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Lender on Lender Violence: Section 1123 Strikes Back

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On Sept. 25, 2025, the United States District Court for the Southern District of Texas (District Court) issued an appellate ruling in *In re ConvergeOne Holdings*, Case No. 24-02001 (S.D. Tex. Sept. 25, 2025) reversing the bankruptcy court's prior confirmation of ConvergeOne Holdings, Inc and its subsidiaries (collectively, the debtors) Chapter 11 plan (plan). The debtors, which provided IT, cloud and communications-based solutions, negotiated a restructuring support agreement (RSA) with approximately 81% of their first and second lien holders prior to commencing their chapter 11 cases. The RSA and the subsequent prepackaged Chapter 11 plan aimed to eliminate $1.6 billion in secured debt and included an "equity rights offering" at a discount, which was exclusively available to the majority of first lien holders (majority lenders), along with a 10% backstop fee. Importantly, those non-majority lenders (minority lenders) were excluded from both the negotiations and the opportunity to participate in the backstopping and equity purchase.

After the plan was filed, minority lenders objected to the confirmation of the prepackaged plan, arguing that their exclusion from the rights offering violated the equal treatment requirement of Section 1123 of the Bankruptcy Code. The District Court, reversing the bankruptcy court's prior confirmation of the plan over the objection of the minority lenders, found that the exclusive rights offering violated the sacred tenant of equal treatment found in the Bankruptcy Code. Specifically, the requirement that a plan "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" found under Section 1123(a)(4).

In reaching its conclusion, the District Court focused on the Supreme Court decision in *Bank of America National Trust & Savings Association v. 203 N LaSalle St. Partnership*, 526 U.S. 434 (1999), which, while addressing the absolute priority rule under Section 1129(b) of the Bankruptcy Code, was found to be instructive regarding exclusive opportunities and market testing. In *LaSalle*, the Supreme Court rejected a plan that gave equity holders an exclusive opportunity to invest in the reorganized debtor without market testing, finding this constituted a property interest received "on account of" their prior interest. The District Court also specifically noted and distinguished the circumstances before it in the *ConvergeOne* plan from those present in *In re Peabody Energy*, where **all** creditors had the opportunity to participate in a discounted stock offering, as well as the Fifth Circuit's recent decision in *In re Serta Simmons Bedding*, 125 F.4th 555 (5th Cir. 2024), which held that equal treatment under Section 1123(a)(4) requires both equality of opportunity and approximate equality of value. The following are several of the focal points in the District Court's decision:

1. Exclusivity and Lack of Market Test: The backstopping opportunity was offered exclusively to majority lenders,

with minority lenders intentionally excluded from negotiations and participation. There was no market test or competitive bidding to determine the fair value of the opportunity.

2. Disparate Value: The exclusive opportunity resulted in majority lenders receiving, on average, a 30% higher recovery for their claims compared to minority lenders, far exceeding "approximate equality."

3. No Consideration for Opportunity: While majority lenders provided backstop funds in consideration for the returned equity, there was no consideration for the opportunity itself, which was granted solely based on their status as majority lenders.

4. Illusory Alternatives: The minority lenders were given only a brief window to propose alternative plans after the RSA and plan were finalized, but the District Court found these alternatives were not genuinely considered and could not realistically succeed given the pre-packaged nature of the plan and the supermajority support for the original deal.

5. Precedent and Policy: The Court found the plan analogous to *LaSalle*, where exclusive opportunities **without** market testing or genuine competition violate the Bankruptcy Code's equal treatment requirements, which was further supported by the *Serta* decision's mandating that both the opportunity and the result must be equal among class members.

In sum, the District Court staked the following guideposts in remanding the *ConvergeOne* plan back to the bankruptcy court:

- Section 1123(a)(4) mandates equality in opportunity to participate

- An "open market test" is instructive in determining whether an associated backstopping fee is appropriate

ConvergeOne is the most recent in a growing number of challenged restructuring and liability management transactions brought by minority lenders who have either been kept in the dark or flatly shut out of negotiations by borrowers and majority lender groups. The District Court's opinion makes clear that there is a low tolerance for efforts to exclude minority groups for the ultimate benefit of a select group of lenders through restructuring transactions and similar liability management exercises. Indeed, equality is a chief pillar of the Bankruptcy Code, and any Chapter 11 plan that seeks to unabashedly shun that requirement will be refuted by the courts. Moreover, the *ConvergeOne* decision appears to potentially widen the holding in *Serta* to require that nearly all prepetition restructuring transactions (*e.g.*, backstopping arrangements and related fees) are subject to an "open market test" requirement if a bankruptcy court is to find Section 1123(a)(4) has been satisfied in support of confirmation.

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