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District Court in Houston Further Clarifies "Equal Treatment" Rule, Supporting "Minority" Creditors in ConvergeOne Bankruptcy

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On September 25, 2025, the U.S. District Court for the Southern District of Texas overturned the Bankruptcy Court's confirmation of ConvergeOne's chapter 11 plan for violating the Bankruptcy Code's "equal-treatment" rule. The Court held that a plan cannot provide unequal treatment to similarly situated creditors, and that the plan erred by offering some, but not all, lenders equity and backstop rights. The *ConvergeOne* opinion relies heavily on the Fifth Circuit Court of Appeals' *Serta* decision, and provides the latest guidance on how the Southern District of Texas courts will view transactions that favor some creditors over others. *In re ConvergeOne Holdings, Inc.*, No. 4:24-CV-02001 (S.D. Tex. Oct. 23, 2024).

The ConvergeOne Chapter 11 Case

In December 2024, ConvergeOne, a leading provider of information technology services, reached a Restructuring Support Agreement with the holders of over 80% of its first and second lien debt. In April 2025, ConvergeOne and its affiliates filed for chapter 11 bankruptcy protection with a proposed plan based on the agreed-upon RSA.

The terms of the plan included: (1) a $245 million equity rights offering, which gave first lien creditors the opportunity to exchange debt for equity in the reorganized company at a 35% discount to the reorganized company's stipulated value under the plan, and (2) a commitment from certain first lien creditors to purchase up to $159.25 million of equity interests in the reorganized company at the same 35% discount while earning a 10% "backstop" fee on the entire amount of the equity rights offering. The backstop opportunity was available only to a select group of preferred first lien lenders, and the RSA included a "no-shop" provision. In total, the Court concluded that the preferred lenders likely received a 30% greater recovery than their excluded fellow lenders. Excluded lenders (about 19% of the lenders) objected and the Bankruptcy Court confirmed the plan over their objections. The excluded lenders then appealed to the District Court, arguing that the plan improperly treated the first lien lenders unequally, violating the Bankruptcy Code.

Applicable Law

Section 1123(a)(4) of the Bankruptcy Code enshrines the "equal-treatment rule," which states that, to be confirmable, "a plan shall... 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."

To understand the meaning of "equality," the *Serta* case is illustrative. In *Serta*, the Fifth Circuit Court of Appeals looked "below the surface" of the Chapter 11 plan provisions to make a holistic determination of whether distributions to certain classes "were in fact equal in value." *In re Serta Simmons Bedding, L.L.C.*, 125 F.4th 555, 591-2 (5th Cir. 2024), as revised (Jan. 21, 2025), as revised (Feb. 14, 2025). Equality may be "proximate," it is not required to be absolute. *ConvergeOne*, No. 4:24-CV-02001, No. 54 at 12. However, at a minimum, plans must offer equality of opportunity, even if equality of recovery does not necessarily result.

The meaning of "treatment" can be inferred from the Bankruptcy Code's "absolute priority rule." Pursuant to Section 1129(b)(2)—which codifies the rule—a plan must be "fair and equitable" with respect to a class of claims or interests that is impaired under, and has not accepted, the plan. To be "fair and equitable" to a class of creditors, a plan must not grant "property" to holders of junior claims or interests "on account of" those claims unless all holders of more senior claims are fully paid or consent to such treatment.

In *LaSalle*, the Supreme Court held that an exclusive opportunity to obtain equity in a reorganized entity, without market valuation or competition, is a property interest "extended on account of" a claim or interest for purposes of Section 1129(b)(2). *In re 203 N. LaSalle St. P'ship*, 526 U.S. 434 at 456 (1999). Sections 1123 and 1129 set parameters that parties must observe when distributing assets from the debtor's estate.

Analysis

Guided by the Fifth Circuit's ruling in *Serta*, the District Court in *ConvergeOne* determined that the plan did not treat the excluded lenders equally with their fellow lenders, especially with respect to the backstop.

The Court in *ConvergeOne* drew on both the *Serta* court's analysis of Section 1123(a)(4) and the Supreme Court's ruling in *N. LaSalle* with respect to Section 1129(b). Citing to *Serta,* the Court noted several factors considered by the Fifth Circuit in determining whether treatment of creditors was "equal" for purposes of satisfying Section 1123(a)(4).

In discussing these factors against the backdrop of the Supreme Court's analysis of Section 1129(b) in *LaSalle*, Judge Hanen found the *ConvergeOne* plan wanting. First, he noted that the parties were treated unequally from a process standpoint—the debtors never offered the backstop opportunity to the excluded lenders. Moreover, he was not persuaded by the majority lenders' argument that the excluded lenders "were not *really* excluded from the proposal" because they could have offered a competing deal after the plan had been filed. Judge Hanen found that at no point were the excluded lenders ever given any opportunity to participate in the backstop.

Judge Hanen also expressed concern that the Debtors made no effort to market test the value of the backstop, *e.g.* by soliciting real competing offers.

Guided by *Serta,* Judge Hanen also looked closely at the facts to assess the equivalence of the distributions. First, he held that the variance in recovery amongst the first lien creditors went "far beyond approximate equality." The financial impact of the backstop in particular "involve[d] the reallocation of an eight-figure sum and the availability of discounted equity to some class members but not those who were excluded from the backstopping opportunity."

Second, Judge Hanen examined the "inequality in both opportunity and result." The backstop opportunity "was offered to the subclass of creditors without any exchange of value *for the opportunity*" to participate." The case was therefore "more straightforward" than *Serta*, where facially, lenders who had not participated in the challenged uptier transaction received the same indemnity against related liabilities as lenders who had participated, with the difference in "treatment" consisting in the fact that the indemnity had no value to lenders who had not participated in the transaction. Here, the treatment was not even facially equal. There was simply no opportunity for the excluded lenders to participate in the backstop—and thus their resulting recovery would be lower than that of the backstop parties. Moreover, "[t]he fact that the unequal treatment happened before the bankruptcy petition was even filed does not insulate the Plan from the requirements of §1123(a)(4)." To the contrary, courts have long held that prepackaged plans must satisfy section 1123(a)(4).

Finally, the Debtors argued that they could offer the backstop to a subset of lenders so long as the Debtors received consideration in return. The Court held that "this argument, however, is already foreclosed by *LaSalle*. Rather than relying on the backstopping as consideration for the access to discounted equity, [the] Debtors would have to show consideration for the *opportunity* to backstop the equity-rights offering to justify the exclusive opportunity." Here, the backstop lenders never provided this consideration.

Read together, the *Serta* and *ConvergeOne* holdings support the view that the equal-treatment rule may be used by minority lenders and creditors in a bankruptcy case to challenge plans and transactions that make distributions

available only to certain preferred lenders. Majority lenders should consider ensuring that all lenders with similar claims have the opportunity to participate in any proposal they make. They should also consider looping minority lenders into any negotiations in a timely manner to ensure the minority lenders have some opportunity to participate.

A Note on Wesco Aircraft

The *ConvergeOne* ruling comes at an interesting time—approximately a week after U.S. District Court Judge Randy Crane surprised observers by indicating from the bench, that he is prepared to overturn a 2024 Bankruptcy Court decision favoring minority noteholders in the *Wesco Aircraft* case. That decision by the Bankruptcy Court for the Southern District of Texas, Houston Division held that Wesco's 2022 uptiering transactions were not authorized under the applicable indenture. Judge Crane said he will reverse that decision and find that the underlying indenture permitted the uptiering transaction. Judge Crane indicated that he did not view this outcome as being inconsistent with *Serta*, because the transaction at issue in *Serta* had violated the non-consenting lenders' "sacred rights" under the applicable loan documents, whereas the transaction at issue in *Wesco* had not violated any "sacred rights." To date, Judge Crane has not issued a formal opinion.

Wesco Aircraft and *ConvergeOne*, two seemingly divergent opinions, each purport to ground themselves in *Serta*. The parties may appeal the courts' opinions, in which case, we expect greater clarity from the Fifth Circuit on the significance of *Serta*—including whether the Fifth Circuit intended to rule that creditors under the same loan agreement must generally be treated equally in and out of bankruptcy.