Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10169 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

ConvergeOne Ch. 11 Ruling Clarifies Lender Incentive Limits

By **Pratik Raj Ghosh** (October 29, 2025, 2:17 PM EDT)

Pratik Raj Ghosh

In a significant ruling from the U.S. District Court for the Southern District of Texas, U.S. District Judge Andrew S. Hanen's In re: ConvergeOne Holdings Inc. decision marks the latest rebuke of selective lender incentives in bankruptcy.[1]

The Sept. 25 opinion underscores that offering an investment opportunity only to a subset of lenders within a creditor class, without providing other lenders in that creditor class any meaningful chance to participate, violates Section 1123(a)(4) of the Bankruptcy Code.

ConvergeOne is the latest in a series of decisions delineating the boundaries of liability management exercises, or LMEs.

Two appellate decisions issued on Dec. 31, 2024, reshaped the landscape for LMEs. First, the U.S. Court of Appeals for the Fifth Circuit's In re: Serta Simmons Bedding LLC decision scrutinized open market purchase provisions in syndicated loan agreements.[2] Then, the New York Appellate Division, First Department's Mitel Networks decision, captioned Ocean Trails CLO VII v. MLN Topco Ltd., reached the opposite conclusion on similar facts, based on different contractual language.[3]

Now, Judge Hanen's ConvergeOne decision applies Serta's reasoning to invalidate a backstopped equity rights offering in bankruptcy that excluded a minority of lenders.

Together, these rulings clarify what lenders and debtors can and cannot do both inside and outside of Chapter 11. And the Fifth Circuit will get another chance to weigh in on this topic as ConvergeOne filed a notice of appeal of Judge Hanen's decision on Oct. 22, and the minority lender ad hoc group cross-appealed on Oct. 24.[4] Though the outcome of the appeal is uncertain, Judge Hanen's opinion provides important guidance on how courts may view selective lender incentives in the Fifth Circuit.

Unequal Rights Offerings Violate Section 1123(a)(4)

Judge Hanen's decision arose from ConvergeOne Holdings' prepackaged Chapter 11 plan. The company entered bankruptcy in April 2024 with $1.8 billion in secured debt and a restructuring support agreement backed by 81% of its first- and second-lien lenders.

The plan included a $245 million equity rights offering, backstopped by a majority group of first-lien lenders who also received the exclusive opportunity to buy discounted equity as compensation for that backstop. The backstop economics translated into roughly 30% higher recoveries for those lenders

compared to minority lenders in the same class, who were excluded from participation.

The minority lenders appealed confirmation of the plan, arguing that the exclusive backstop violated Section 1123(a)(4) of the Bankruptcy Code, which requires equal treatment of creditors within the same class. Judge Hanen agreed.

Relying on both the Fifth Circuit's Serta Simmons decision and the U.S. Supreme Court's 1999 decision in Bank of America v. 203 North LaSalle Street Partnership, Judge Hanen held that offering a valuable, exclusive investment opportunity to some, but not all, members of a creditor class constitutes unequal treatment on account of their claims.

The U.S. Bankruptcy Court for the Southern District of Texas had previously upheld the plan, finding LaSalle inapplicable because it concerned Section 1129(b)(2), not Section 1123(a)(4).

Judge Hanen disagreed, finding LaSalle instructive. Just as LaSalle held that exclusive equity opportunities for existing owners must be market-tested to avoid violating absolute priority, Judge Hanen concluded that exclusive opportunities for creditors within a class must either be extended to all class members or subjected to a competitive process.

Because ConvergeOne's backstop opportunity was offered only to majority lenders, and there was no meaningful market test, the plan violated Section 1123(a)(4).

ConvergeOne Expands on Serta's Reasoning

The Fifth Circuit's December 2024 decision in Serta marked a major turning point for non-pro rata uptier transactions. In 2020, Serta executed a transaction that allowed certain participating lenders to exchange their existing loans for new superpriority debt under a credit agreement's open market purchase exception. Nonparticipating lenders sued, arguing that the deal violated the credit agreement's sacred rights provisions, which required unanimous consent for changes affecting pro rata sharing.

The U.S. Bankruptcy Court for the Southern District of Texas sided with Serta, but the Fifth Circuit reversed, holding that "open market purchase" meant a purchase on the actual secondary market for syndicated loans, not a privately negotiated exchange. Because the transaction did not qualify, it breached the sacred rights provisions.

Judge Hanen imported this reasoning into the bankruptcy context. He rejected the debtor's argument that the backstop rights were simply "additional consideration" for new financing commitments.

Instead, echoing Serta, he emphasized substance over form: The backstop opportunity provided real value that was tied to the lenders' claims, not to any distinct new money contribution. By treating that opportunity as part of the overall blended recovery, Judge Hanen applied Serta's framework to hold that selective participation violated the Bankruptcy Code's equal treatment rule.

While Serta addressed out-of-court uptiers under credit agreements, ConvergeOne applies similar reasoning to in-court transactions under Chapter 11 plans. It makes clear that debtors cannot sidestep equal treatment requirements through clever structuring of so-called sweeteners for supportive creditors. Backstop rights, rollups or other selective incentives must be offered on equal terms to all creditors in the same class, or subjected to a genuine market process.

Mitel Illustrates Different Outcome Driven by Contract Language

On the same day that the Fifth Circuit decided Serta, the New York Appellate Division, First Department, reached the opposite result in Mitel Networks. Mitel had undertaken a similar uptier transaction, negotiating with a subset of lenders to exchange existing debt for new priming debt.

Nonparticipating lenders sued, arguing that the exchange violated the credit agreement's pro rata sharing and sacred rights provisions. But unlike Serta's loan documents, Mitel's credit agreement broadly permitted the borrower to purchase loans from lenders at any time, without an "open market" qualifier.

The court found that the cashless exchange qualified as a permissible purchase under that provision. It also held that the sacred rights provision required the consent only of lenders "directly adversely affected" by a modification to the credit agreement.

Because the uptier transaction indirectly subordinated nonparticipating lenders without amending their loan terms, the court concluded that their sacred rights were not implicated. In other words, the outcome turned on the specific language of Mitel's loan documents.

The contrast between Serta and Mitel highlights the importance of the particular contractual language chosen by the parties. Credit agreements that contain narrowly defined exceptions to sacred rights, like open market purchase provisions, may limit borrowers' ability to execute uptier transactions.

By contrast, agreements with broader purchase language, like Mitel's, can permit such transactions. This divergence underscores that the viability of an uptier depends on the precise wording of buyback and sacred rights provisions.

LMEs in Bankruptcy After ConvergeOne

ConvergeOne adds a new dimension to this developing body of law. While Serta and Mitel focused on out-of-court uptiers under syndicated loan agreements, ConvergeOne applies similar scrutiny to in-court transactions under Chapter 11 plans. It signals that debtors cannot use Chapter 11 to replicate non-pro rata LME outcomes that would violate the Bankruptcy Code's equal treatment provisions.

This could have significant practical consequences. Rights offerings backstopped by select creditor groups have become a common feature in Chapter 11 exit financing.[5] ConvergeOne suggests that this approach could face closer scrutiny in the Fifth Circuit. Debtors will either need to structure these opportunities to include all class members on equal terms or run a market test to validate exclusivity.

Comparative Lessons From Serta, Mitel and ConvergeOne

Read together, Serta, Mitel and ConvergeOne offer a road map for lenders and borrowers navigating LMEs:

- Contract language is determinative outside bankruptcy. Serta and Mitel show that courts will parse loan agreements closely. Narrow open market exceptions may block uptiers; broader purchase exceptions may allow them. Drafters should consider whether to adopt the Fifth Circuit's narrower interpretation or preserve flexibility for exchanges like Mitel's.

- Bankruptcy does not override equal treatment. ConvergeOne demonstrates that Chapter 11 is not a safe harbor for selectively rewarding supportive creditors. Section 1123(a)(4) applies regardless of the form of consideration, and exclusive opportunities within a class are impermissible absent equal access or a market test.

- Market testing matters. Both LaSalle and ConvergeOne emphasize that exclusive opportunities must be tested through a competitive process to avoid violating core bankruptcy principles. Private deals among majority lenders will be vulnerable to challenge.

Conclusion

ConvergeOne clarifies that in bankruptcy, differential treatment of creditors within a class cannot be disguised through selective investment opportunities. In doing so, ConvergeOne extends the reasoning of Serta beyond contract interpretation and applies it to the heart of the Bankruptcy Code's equal treatment mandate.

Pratik Raj Ghosh is an associate at MoloLamken LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] In re: ConvergeOne Holdings, Inc., Case No. 24-cv-02001 (S.D. Tex. Sept. 25, 2025).

[2] In re: Serta Simmons Bedding, L.L.C., 125 F.4th 555 (5th Cir. 2024).

[3] Ocean Trails CLO VII v. MLN Topco Ltd., 233 A.D.3d 614 (N.Y. 1st Dept. 2024).

[4] ConvergeOne Holdings, Inc. v. Ad Hoc Group of Excluded Lenders, No. 25-20478 (5th Cir. 2025).

[5] Vincent S.J. Buccola, Adi Marcovich Gross & Matthew R. McBrady, The Backstop Party, Oxford Bus. L. Blog (June 3, 2025), https://blogs.law.ox.ac.uk/oblb/blog-post/2025/06/backstop-party.