at 6.

[29] Id.

[30] Id. at 9.

opportunity to certain creditors within the same class, resulting in significantly higher recoveries for those creditors in violation of Section 1123(a)(4).[31]

2. *Lack of Market Test*: The Court emphasized that, consistent with *LaSalle* and *Castleton*, the absence of an open-market and competitive process to determine the value of the backstopping opportunity did not satisfy the "market test" requirement.[32]

3. *No Consideration for the Opportunity*: While the Majority Lenders provided consideration in the form of backstopping commitments, the Court held that the opportunity to participate in the backstop, and to receive enhanced recoveries for that participation, was itself a valuable right that was not made available to all similarly situated creditors, nor was any consideration paid for the exclusivity.[33]

4. *Illusory Alternative Proposals*: The Court rejected arguments that Minority Lenders had a meaningful opportunity to propose alternative plans after the RSA and the Plan were finalized, finding that the prepackaged nature of the case and the overwhelming creditor support for the Plan made alternative proposals effectively futile.[34]

5. *Application of* Serta *and* LaSalle: The Court drew parallels to *Serta*, where the Fifth Circuit held that equal treatment under Section 1123(a)(4) requires both equality of value and opportunity.[35] The Court also relied on *LaSalle*'s instruction that exclusive investment opportunities, absent market testing, constitute value received on account of a prepetition claim or interest.[36]

6. *Impact*: The scope and potential impact of the Court's decision remain unclear. While the decision was rendered in the context of Chapter 11 plan confirmation, parties must assess whether other exclusive rights offered prior to plan confirmation to certain similarly situated creditors (e.g., the right to participate in DIP financing) may run afoul of the ConvergeOne decision.

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[31] ConvergeOne Dist. Ct. Order at 13.

[32] Id. at 18.

[33] Id. at 21.

[34] Id. at 16-17.

[35] Id. at 12-13.

[36] Id. at 11.

The Court's Conclusion

The Court concluded that the Plan's exclusive backstopping and equity rights offering violated the equal treatment requirement of Section 1123(a)(4) by providing certain creditors with a valuable opportunity not available to others in the same class, without adequate consideration or market testing.[37] The Court found that the Plan's structure resulted in a significant disparity in recoveries among class members, and that the process by which the backstopping arrangement was negotiated and implemented failed to provide all similarly situated creditors with an equal opportunity to participate.[38] As a result, the Court reversed the bankruptcy court's confirmation order to the extent that it overruled the Minority Lenders' objection and remanded the case for further proceedings consistent with its decision.[39]

IMPLICATIONS

It is too early to fully appreciate the potential scope of the Court's ruling in *ConvergeOne*. The decision leaves open the possibility that similar exclusive opportunities, even outside the context of a backstopping agreement, may be subject to scrutiny under Section 1123(a)(4) if they result in unequal treatment among similarly situated creditors. For example, in addition to potential DIP financing exclusive rights, the decision could also impact other common restructuring practices, such as exit financing arrangements, rights offerings, or private placements where participation is limited to select creditors or investors. As a result, debtors and plan proponents may need to carefully evaluate the fairness and openness of any process that confers special benefits or investment rights on a subset of creditors, particularly if no consideration is paid for such exclusive investment opportunity or if the process for valuing such opportunity is not subjected to a market test.

It is also uncertain how the bankruptcy court will fashion a remedy on remand. Though the Court agreed with the Minority Lenders that relief was possible without unwinding the Plan, the decision does not prescribe a specific solution to resolve the inequality. The form and scope of relief remain undetermined, and the decision leaves open whether the bankruptcy court will implement the Minority Lenders' proposed equity transfer solution. Ultimately, the decision may lead to a settlement among the parties or further appeals to higher courts, in which case the process could take several years to reach a final resolution.

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[37] Id. at 20-21.

[38] Id. at 20.

[39] Id. at 22.