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Equitable Mootness: Will Surgery Kill the Patient?

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It is important to observe that appellate cases generally apply equitable mootness with a scalpel rather than an axe.
—Hon. Edith H. Jones, *In re Pacific Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009).

Finality of judgments is important—so important, in fact, that the concept of finality has been described as fundamental to the rule of law.[1] The importance of finality applies to every area of the law and has been specifically recognized in the context of confirmed bankruptcy plans.[2] Despite the fundamental importance of finality, the concept must be weighed against a party's due-process right to challenge a judgment it sees as incorrect or inequitable. Such "challenges" generally arise via an appeal. If, as is often the case in the context of a confirmed plan, a stay of the confirmation order is not granted prior to the effective date of the plan, the potential arises for the distribution of assets to reach such a level that it is impossible or impractical to overturn the confirmation order. In other words, the appeal becomes moot.

While the concept of mootness is generally applicable to any area of law, the doctrine of "equitable mootness" is unique to bankruptcy practice. A court will refuse to hear a matter that is truly moot on the grounds that there is no "case or controversy" as required under Article III of the Constitution.

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Feature

In contrast to Article III—or constitutional—mootness, equitable mootness addresses a situation where redress is possible, but it would be inequitable to grant the relief sought by the appellant. While the doctrine of equitable mootness has been subject to criticism, the doctrine is well-accepted in bankruptcy practice. However, recent decisions by the Fifth Circuit Court of Appeals suggest that while the equitable mootness doctrine remains alive and well, courts may now apply it more narrowly than in the past.

The Origin and Development of the Doctrine

From Origin to Acceptance

The doctrine of equitable mootness is not based in statute. Rather, the doctrine was judicially created in recognition of the fact that it would be inequitable, in certain circumstances, to overturn a confirmed plan of reorganization.[3] It is not clear when the term first came into use, but the concept—while not initially labeled as "equitable mootness"—was applied not long after the enactment of the Bankruptcy Code in 1978.[4] In modern practice, the doctrine has been well-accepted by the majority of circuits. Courts have identified certain factors to consider in determining whether equitable mootness applies. For example, the leading Third Circuit case considered "(1) whether the reorganization plan has been substantially consummated; (2) whether a stay has been obtained; (3) whether the relief would affect the rights of parties not before the court; (4) whether the relief would affect the success of the plan; and (5) the public policy of affording finality to bankruptcy judgments."[5] Other circuits have considered the same, or very similar, factors.[6]

Criticism of the Doctrine

While the equitable mootness doctrine is well-accepted by several courts of appeal, it is not without its critics. Hon. Frank Easterbrook, writing for the Seventh Circuit, noted that the term "equitable mootness" is misleading because "[t]here is a big difference

1 Abraham Freeman, *Law of Judgments* § 305 at 602-3 (1925).
2 *See, e.g., In re New Century TRS Holdings Inc.*, 407 B.R. 576, 590 (D. Del. 2009); *In re Pub. Serv. Co. of New Hampshire*, 963 F.2d 469, 472 (1st Cir. 1992).
3 *See, e.g., In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994) (noting that equitable mootness "is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental changes in reorganization actions").
4 *See, e.g., In re Roberts Farms Inc.*, 652 F.2d 793 (9th Cir. 1981); *see also In re AOV Indus. Inc.*, 792 F.2d 1140 (D.C. Cir. 1996).
5 *In re Cont'l Airlines*, 91 F.3d 553, 560 (3d Cir. 1996).
6 *See, e.g., In re Paige*, 584 F.3d 1327, 1339 (10th Cir. 2009); *In re Am. Homepatient Inc.*, 420 F.3d 559, 563-64 (6th Cir. 2006); *Nordhoff Invs. Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir. 2001); *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994); *Chateaugay Corp. v. LTC Steel Co.*, 10 F.3d 944, 952-53 (2d Cir. 1993).

between inability to alter the outcome (real mootness) and *unwillingness* to alter the outcome ('equitable mootness')."[7] The Seventh Circuit therefore "banish[ed] [the term] 'equitable mootness' from the (local) lexicon."[8] The court resolved to ignore issues of mootness and focus simply on whether it would be "prudent to upset the plan of reorganization at this late date."[9]


Jason Binford

Judge Easterbrook's "banishment" of the term "equitable mootness" demonstrates a recurring issue in the case law on the subject. It is well-recognized that constitutional mootness is a valid basis for a court's refusal to hear an appeal. In fact, constitutional mootness can be framed as a jurisdictional question because if relief truly is impossible, then there is no "case and controversy." Equitable mootness, on the other hand, is not a jurisdictional issue because relief is possible. The natural question then is: Where does one draw the line between the two concepts? For example, when do efforts to collect funds distributed—to unscramble the egg—become so difficult and impractical as to reach the level of impossible for the purposes of constitutional mootness? Critics of the doctrine have pointed to this foggy distinction to support their argument that equitable mootness is not truly mootness and therefore should not be applied as such.[10]

A notable critic of the doctrine is Supreme Court Justice Samuel Alito. In a 1996 *Continental Airlines* decision by the Third Circuit, then-Judge Alito authored a lengthy dissent, observing that the doctrine has no clear basis in the law. In his dissent, Judge Alito first noted that the doctrine is not about mootness because mootness is a jurisdictional issue concerning a court's power to hear a case.[11] He further explained that the doctrine seemed to be based merely on a federal common-law rule designed to further the polices of the Bankruptcy Code.[12] Judge Alito questioned whether this was sufficient authority for the court to refuse "to entertain a live appeal over which [the court] indisputably possess[es] statutory jurisdiction and in which meaningful relief can be awarded."[13] Judge Alito again questioned the doctrine in another dissent to a 2001 Third Circuit opinion, writing that the "doctrine can easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization plans [and therefore] places far too much power in the hands of bankruptcy judges."[14] These decisions signal that at least one member of the current Supreme Court disagrees with how equitable mootness has generally been applied in bankruptcy appeals.

Application in Analogous Contexts


David Liebenstein

In addition to the case law adopting—and criticizing—the doctrine, other courts have addressed the issue of whether equitable mootness applies in situations other than appeals of confirmed bankruptcy plans. For example, in *In re San Patricio County*, the Fifth Circuit noted that it was "certainly arguable" that equitable mootness applied to settlement agreements.[15] A handful of other courts have considered the doctrine in similar circumstances.[16]

In addition to considering mootness in the context of settlement agreements, courts have considered whether to apply the doctrine of equitable mootness in other contexts.[17] This includes analyzing whether it is appropriate to apply this common-law doctrine in the context of appeals of orders authorizing the sale of a debtor's assets pursuant to § 363.[18] However, Congress—in § 363(m)—has specifically addressed appeals of sale orders. Courts therefore have suggested that the application of equitable mootness, which is not based in statute, may not be appropriate in appeals of asset sales.[19]

Recent Refinements to the Doctrine by the Fifth Circuit

The Fifth Circuit has issued a number of significant cases on the issue of equitable mootness, and one of the leading cases was issued by the court in 1994. In *In re Manges*, the court considered the following factors in determining whether an appeal is equitably moot: "(i) whether a stay has been obtained, (ii) whether the plan has been 'substantially consummated,' and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan."[20] The *Manges* case involved a plan of reorganization that created a liquidating trust for the distribution of the debtors' assets. The plan had been submitted by one of the debtors' secured creditors, and the debtors appealed. The debtors failed to obtain a stay of the confirmation order and, during the pendency of the appeal, the trust was established, real property was sold and millions of dollars were distributed to creditors. The court held that the appeal was equitably moot because "the Plan [had] been virtually fully implemented and, at [that] point, unraveling it would be virtually impossible."[21]

Fifth Circuit law subsequent to *Manges* further demonstrates that the doctrine is firmly established in that jurisdiction.[22] However, a recent decision by the court may signal a more narrow application of the doctrine. In *In re Pacific Lumber Co.*, the court considered the appeal of a confirmed plan in a case concerning six affiliated entities involved in the redwood timber business in California.[23] After the plan was confirmed, the indenture trustee for certain secured noteholders (the "noteholders"), together with one of the debtors and certain individual noteholders (collectively, the "appellants"), filed an appeal on a number of different grounds. The appellants sought a stay of the confirmation order pending appeal. The bankruptcy court denied the stay, but granted the request to certify the appeal directly to the Fifth Circuit.[24] Several parties (collectively, the "appellees") argued that the appeal was equitably moot on grounds including: (1) parties had relied on the valuation of the noteholder's collateral, (2) distributions had been made pursu-

7 *In re UNR Indus. Inc.*, 20 F.3d 766, 769 (7th Cir. 1994).
8 *Id.*
9 *Id.*
10 *See id.; In re Nordhoff Invs. Inc.*, 258 F.3d 180, 192 *(3d Cir. 2001) (Alito, J. concurring); *In re Cont'l Airlines*, 91 F.3d 553, 560 (3d Cir. 1996) (Alito, J. dissenting); *see also* Ross E. Elgart, "Bankruptcy Appeals and Equitable Mootness," 19 *Cardozo L. Rev.* 2311, 2314 (1998).
11 *In re Cont'l Airlines*, 91 F.3d at 570.
12 *Id.* at 571.
13 *Id.*
14 *Nordhoff Invs. Inc. v. Zenith Elecs Corp.*, 258 F.3d 180, 192 (3d Cir. 2001).
15 *In re San Patricio Co. Cmty. Action Agency*, 575 F.3d 553, 558 (5th Cir. 2009). Ultimately, the court made no "comprehensive statement" on the issue because even "under [a] traditional equitable mootness analysis," the appeal was not moot under the specific facts of that case.
16 *See In re Delta Air Lines Inc.*, 374 B.R. 516 (S.D.N.Y. 2007); *In re Healthco Int'l Inc.*, 136 F.3d 45 (1st Cir. 1998).
17 *See In re Sasso*, 409 B.R. 251 (B.A.P. 1st Cir. 2009) (order converting case to chapter 7); *In re Villaje del Rio*, 283 Fed. Appx. 263 (5th Cir. 2008) (order approving foreclosure); *In re Trico Marine Servs Inc.*, 337 B.R. 811 (Bankr. S.D.N.Y. 2006) (complaint seeking revocation confirmation order under § 1144); *In re Grimland Inc.*, 243 F.3d 228 (5th Cir. 2001) (surcharge order in chapter 7 case); *In re SS Retail Stores Corp.*, 216 F.3d 882 (9th Cir. 2000) (fee application).
18 *See, e.g., In re Popp*, 323 B.R. 260 (9th Cir. B.A.P. 2005).
19 *In re Supertrail Mfg. Co.*, 2010 U.S. App. LEXIS 14200, at *8 n.5 (5th Cir. June 23, 2010); *In re Pac. Lumber Co.*, 584 F.3d 229, 249 & n.15 (5th Cir. 2009).
20 *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994).
21 *Id.* at 1043-44.
22 *See, e.g., In re Hilal*, 534 F.3d 498 (5th Cir. 2008); *In re SI Restructuring Inc.*, 542 F.2d 131 (5th Cir. 2008).
23 *In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009).
24 Pursuant to 28 U.S.C. § 158(d)(2).

ant to the creditor classes set forth in the confirmed plan and (3) proponents of the plan who had contributed significant financial sums as part of the plan's terms would not have supported the plan if releases had not been granted.

In *Pacific Lumber*, the Fifth Circuit first acknowledged that the doctrine of equitable mootness "is firmly rooted in Fifth Circuit jurisprudence."[25] The court went on to note, however, that it would apply the doctrine "with a scalpel rather than an axe."[26] As to the three substantive issues on appeal discussed above, the court analyzed each in turn. The court held that the collateral-valuation issue was not equitably moot. The court recognized that the parties' expectations should be protected, but that those expectations "should not be a shield for sharp or unauthorized practices."[27] The court noted, however, that because this issue involved property rights (*i.e.*, the collateral), the noteholders were due "a minimum level of protection" by the takings and due-process clauses of the Constitution. The court also expressed a concern that applying equitable mootness too broadly may "destabilize the credit market for financially troubled companies."[28] Taken alone, these statements would seem to indicate that the court will consider a large number of factors (*e.g.*, credit markets) in determining whether to apply equitable mootness and that litigants might expect a narrower application in the future. This is supported by the fact that the court allowed the appeal of the releases against MRC and Marathon to proceed. On that issue, the court dismissed the argument that the releases were an integral part of the bargain struck by MRC and Marathon, including their agreement to finance the plan. The court averred that "[a]ny costs the released parties might incur in defending against [the claimed] negligence are unlikely to swamp either these parties or the consummated reorganization... In short, the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process."[29]

The view that this decision signals a narrowing of the doctrine is tempered, however, by the fact that the court found certain elements of the appeal to be equitably moot. This included the argument by the appellees that the plan impermissibly gerrymandered certain creditor classes. The court noted that the structure of certain classes was "troubling," but held that this element of the appeal was equitably moot because creditors had received distributions according to the classifications, "[t]hird-party expectations [could not] reasonably be undone, and no remedy...[was] practicable other than unwinding the Plan."[30]

Therefore, while some may interpret the *Pacific Lumber* case to signal a narrowing of the equitable mootness doctrine, the fact that the Fifth Circuit held certain parts of the appeal to be equitably moot indicates that the court harbors no overriding hostility to the doctrine itself. However, the more narrow application of the theory is bolstered by a subsequent decision issued by the Fifth Circuit wherein the court remanded a district court order finding an appeal of a confirmation equitably moot on the grounds that the lower court failed to adequately explain how the appeal would disturb the plan or adversely affect third parties.[31] Rather than an overall narrowing of the doctrine, the *Pacific Lumber* case most likely signals the importance courts will place on the interests of secured creditors, given the constitutional protection of property rights.

If Courts Narrow the Doctrine, What Can Practitoners Expect?

As stated, it is unclear whether recent case law should be construed to limit the equitable-mootness doctrine. However, for the sake of argument, what could bankruptcy practioners expect if courts begin to apply the doctrine more narrowly? Various plan proponents likely would suggest that the resulting uncertainty concerning the finality of confirmation orders would negatively impact bankruptcy practice. However, these concerns should also be weighed against the fact that while equitable mootness is unique to bankruptcy, the issue of how to address finality of judgments is not. For example, while the common law of restitution has long held that a party conferring a benefit on another pursuant to a judgment is entitled to restitution if that judgment is later overturned, the well-recognized exception to this rule is that such restitution will not be required if, under the facts of the case, it would be *inequitable* to require the other party to return the benefit.[32] In other words, if courts choose to apply equitable mootness more narrowly in the future, there may be certain unpleasant side effects, but it is questionable whether this would result in a fundamental shift in bankruptcy practice.

How Should Plan Proponents Respond If Courts Limit the Doctrine?

While the *Pacific Lumber* case may present a challenge to future plan proponents, it also serves as a road map for crafting a plan with the best chance for withstanding an appeal. As discussed above in *Nordoff*, then-Judge Alito was concerned that equitable mootness could "easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization plans."[33] While Judge Alito expressed that concern, it should be noted that his viewpoint on the doctrine is not the majority viewpoint. The doctrine—whether it will be applied more narrowly or not—is still a viable doctrine in bankruptcy practice, and there is nothing wrong with taking specific actions to shore up the elements of equitable mootness. Some may consider that an offensive use of equitable mootness. To others (*i.e.*, plan proponents), it is a smart way to ensure that parties relying on a confirmation order can continue to rely on the order.

Using *Pacific Lumber* as a guide, the court held that the appeal of the releases was not equitably moot because, in part, it was not clear that this was an integral part of the bargain struck by the plan proponents. The natural response will be for plan proponents to ensure that sufficient evidence is proffered at the confirmation hearing—for example, putting parties on the stand to testify specifically that they would not have provided their material support if they had not been provided with the release, or other considerations provided to them under the plan. This will allow the plan proponent to point to this evidence when—and if—an appellant argues that some aspect of the plan was not integral to the bargain struck in bringing parties together to support the plan.

Conclusion

Using a handful of cases to predict the trajectory of a particular doctrine is

25 *In re Pac. Lumber Co.*, 584 F.3d at 240.
26 *Id.*
27 *Id.* at 244, n.19.
28 *Id.*
29 *Id.* at 252. The court's willingness to unwind non-debtor releases in a confirmed plan is in stark contrast to the Second Circuit's opinion in *In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 145 (2d Cir. 2005) ("Even if we could carve out appellants' claims from the nondebtor releases, we would not do so. If appellants' claims are substantial (as they urge), it is as likely as not that the bargain struck by the debtor and the released parties might have been different without the releases.").
30 *Id.* at 251.
31 *In re Blast Energy Servs Inc.*, 593 F.3d 418 (5th Cir. 2010).
32 *See* Restatement (First) of Restitution § 74 (1937).
33 *Nordhoff Invs. Inc.*, 258 F.3d at 192.

always an inexact science. Therefore, it cannot be said with any certainty whether recent equitable mootness case law predicts any sort of doctrinal shift. However, even if this recent case law ends up creating only minor ripples in the overall body of equitable mootness law, it does provide bankruptcy practioners with a reminder of the importance of the doctrine. For plan proponents, it probably cannot be overstated how important it is to make a clear evidentiary record of the reasons that various parties provided their support to the plan of reorganization. Other factors certainly contribute to whether an appeal is equitably moot, but creating a clear and unequivocal evidentiary record will be a strong foundation for making a confirmation order as "appeal-proof" as possible. ■

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