

Equitable Mootness Doctrine Persists in Bankruptcy Appeals

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In recent years, courts have become increasingly critical of the doctrine of equitable mootness, a judicially created abstention doctrine that allows appellate courts to dismiss appeals from a bankruptcy court's confirmation order in certain circumstances. Although the doctrine is meant to be applied only sparingly, to avoid unscrambling complex reorganizations on appeal, it has been invoked in noncomplex cases or where limited relief is practicable. As a result, some circuit courts have urged a more limited application of the doctrine.

Nevertheless, the doctrine persists in some form within every circuit that has jurisdiction over bankruptcy appeals. Thus, plan proponents and objectors alike must be aware of its implications on contested plan confirmations.

Background

The doctrine of equitable mootness promotes finality and protects parties that have justifiably relied on the bankruptcy court's confirmation order and transactions effectuated pursuant to that order. In deciding whether to dismiss an appeal of a confirmation order as equitably moot, courts consider some or all the following factors:

- Whether the appellant has sought or obtained a stay.
- Whether the plan of reorganization has been substantially consummated.
- The effect the requested relief would have on the rights of third parties not before the court.
- The impact the requested relief would have on the likelihood of successful reorganization.
- Public policy concerns.

Typically, the burden to prove equitable mootness falls on the party seeking dismissal of an appeal; however, in the U.S. Court of Appeals for the Second Circuit, the appellant must overcome a presumption of equitable mootness when a plan of reorganization has been substantially consummated.

The Blue Pencil Method Alternative

Faced with the prospect of an equitably moot appeal, a critical inquiry for appellants and appellate courts is whether it is possible to fashion limited remedies that would not cause an unwinding of the reorganization plan. Courts may seek to balance the finality of plan confirmation against the plan objector's appellate rights by striking or rewriting — sometimes referred to as “blue penciling” — certain aspects of the confirmed bankruptcy plan on appeal. Thus, rather than dismissing appeals as equitably moot, courts have allowed parties to seek disgorgement of plan distributions or professional fees, or strike indemnification provisions or plan releases.

For example, in *In re Tribune Media Co.*, the U.S. Court of Appeals for the Third Circuit refused to affirm as equitably moot an appeal that was brought by trustees acting on behalf of certain creditors and sought relief based on their rights as beneficiaries of a putative subordination agreement. The trustees argued that under the agreement, they were entitled to \$30 million of any recovery ahead of another class of creditors, and the plan unfairly allocated their recovery to the other class. The court reasoned that the appeal concerned only the proper allocation of \$30 million of plan distributions between two competing classes of creditors, in the context of a \$7.5 billion reorganization, and

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there was “no chance” this would unravel the plan. The court explained that disgorgement could be ordered against the class of creditors that had received more than its fair share, and the plan could be modified to make sure the creditors represented by the trustees receive their recovery to the exclusion of the other class.

Key Considerations

Long before confirmation proceedings, both plan proponents and objectors should understand the contours of the equitable mootness doctrine in their jurisdiction and prepare to act quickly to advance their interests following plan confirmation.

Plan proponents should be ready to:

- Demonstrate any justifiable exigencies that may require a confirmed plan to promptly take effect and seek to effectuate the plan of reorganization quickly — potentially all on the same day.
- Oppose a motion to stay the reorganization, presenting fact and expert evidence of harm that the debtor and creditors will suffer if plan effectiveness is delayed.
 - In ruling on a stay request, courts consider the likelihood of success on the merits of the appeal, whether the movant will suffer irreparable harm absent a stay, the potential harm to other parties if a stay is granted and the public interests that might be affected. Notably, courts disagree on whether the risk of equitable mootness constitutes irreparable harm.
- Argue that the court should require any plan objector seeking a stay pending appeal to post a *supersedeas* bond.
 - A stay may be conditioned on the appellant’s posting of the bond, which protects the debtor and its other creditors against the substantial risks of harm caused by delaying the plan’s effective date.

- Avoid blue penciling by establishing a record in the bankruptcy court that contested plan provisions are central to and necessary for confirmation. This might include proving the interdependence of each element of a multiparty, global resolution or the impossibility of severing any specific aspect of a settlement without unwinding the plan.
- Establish an evidentiary record demonstrating the plan has been substantially consummated, with an emphasis on the various post-confirmation transactions that have been authorized and carried out based on the plan and confirmation order.

Plan objectors should be prepared to:

- Exhaustively pursue a stay of the confirmation order pending appeal. Failure to do so could be fatal to the objector’s case.
- Identify early in the process the various forms of possible relief, short of denying plan confirmation or later unscrambling the plan, that may satisfy the objector’s specific concerns about the plan.
- Develop evidence to establish the forms of limited relief, including blue penciling, that would not preclude plan confirmation or later cause an unwinding of the plan.
- Seek discovery to determine whether plan proponents have manufactured a sense of urgency in the plan implementation so as to moot a valid appeal.

Conclusion

In coming years, the doctrine of equitable mootness may fall out of favor if courts limit its application. For the time being, however, the concept of equitable mootness persists and understanding its implications is essential for bankruptcy litigants.