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Client Alert

October 2025

CovergeOne Holdings Inc. – District Court Overturns Bankruptcy Court, Rejects Exclusive Rights Offering in Favor of "Market Test" and "Equal Treatment"

So-called "creditor on creditor violence" resulting from liability management exercises ("LME") can take different forms. In some aggressive cases, certain lenders are given the opportunity to finance the borrower and gain extra value or better their positions in a restructuring, while other similar lenders are left out.

In *In re ConvergeOne Holdings, Inc*., No. 4:24-cv-02001 (S.D. Tex. Sept. 25, 2025), the District Court for the Southern District of Texas held that a bankruptcy plan unfairly discriminated against minority lenders who were excluded from investment opportunities that yielded higher recoveries for majority lenders. Relying on last year's seminal Fifth Circuit decision in *In re Serta Simmons Bedding, LLC*, 125 F.4th 555 (5th Cir. 2024) and the Supreme Court's decision in *Bank of America National Trust & Savings Association v. 203 N. LaSalle St. Partnership*, 526 U.S. 434 (1999), the court concluded such exclusions result in unequal treatment within the same creditor class.

Background

ConvergeOne Holdings, Inc. and its subsidiaries (collectively, "Debtors") filed for Chapter 11 bankruptcy in the Southern District of Texas. The Debtors, operating in the information technologies sector, had reached a restructuring support agreement ("RSA") with approximately 81% of their first and second lien holders before filing for bankruptcy. The RSA was designed to eliminate $1.6 billion of secured debt and included an equity rights offering that allowed certain creditors, herein referred to as the Majority Lenders, to purchase discounted equity in the reorganized company. The Minority Lenders were excluded from this opportunity and objected to the Debtors' Plan, arguing that it violated the equal treatment requirements of 11 U.S.C. § 1123(a)(4) by providing exclusive investment opportunities to certain creditors, resulting in higher recoveries for them.

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Bankruptcy Court's Decision

The Bankruptcy Court confirmed the Plan, finding that the backstop was necessary and reasonable and held that the Plan did not violate 11 U.S.C. § 1123(a)(4) because the extra value recovered by the Majority Lenders was consideration for new additional commitments and was not on account of their existing claims. The Bankruptcy Court did not require a market-test requirement for the backstopping opportunity at issue. The Minority Lenders appealed.

Motion to Dismiss on "Mootness"

Importantly, prior to the District Court's decision, it previously denied the Majority Lenders' motion to dismiss the appeal as equitably moot. The Majority Lenders argued that the Minority Lenders' failure to obtain a stay, and the substantial consummation of the Plan that followed, meant that the Minority Lenders' requested relief would require "unwinding" the Plan and the destruction of third parties' rights. Importantly, in denying the motion to dismiss, the District Court held that relief could be granted without "unwinding" the Plan or unfairly impairing the rights of third parties, as the dispute concerned a discrete payment and the sale of certain equity interests.

District Court Reverses: Analysis

The District Court then reviewed the appeal *de novo* and focused on whether the exclusion of the Minority Lenders from the backstopping opportunity constituted unequal treatment under 11 U.S.C. § 1123(a)(4). The Court found that the Majority Lenders were given the exclusive opportunity to purchase discounted stock in the new company in exchange for agreeing to backstop the Plan and Debtors' emergence from bankruptcy. It found that this exclusive agreement with the Majority Lenders resulted in significantly higher recoveries on the Majority Lenders' claims and, contrary to Supreme Court precedent, was not subject to a market test. The Court noted that the Minority Lenders were excluded from negotiations and were not given a genuine opportunity to propose an alternative plan.

The Court relied on the Supreme Court's decision in *203 N. LaSalle St. Partnership*, and the Fifth Circuit's decision in *In re Serta Simmons Bedding, LLC*, to conclude that the exclusive backstopping opportunity constituted unequal treatment. The Court emphasized that the Plan must provide an equality of opportunity, even if equality of recovery does not necessarily result. The Court noted that the Debtors' discussions with the Majority Lenders, which excluded the Minority Lenders, and conclusory testimony regarding comparable rights offerings did not constitute a "genuine test of the market" of the backstopping opportunity. It further

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remarked that the Minority Lenders were never given the chance to propose a viable alternative plan for the Debtors to consider. Thus, the exclusive backstopping opportunity resulted in unequal treatment under both *LaSalle* and *Serta*.

Takeaway

When only some lenders in a lending group get exclusive opportunities and others are left out, it often leads to uncertainty in the market and lawsuits. Some bankruptcy courts have approved these deals in the past, but that may be changing. Following *Serta* and *ConvergeOne*, courts will continue to focus on whether "excluded" lenders had a meaningful opportunity to participate in LME's and whether a legitimate market test occurred.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys below if you would like to discuss further or have any questions.

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