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Bankruptcy Financing Becomes New Front For Lender Battles

By **Alex Wittenberg**

Law360 (March 25, 2026, 4:38 PM EDT) -- Lender-on-lender brawling that normally occurs out of court is increasingly unfolding in the Chapter 11 financing arena, forcing bankruptcy judges to reckon with in-court deals that use aggressive liability management tactics to promote certain investors over others.

In the recent Chapter 11 cases of Del Monte Foods, Multi-Color Corp. and First Brands Group, debtors have proposed financing packages that provide disparate treatment to creditors in similar positions. Bankrupt companies have also attempted to roll up only certain lenders' prepetition debt into their Chapter 11 loans, effectively aiming to "uptier" favored creditors' debt through the court process.

The result is more liability management-style disputes centered on debtor-in-possession financing, and increased lender infighting playing out in bankruptcy court, experts told Law360.

"As lenders have become more accustomed to [liability management exercises], they're more willing to consider non-pro rata sharing in multiple contexts," said Andrew J. Gallo, a partner at Morgan Lewis & Bockius LLP. "It was only natural it would come over into the DIP context."

DIPs that provide better treatment for favored lenders are also facing heightened scrutiny following a decision in the ConvergeOne case last year. In that matter, a Texas federal judge held that a backstop deal open to only select investors violated the equal treatment requirements of bankruptcies, sparking questions about whether non-pro rata DIPs would be implicated by the ruling.

The ConvergeOne decision may explain why some of the most contentious DIP disputes this year have occurred in New Jersey bankruptcy court, where the ruling isn't binding, attorneys noted. The New Jersey cases of Multi-Color, Del Monte and STG Logistics have all featured DIP disputes in recent months.

"We're seeing more filings in New Jersey, perhaps seeking to avoid the ConvergeOne issue," said Shai Schmidt, a partner at Cadwalader Wickersham & Taft LLP. "Some parties may be betting that New Jersey courts won't follow ConvergeOne."

Rollup Holdup

In late 2024, U.S. Bankruptcy Judge Craig T. Goldblatt of Delaware ruled that a non-pro rata DIP in the Chapter 11 case of American Tire Distributors probably breached the company's pre-bankruptcy credit agreement. The judge found that American Tire's plan to roll up only some lenders' prepetition debt

likely would have violated the credit agreement's equal sharing provisions.

The decision provided grist for other lenders challenging unequal DIP deals. In September, education technology company Anthology Inc. sought Chapter 11 protection and proposed a DIP facility whose syndication was only open to some lenders, prompting an objection by an excluded creditor.

The snubbed lender, Vector Capital, charged that Anthology's DIP broke pro rata treatment protections in the pre-bankruptcy credit agreement. In its objection, Vector cited the ConvergeOne decision to argue that "discriminatory" DIPs could constitute "impermissible discrimination."

In both cases, the parties reached deals to modify the non-pro rata parts of the DIPs, leaving open questions about how judges will handle future cases in which settlements cannot be struck.

If permitted, unequal DIPs function in similar ways as out-of-court LMEs. A favored group of lenders is given the exclusive opportunity to provide new financing that outranks formerly senior debt. Lenders excluded from the deal are subordinated, while the favored group gets priming liens and an elevated place in the repayment order.

DIPs with rollups only for favored lenders allow debtors to promote certain investors' pre-bankruptcy debt into super-senior postpetition debt that normally must be repaid before the company exits bankruptcy. That maneuver resembles an out-of-court uptier, or a type of deal popularized by Serta Simmons Bedding in 2020 that elevates favored lenders' debt.

"The original LME type of transaction in Serta was an uptier that offered certain lenders new debt that had different or better enhancements than their existing debt," Gallo said. "That's exactly what a rollup is in bankruptcy."

"So if you can do a selective rollup, you're accomplishing in bankruptcy what you may not be able to accomplish outside of bankruptcy through an LME," Gallo added.

DIPs After ConvergeOne

The ConvergeOne decision and the Fifth Circuit's 2024 ruling in the Serta Simmons case threw out deals that provided favorable treatment to select lenders. Since then, some parties excluded from non-pro rata DIPs have cited both decisions to argue that such unequal deals aren't permitted in Chapter 11 bankruptcies.

"A lot of what was decided in both the Serta and ConvergeOne cases was that, if a debtor tries to cherry-pick which lenders it works with, then the court's not going to approve or sanction that," said Byron Moldo, a partner at Ervin Cohen & Jessup LLP.

Yet, whether the decisions apply to DIP financing disputes remains unclear. The ConvergeOne deal was proposed as part of a Chapter 11 plan, thereby implicating Bankruptcy Code Section 1123(a)(4)'s equal treatment requirements. But DIP financing is separate from a Chapter 11 plan, meaning those same requirements might not apply in DIP disputes.

"It remains to be seen whether courts will extend the ConvergeOne ruling to non-pro rata DIPs," Schmidt said.

Debtors' prepetition credit agreements might instead apply, forcing bankruptcy judges to interpret those contracts when weighing whether to approve contested DIP motions.

Some excluded lenders, though, have argued that certain DIPs constitute "sub rosa" Chapter 11 plans in an attempt to invoke the Bankruptcy Code's equal treatment requirements. Vector, in the Anthology bankruptcy case, said the technology company's DIP rollup operated "functionally as a plan distribution mechanism" by predetermining creditor recoveries or class treatment.

Excluded creditors in the Multi-Color case have taken a similar tack. In an objection to final approval of Multi-Color's DIP filed this month, a cross-holder group of investors charged that the debtor's DIP facility constituted a prohibited sub rosa plan because it "predetermines the outcome of these cases."

That group also cited the ConvergeOne decision to criticize Multi-Color's move to offer rollup and backstop opportunities exclusively to the debtor's private equity sponsor and favored lenders "free from competition."

"The sub rosa argument can play an important role in DIP fights, especially where the DIP attempts to bake in plan treatment such as equity splits," Schmidt noted. "If the DIP amounts to a sub rosa plan, the ConvergeOne equal-treatment ruling may directly apply."

NJ as Battleground

New Jersey is playing host to a number of contested Chapter 11 cases this year in what some experts said reflects debtors' and their advisers' attempts to avoid the ConvergeOne and Serta Simmons rulings.

In canned food company Del Monte's case, a group of minority lenders has launched an adversary proceeding over the company's DIP loan that accuses other lenders of violating a pro rata sharing requirement of a credit agreement. The minority lenders allege that their opponents breached the agreement by having their prepetition debt rolled up as part of Del Monte's DIP package.

Lenders to STG Logistics, which filed for bankruptcy in January, have also sued over a liability management deal and the debtor's DIP financing, which they say rolls up only favored creditors' debt. The excluded lenders argue that STG's DIP attempts to "consolidate the ill-gotten value" that the company and the favored lenders garnered through the LME.

Multi-Color's case features similar litigation. The cross-holder investor group said in its objection to Multi-Color's DIP this month that the debtor's proposed rollup would transfer "between $133 million and $167 million of value from unsecured creditors to the sponsor and favored lenders by elevating their undersecured deficiency claims to superpriority DIP claims payable in full."

How those disputes in New Jersey shake out could provide general guidance on how courts will rule on contested DIP motions in future cases across the country.

"If it doesn't settle," Gallo said of Multi-Color's DIP dispute, "we may get some guidance from that case as to how the court is reviewing these types of transactions."

--Editing by Melissa Treolo.