Westlaw Today

ConvergeOne: Restructuring risk and plan certainty

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NOVEMBER 5, 2025

On September 25, 2025, the U.S. District Court for the Southern District of Texas reversed key portions of the bankruptcy court's approval of ConvergeOne's prepackaged Chapter 11 bankruptcy plan, holding that exclusive backstop and equity subscription rights granted to a subset of prebankruptcy first-lien creditors violated 11 U.S.C. § 1123(a)(4) by granting unequal treatment to similarly situated lenders.

The decision intensifies scrutiny of non-*pro rata* exit financing structures in Chapter 11, raises fresh concerns about Chapter 11 plan finality, and compels investors to rethink both execution strategy and disclosure frameworks in distressed scenarios.

For sponsors, borrowers, lenders, and their counsel, the message is clear: To ensure certainty in Chapter 11, parties should prioritize a disciplined approach to inclusive outreach to similarly situated lenders, incorporation of defensible market tests, rigorous documentation of steps taken to ensure fairness, and cost controls.

In many scenarios, the value-maximizing path may lie outside the courtroom — but where bankruptcy remains necessary, a confirmed Chapter 11 plan may not be the final word if the process to negotiate the plan and substance of the plan do not meet the heightened bar laid out in the district court's opinion.

Background: Prepetition and Chapter 11 case

ConvergeOne, Inc., which was private equity-owned at the time of its bankruptcy filing, is a multinational information technology company. ConvergeOne had approximately $1.8 billion in secured debt when it filed for Chapter 11 in the Southern District of Texas in April 2024 with a fully negotiated bankruptcy plan, including a restructuring support agreement (RSA) signed by the majority of its senior creditors (~81% of the first lien and 100% of the second lien).

The proposed plan involved the exchange of approximately $1.6 billion of debt for equity and a $245 million capital raise in the form of a discounted equity rights offering backstopped by the majority lenders.

$159 million of the equity would be offered *pro rata* to first-lien creditors, while the remaining $86 million was reserved exclusively for the backstopping majority, who would also receive a 10% backstop premium on their claims plus rights to any unsubscribed shares. This allowed the majority lenders to recover 31% more than the excluded minority lenders. Crucially, the debtors did not solicit alternative proposals for the backstop arrangement prepetition.

A group of first-lien lenders holding around $164 million in first-lien claims that were excluded from participation in the backstop objected to confirmation of the plan, arguing that limitation of the right to participate in the backstop to only a subset of the first-lien lender group resulted in disparate treatment of similarly situated creditors, violating a central pillar of U.S. bankruptcy practice.

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The bankruptcy court overruled the objection and confirmed the plan, finding the backstop to be necessary and reasonable new-money compensation reached after extensive arm's-length negotiations. The bankruptcy court viewed the backstop premium and right of the majority lenders to participate in the backstop as a new-money transaction separate from the plan's treatment of the prebankruptcy debt and declined to require a formal market test.

Analysis: District court decision

On appeal to the district court, Judge Andrew Hanen reversed that portion of the confirmation authorizing exclusive backstop and discounted equity rights, ruling that those features violated 11 U.S.C. § 1123(a)(4) absent a robust market process, and remanded to the bankruptcy court for further proceedings.

The district court focused on the text of §1123(a)(4) and its requirement that a plan must "provide the same treatment for each claim or interest of a particular class" unless a claimholder agrees to less favorable treatment.

The district court determined that the opportunity to participate in the backstop constituted "treatment" of the prepetition loans for the purposes of § 1123(a)(4) because the majority lenders gave no consideration for the opportunity to participate, other than their existing prepetition loans, and the value of participation in the backstop was not market tested.

Therefore, the majority lenders received something of value (the ability to participate in the backstop) on account of their claim in the secured lender class (rather than on account of new value given to the debtors).

In its analysis, the district court draws heavily from analogies to three cases. The first is *LaSalle*, a 1999 U.S. Supreme Court case that deals with the "absolute priority rule" of 11 U.S.C. § 1129(b) (dealing with relative payment priority among creditor classes rather than equal treatment within an individual class).

The court found *LaSalle* instructive for the proposition that the grant of an exclusive opportunity to purchase equity in a reorganized entity tied to a creditor's prebankruptcy equity interest in, or debt claim against, a bankrupt company constitutes "treatment" on the basis of that claim rather than an independent transaction in exchange for new money.

The district court distinguished *In re Peabody*, an Eighth Circuit case from 2019, in which a bankruptcy plan was confirmed that involved "an exclusive sale of discounted preferred stock to qualifying creditors," because the opportunity in *Peabody* was offered to all lenders and the debtor had conducted a process to identify alternative capital raising methods.

Drawing on the recent 2024 Fifth Circuit decision in *In re Serta Simmons Bedding, LLC*, (which we previously analyzed, https://bit.ly/3Jw1NwE), the district court held *Serta* to be instructive for the principle that "a plan must provide an equality of opportunity, even if equality of recovery does not necessarily result."

In *Serta*, all lenders of a specific class received the same indemnity, but the indemnity was of much greater value to the lenders who had participated in the prebankruptcy "uptier" transaction and thus exposed themselves to substantial litigation risk.

Drawing on the Fifth Circuit's *Serta* decision, the district court emphasized the need to "look below the surface to determine whether distributions [under a bankruptcy plan] were in fact equal" — that is, to evaluate parity in opportunity, not just facially equal treatment.

The district court's opinion also focused in significant part on the fact that the opportunity to participate in the backstop was valuable (leading to a 31% higher recovery for backstop parties vs. nonbackstop parties), participation rights were granted to the majority lenders for no consideration, and the economic terms of the backstop were not market tested.

Had the backstop's terms been market tested and the majority lenders' proposal reasonably determined by the debtors to have been the best available source of liquidity, the case likely would have come out differently.

The district court declined to provide a working definition of a "market test" for backstops and similar arrangements but determined that no such market test occurred because the only alternatives to the backstop that the debtors considered were the proposals the minority lenders made during the bankruptcy cases, when "the train had already left the station."

The district court also rejected the debtors' fallback arguments that the minority lenders' proposals during the bankruptcy cases constituted a market test.

Because key mechanics were locked in prepetition via the RSA, there was, as a practical matter, insufficient time to structure an alternative, and the majority lenders, who held a blocking position in the relevant creditor classes, were heavily incentivized to vote against any alternative in order to preserve for themselves the benefit of the backstop.

On October 22, 2025, ConvergeOne filed a notice of appeal of the district court's decision to the U.S. Court of Appeals to the Fifth Circuit.

Structural and strategic implications for investors

ConvergeOne amplifies the building tension between judicial policing of fairness in both in- and out-of-court restructurings and the Bankruptcy Code's policy of facilitating creditors' reliance on confirmed Chapter 11 plans. By refusing to bless exclusive anchor economics without a market test, the district court strengthened the "equality of opportunity" norm that has animated other recent decisions and narrowed the margins for structural creativity in the Chapter 11 context.

Following *ConvergeOne*, exclusive backstop or anchor rights are now legally riskier unless subjected to a defensible market process, which may be impractical to run where the restructuring company is smaller or facing extreme liquidity constraints. Investors should understand that even a Chapter 11 plan confirmed by a bankruptcy court may be vulnerable to continuing litigation, including unwinding of side deals (e.g., exclusive backstop rights or equity allocation carveouts) if process or fairness objections are sustained on appeal.

In large, protracted cases, where advisers' fees can reach tens or even hundreds of millions of dollars, lack of certainty upon plan confirmation may cause investors to rethink the relative benefits and risks of pursuing a non-*pro rata* structure, demand enhanced economics to compensate themselves for enhanced litigation risk, or decline to participate in exit financing at all, depending on the scenario.

Takeaways

- Post-*ConvergeOne* and *Serta*, functionally non-*pro rata* transaction structures carry enhanced litigation risk both in and out of court, even if facially neutral. Investors will likely price the risk into deal economics, making non-*pro rata* structures more expensive for debtors.

- Transparency, risk allocation, and equality of opportunity should be front of mind when structuring a distressed recapitalization. Maintaining a clear record of solicitation, management and the board's evaluation of bids, valuation rationales, and internal deliberations remains imperative.
- Structuring may shift toward classwide offers, subscription vehicles, or less carveout-heavy designs.
- Clear governance protocols are essential. It may not be enough to show that a lender-approved "independent" director consented to a transaction if other indications of a robust process are not present (i.e., a market test, meaningful opportunity for broad creditor participation in the process, involvement of an investment banker or other professionals).
- Robust independent valuation efforts and/or fairness committee oversight for structuring decisions may help mitigate litigation risk.
- In some situations, out-of-court alternatives (workouts, distressed exchanges, hybrid structures) may provide better opportunity to restructure balance sheets, particularly where structural or cost risk outweigh benefits.
- Because *ConvergeOne* introduces elevated structural litigation risk and uncertainty in economic awards, funds active in distressed credit or special situations should proactively disclose the existence of these risks to investors to help align expectations and reduce surprises and should note that such challenges could increase costs and reduce or delay anticipated returns.
- Sponsors should disclose affiliate relationships, for example, where a sponsor-related affiliate is acting as a backstop provider or participating in an investment. Such roles may be subject to greater scrutiny and materially increase litigation risk challenge in a downside case. While the affiliate may be the only party who sees value and is willing or able to negotiate and steer a meaningful turnaround, disclosure and documenting the broader market's relative lack of interest are key.

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This article was published on Westlaw Today on November 5, 2025.