APPEALS OF CONFIRMATION ORDERS: IS THE DOCTRINE OF EQUITABLE MOOTNESS MOOT?

PRESENTED TO THE BBA
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I. About the Doctrine

A. "Mootness" is a doctrine that precludes a reviewing court from reaching the underlying merits of a controversy. In federal courts, an appeal can be constitutionally moot, statutorily moot or equitably moot.

1. Constitutional mootness may result under Article III of the Constitution, which limits the jurisdiction of federal courts to actual cases or controversies. In the interest of conserving judicial resources, constitutional mootness precludes adjudication of cases that are hypothetical or merely advisory.

2. Statutory mootness arises in the bankruptcy context under Section 363(m), which provides that reversal or modification on appeal of a sale order does not affect the validity of the sale to an entity that purchased the property in good faith, and under Section 364(e), which provides that reversal or modification on appeal of a financing order does not affect the validity of the debt incurred or any priority or lien granted to an entity that extended the credit in good faith.

3. Equitable mootness is a judge-fashioned remedy, which *may* preclude adjudication of an appeal when a comprehensive change of circumstances occurs such that it would be inequitable for a reviewing court to address the merits of the appeal.

B. Courts hearing appeals of bankruptcy court decisions have relied on the doctrine of equitable mootness to decline to exercise their statutory-based appellate jurisdiction and dismiss bankruptcy appeals on equitable grounds because a plan has been substantially consummated (*i.e.*, "the egg cannot be unscrambled").

C. Although financing and sale orders are protected by statute, courts have applied the doctrine to confirmation orders even though there is no statutory basis to do so.

D. Each Circuit that has adopted the doctrine has formulated its own test or standard.

1. Common elements include:

a. Whether the plan has been substantially consummated (see definition in Section 1101(2);

b. Whether a stay could have been sought and obtained;

c. Whether the relief requested would affect third parties who relied to their detriment on the plan or from whom it would be inequitable to require disgorgement;

d. Whether the relief requested would affect the success of the plan or affect only a limited group; and

e. The public policy of affording finality to bankruptcy court orders

2. Variations include:

a. What factors/steps/analyses should be considered;

b. The degree of reliance by third parties;

c. The effect of the appellant's failure to seek or obtain a stay pending appeal;

d. Whether a presumption arises upon a finding of substantial consummation;

e. Which party bears the burden to prove (or disprove) equitable mootness is appropriate; and

f. The standard of review for a determination of whether an appeal is equitably moot.

E. The Fourth Circuit recognizes the doctrine "represents a pragmatic recognition by courts that reviewing a judgment may, after time has passed and the judgment has been implemented, prove 'impractical, imprudent, and therefore inequitable.'" *Behrmann v. National Heritage Found.*, 663 F.3d 704, 713 (4th Cir. 2011). In determining whether to apply the doctrine in *Behrmann*, the Fourth Circuit considered:

1. Whether the appellant sought and obtained a stay;

2. Whether the reorganization plan has been substantially consummated;

3. The extent to which the relief requested on appeal would affect the success of the reorganization plan; and

4. The extent to which the relief requested on appeal would affect the interests of third parties.

Id.

II. Relevant Statutes

A. 28 U.S.C. § 158(a)(1): "The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees."

B. 28 U.S.C. § 158(d)(1): "The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section."

C. 11 U.S.C. § 363(m): "The reversal or modification on appeal … of a sale or lease of property does not affect the validity of a sale or lease ... to an entity that purchased or leased such property in good faith."

D. 11 U.S.C. § 364(e): "The reversal or modification on appeal ... does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith."

III. Development of Case Law

A. *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (9th Cir. 1981) (viewed as the source of the doctrine (pre-Code period))

"Are we not quite patently faced with a situation where the plan of arrangement has been so far implemented that it is impossible to fashion effective relief for all concerned? Certainly, reversal of the order confirming the plan of arrangement, which would knock the props out from under the authorization for every transaction that has taken place, would do nothing other than create an unmanageable, uncontrollable situation for the Bankruptcy Court."

B. *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996) (7-6 *en banc*)

Then-Judge Alito authored the dissent, noting that *Roberts Farms* was based on former Bankruptcy Rule 805, which applied only to sales. He said he would hear the appeal, then remand if the appeal were successful, understanding some remedies might be precluded. The court adopted a five-factor test for determining if equitable mootness should be applied.

C. *In re Semcrude, L.P.*, 728 F.3d 314 (3d Cir. 2013)

"Following confirmation of a reorganization plan by a bankruptcy court, an aggrieved party has the statutory right to appeal the court's rulings." *Id.* at 320.

"Once there is an appeal, there is a 'virtually unflagging obligation' of federal courts to exercise the jurisdiction conferred on them." *Id.* at 320.

"In practice, it is useful to think of equitable mootness as proceeding in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation." *Id.* at 321.

D. *In re Tribune Media Co.*, 799 F.3d 272, 278 (3d Cir. 2015), *cert. denied sub nom. Aurelius Capital Mgmt., L.P. v. Tribune Media Co.*, 136 S. Ct. 1459, 194 L.Ed.2d 575 (2016) (setting forth the two-step equitable mootness analysis applied in the Third Circuit)

Judge Ambro specially concurred in his own majority opinion to respond to Judge Krause's concurrence in *One2One*.

Judge Ambro said the doctrine should be applied only in rare circumstances and must be policed by courts. He also said concurrent review of the merits along with mootness may be appropriate in certain circumstances.

E. *In re One2One Communications, LLC*, 805 F.3d 428, 431 (3d Cir. 2015)

The Third Circuit reviewed the district court's order dismissing an appeal of a bankruptcy order confirming a debtor's chapter 11 plan on equitable mootness grounds. The appellant asked the court, through its appeal, to declare the equitable mootness doctrine invalid. The court concluded that the panel was bound to follow the Third Circuit's adoption of the doctrine under precedent. The court did, however, highlight that, since adoption of the equitable mootness doctrine, the Third Circuit has "emphasized that the doctrine must be construed narrowly and applied in limited circumstances." The Third Circuit reversed and remanded the case to the district court for an adjudication on the merits.

The concurrence by Judge Krause questioned equitable mootness, calling it:

- Legally ungrounded and practically unadministrable (referring to it as a judge-made doctrine unsupported by law);
- Unmanageable (noting the court had reversed district court decisions on mootness seven times since *Continental*);
- Unconstitutional (by preventing Article III court supervision over bankruptcy court decisions);
- Unauthorized (lacking a statutory basis); and
- Lacking in efficacy (the duration and extent of appeals over mootness show it does not promote finality, but uncertainty, delay and opportunism, and prevents the healthy development of uniformity of appellate case law on important confirmation issues).

Judge Krause also criticized the doctrine because it is not included among the limited abstention doctrines recognized by the Supreme Court that contemplate postponement, as opposed to abdication, of a federal court's exercise of jurisdiction.

Application of the equitable mootness doctrine results in the litigant having no ability to enforce its legal rights (abdication) whereas abstention allows the litigant to be heard in a different forum.

Judge Krause urged *en banc* review to replace the doctrine of equitable mootness with a doctrine that examines the merits first, then remedies afterwards or, if not, to revise the equitable mootness doctrine to:

- Place greater weight on appellants' attempts to obtain a stay;
- Clarify what constitutes harm to third parties, depending on whether they had the opportunity to participate in the bankruptcy case and be less solicitous of those who act opportunistically or advocate unlawful plan provisions;
- Change the standard of review to *de novo*; and
- Incorporate a quick look at the merits to determine whether the appeal has merit.

F. *In re City of Detroit, Michigan*, 838 F.3d 792 (6th Cir. 2016)

The Sixth Circuit affirmed the district court's dismissal of appeals from the bankruptcy court's order confirming the City of Detroit's chapter 9 plan on equitable mootness grounds.

Through the plan, the City crafted a complex network of settlements and agreements among thousands of creditors and stakeholders. Significant post-confirmation transactions had since occurred in reliance on the plan.

The court rejected the contention that equitable mootness was no longer a viable option in light of the Supreme Court's recent challenge to doctrines abdicating jurisdiction.

The dissent, inter alia, states that there is a trend at the Supreme Court toward greater recognition of a court's "virtually unflagging obligation" to exercise jurisdiction that has been given to it and also highlights that there is no legal basis for the doctrine.

The dissent's position is premised on appellate review by Article III courts, saying "The problem with equitable mootness is not only that it cuts off entirely the right to appeal to an Article III court, but that 'it effectively delegates the power to prevent that review to the very non-Article III tribunal whose decision is at issue' because 'bankruptcy courts control nearly all of the variables' that are considered in assessing whether an appeal is equitably moot."

IV. Recent Supreme Court Cases on Abstention Doctrines

A. The Supreme Court has not considered the doctrine of equitable mootness but has increasingly narrowed the scope of abstention doctrines in recent years.

B. *Zivotofsky ex rel. Zivotofsky v. Clinton*, 566 U.S. 189, 132 S. Ct. 1421, 1427 (2012) (Court relied on same principal to decline to extend the political question doctrine)

C. *Sprint Communications, Inc. v. Jacobs*, ___ U.S. ___, 134 S. Ct. 584, 590-91 (2013) (Court relied on the duty to exercise jurisdiction in refusing to extend the situations where *Younger* abstention is appropriate)

D. *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, ___ U.S. ___, 134 S. Ct. 1377, 1386 (2014) (Court confirmed its disapproval of doctrines that permit courts to decline to decide claims on "prudential" rather than statutory or constitutional grounds)

E. *Susan B. Anthony List v. Driehaus*, ___ U.S. ___, 134 S. Ct. 2334, 2347 (2014) (Court rejected prudential ripeness because such equitable doctrines were "in some tension with our recent reaffirmation of the principle that a federal court's obligation to hear and decide cases within its jurisdiction is virtually unflagging")

F. *Wellness Int'l Network, Ltd. v. Sharif*, ___ U.S. ___, 135 S. Ct. 1932, 1944 (2015) (Court held that Bankruptcy Code's delegation of judicial power to non-Article III bankruptcy judges is constitutional only if Article III courts retain sufficient supervisory authority over the process)

V. Criticism of the Doctrine of Equitable Mootness

A. Use of the doctrine has resulted in uncertainty and delay, instead of its intended promotion of finality. It is being used "offensively" to obtain dismissal of bankruptcy appeals of confirmation orders and settlements without review by Article III courts.

B. The doctrine of equitable mootness raises constitutional concerns:

1. Congress did not intend for orders to be "immune" or "invisible" from appeal.

2. Courts have an unflagging obligation to exercise jurisdiction conferred on it by Congress.

3. There is no statutory source for the doctrine.

4. Equitable mootness is not an abstention doctrine. Abstention relinquishes jurisdiction in favor of another tribunal. Equitable mootness effectively halts any further exercise of jurisdiction by any tribunal and deprives a litigant of his right to appellate review.

5. Equitable mootness violates Article III. The Code's delegation of power to Article I bankruptcy judges is constitutional only if the Article III court retains supervisory authority.

C. Application of the doctrine is inconsistent among the Circuits.

1. Is there a presumption of mootness if the plan has been substantially consummated?

Yes: *In re BGI, Inc.*, 772 F.3d 102 (2d Cir. 2014) (applying in liquidation proceeding); *In re Charter Communications, Inc.*, 691 F.3d 476 (2d Cir. 2012) (applying in reorganization proceeding).

No: *In re Semcrude, L.P.*, 728 F.3d 314 (3d Cir. 2013); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 210 (3d Cir. 2000). The Fifth, Ninth and Tenth Circuits follow the Third Circuit's approach.

Maybe: *In re Redf Mktg., LLC*, 536 B.R. 646 (Bankr. W.D.N.C. 2015) (equitable mootness is one of various factors considered in determining whether an appeal should be dismissed); *Cent. States, Southeast and Southwest Areas Pension Fund v. Cent. Transp., Inc.*, 841 F.2d 92, 96 (4th Cir. 1988) ("Orders confirming plans of reorganization do not become immune from appellate review upon their partial, or even substantial implementation. On the other hand, dismissal of the appeal on mootness grounds is required when implementation of the plan has created, extinguished or modified rights, particularly of persons not before the court, to such an extent that effective judicial relief is no longer practically available.").

2. What is the standard of review to apply to the lower court's determination?

Abuse of discretion: Second, Third, and Tenth Circuits

De novo: Fifth, Sixth, Ninth and Eleventh Circuits

Unclear: First, Fourth, Seventh, Eighth and DC Circuits

3. Which party has the burden of proving that an appeal should be dismissed as equitably moot?

Party seeking dismissal: Third, Ninth, Tenth and Eleventh

D. Courts have extended application of the doctrine to other orders, including orders on Chapter 11 liquidation plans, settlements, equity receiverships and cash collateral.

VI. Possible Alternatives to Dismissal of an Appeal as Equitably Moot

A. "Blue pencil method" – The Third Circuit has sought to balance the finality of plan confirmation against the plan objector's appellate rights by striking or rewriting ("blue penciling") specific plan provisions. For example, rather than dismissing appeals as equitably moot, the Third Circuit has allowed parties to strike plan releases, strike indemnification provisions, seek disgorgement of plan distributions and disgorgement of professional fees.

- *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000) (striking plan releases).
- *United Artists Theater Co. v. Walton*, 315 F.3d 217 (3d Cir. 2003) (striking indemnification provisions).
- *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015) (disgorgement of plan distributions).
- *Official Committee of Equity Security Holders v. Unofficial Committee of Equity Security Holders (In re Zenith Electronics Corp.)*, 329 F.3d 338 (3d Cir. 2003) (disgorgement of professional fees).

B. Bond requirements – A court may be more willing to stay a confirmation order and not dismiss an appeal as equitably moot if the appellant posts a supersedeas bond pursuant to Fed. R. Bank. P. 8007(a)(1)(B). Generally, a court will require a bond if necessary to protect "against diminution in the value of property pending appeal and to secure the prevailing party against any loss that might be sustained as a result of an ineffectual appeal." *In re Tribune Media Co.*, 799 F.3d 272, 278 (3d Cir. 2015).