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# U.S. District Court Finds That Exclusive Backstop Agreement Violates Equal Treatment Requirement

*By Sean A. O’Neal, Joshua Brody, Jane VanLare and Theodore L. Leonhardt\**

*In this article, the authors examine a recent court decision in which a court closely scrutinized a transaction favoring a majority-lender group that excluded minority lenders.*

The U.S. District Court for the Southern District of Texas (the District Court) reversed the bankruptcy court’s approval of plan confirmation in *In re ConvergeOne Holdings*,<sup>1</sup> finding that a backstop agreement for an equity rights offering available exclusively to a majority of lenders, without any market test, violated the equal treatment requirement of § 1123(a)(4) of the U.S. Bankruptcy Code.

Relying heavily on decisions by the U.S. Supreme Court in *LaSalle*<sup>2</sup> and the Fifth Circuit in *Serta*,<sup>3</sup> the District Court held that the Debtors’ Chapter 11 plan breached § 1123(a)(4), because it gave better recoveries to a majority of lenders than for others in the same class. *ConvergeOne* represents another decision, like *Serta*, in which a court closely scrutinizes transactions favoring a majority-lender group that exclude minority lenders.

## **BACKGROUND**

ConvergeOne Holdings, Inc. (the Company or ConvergeOne) filed a prepackaged bankruptcy in the U.S. Bankruptcy Court for the Southern District of Texas (the Bankruptcy Court) in April 2024. Pursuant to a restructuring support agreement, the majority of first-lien lenders (the Majority Lenders) agreed to receive take-back debt and the right to purchase additional equity in a direct subscription at a 35% discount to ConvergeOne’s stipulated equity value in a \$245 million rights offering. As a backstop commitment fee, the Majority Lenders received additional equity in an amount equal to 10% of

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<sup>1</sup> *In re ConvergeOne Holdings, Inc.*, Case No. 24-90194 (S.D. Tex. Sept. 25, 2025) (hereinafter, *ConvergeOne*).

<sup>2</sup> *Bank of America National Trust & Savings Association v. 203 N LaSalle St. Partnership*, 526 U.S. 434 (1999) (hereinafter, *LaSalle*).

<sup>3</sup> *In re Serta Simmons Bedding, L.L.C.*, 125 F.4th 555 (5th Cir. 2024) (hereinafter, *Serta*).

the total amount raised in the rights offering, at a 35% discount to plan value. The Majority Lenders represented approximately 81% of first-lien claims and included an affiliate of the Company's private equity sponsor. Other creditors in the same class (the Minority Lenders) received neither the opportunity to participate in the negotiations preceding the prepackaged bankruptcy, nor the chance to serve as backstop parties entitled to additional fees and rights. The backstop agreement sweetened the Majority Lenders' recoveries by, on average, 30% above those of the Minority Lenders.<sup>4</sup>

After the filing of the prepackaged bankruptcy, the Minority Lenders' two attempts at proffering alternative plans were unsuccessful, and they objected to the confirmation of the Company's plan.

Specifically, they argued that the exclusive backstop opportunity in favor of the Majority Lenders violated 11 U.S.C. § 1123(a)(4), which requires a plan to "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest."<sup>5</sup>

The Bankruptcy Court overruled the Minority Lenders' objection and confirmed the prepackaged plan, finding the backstop agreement reasonable and necessary, and further holding that a market test was not required for an arm's-length backstop commitment.

While the District Court denied the Minority Lenders' request for a stay, it rejected the Majority Lenders' argument that the Minority Lenders' appeal of the confirmation order was equitably moot.

On appeal, the issue was "whether the exclusion of the Minority Lenders from the backstopping opportunity constituted unequal treatment in violation of 11 U.S.C. § 1123(a)(4)."<sup>6</sup> The Minority Lenders contended that the plan was improper, because the investment opportunity itself was open only to certain creditors and was not market tested.<sup>7</sup> The Majority Lenders argued that they merely received additional consideration in exchange for the incremental obligations to backstop the rights offering.<sup>8</sup>

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<sup>4</sup> ConvergeOne at 6.

<sup>5</sup> 11 U.S.C. § 1123(a)(4).

<sup>6</sup> ConvergeOne at 6.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 7.

## THE DISTRICT COURT’S DECISION

Like the Fifth Circuit panel in *Serta*,<sup>9</sup> the District Court in *ConvergeOne* observed that “equality of distribution among similarly situated creditors” is a “central policy of the Bankruptcy Code.”<sup>10</sup>

Additionally, the District Court focused on another foundational principle of U.S. bankruptcy law, the “absolute priority rule” that requires senior creditors to be paid in full before junior creditors or equity holders.

The District Court noted that the U.S. Supreme Court’s extended analysis of the absolute priority rule in *LaSalle* provided a helpful analogy for understanding § 1123(a)(4). In *LaSalle*, the U.S. Supreme Court “rejected a reorganization plan that gave a debtor’s pre-bankruptcy equity holders the exclusive opportunity to receive ownership interests in the reorganized debtor if they would invest new money in the reorganized debtor.”<sup>11</sup> Most importantly for the District Court, the Supreme Court had observed that the exclusive opportunity was, itself, “a property interest ‘on account of’” the equity holders’ pre-bankruptcy equity interests.<sup>12</sup> Given that causal relationship, the Supreme Court held that “plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii).”<sup>13</sup> Notably, the Supreme Court did not determine the meaning or scope of a “market test.”<sup>14</sup>

Applying *LaSalle*, the District Court in *ConvergeOne* found that the agreement to backstop the rights offering was, effectively, inseparable from the Minority Lenders’ underlying debt claims. The District Court distinguished another case addressing similar issues, *In re Peabody Energy*,<sup>15</sup> by noting that all of the creditors in the same class in that instance had the opportunity to participate in the private placement, unlike the backstop at issue.

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<sup>9</sup> *Serta* at 565.

<sup>10</sup> *ConvergeOne* at 8 (internal citation omitted).

<sup>11</sup> *Id.* at 9.

<sup>12</sup> *Id.* at 10 (quoting *LaSalle* at 456).

<sup>13</sup> *Id.* at 10-11 (quoting *LaSalle* at 458).

<sup>14</sup> As observed by the District Court, the analysis in *In re Castleton Plaza LP*, 707 F.3d 821 (7th Cir. 2013) (Easterbrook, J.) centered on the existence of competition in the form of bidding for an investment opportunity. In *ConvergeOne*, the Company relied entirely on a review of precedent backstop transactions, and the District Court found the Minority Lenders’ opportunity to offer alternative plans did not represent a market test, being “illusory at best.” *ConvergeOne* at 3, 16-18.

<sup>15</sup> *In re Peabody Energy Corp.*, 933 F.3d 918 (8th Cir. 2019) (hereinafter, *Peabody*).

Moreover, creditors in *Peabody* qualified for the private placement by providing additional consideration, including backstop commitments for the private placement and a separate rights offering, and the debtor there elected to pursue the capital raise from among several financing alternatives. Unlike *Peabody*, the investment opportunity that led to the Majority Lenders' higher recoveries was given for no consideration – the “most salient factor” for the District Court.<sup>16</sup>

Additionally, the District Court relied on the Fifth Circuit's recent decision in *Serta*, which also involved transactions approved by a majority of creditors over the objection of excluded lenders. Following the *Serta* panel's admonition to dive “below the surface to determine whether distributions were in fact equal in value,”<sup>17</sup> the District Court conducted a similarly fact-intensive analysis. The Fifth Circuit in *Serta* had held that a plan must provide “equality of opportunity, even if equality of recovery does not necessarily result.”<sup>18</sup> To the *Serta* panel, “equal treatment prohibits disparate treatment with respect to value,”<sup>19</sup> although it “does not require ‘precise equality, only approximate equality.’”<sup>20</sup> In *ConvergeOne*, not only were the recoveries substantially different, but the investment opportunities were unequal. The occurrence of the unequal treatment before the filing of the bankruptcy petition in *ConvergeOne* did not mitigate it.

Accordingly, the District Court reversed the Bankruptcy Court's confirmation order, to the extent it overruled the Minority Lenders' objection based on § 1123(a)(4), while remanding for further proceedings.

## IMPLICATIONS

Backstopped rights offerings are a common method of increasing certainty for exit financing in Chapter 11 cases. It is not unusual in large Chapter 11 cases for a backstop opportunity to be granted only to certain creditors, even without a market test. The District Court in *ConvergeOne* invalidated the backstop arrangement by reasoning that “at the time the bankruptcy petition was filed, the train had already left the station, and the Minority Lenders were never permitted to board.”<sup>21</sup>

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<sup>16</sup> *ConvergeOne* at 14.

<sup>17</sup> *Id.* at 19 (quoting *Serta* at 592).

<sup>18</sup> *Id.* at 13.

<sup>19</sup> *Id.* at 12-13 (citing *Serta* at 592).

<sup>20</sup> *Id.* at 12 (quoting *Serta* at 591).

<sup>21</sup> *Id.*

*ConvergeOne* could be read as continuing down the track, laid in *LaSalle* and *Serta*, of scrutinizing deals with majority lenders at the expense of minority creditors.