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Examining Equitable Mootness After High Court Ch. 11 Denial

By **Daniel Lowenthal** (July 26, 2022, 5:39 PM EDT)

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The U.S. Supreme Court recently denied a cert petition where the petitioner wanted the controversial doctrine of equitable mootness ruled unconstitutional, in KK-PB Financial LLC v. 160 Royal Palm LLC.[1]

The court's June refusal to take the case means the doctrine remains valid and, in certain situations, appellate courts will continue to refuse to hear appeals of bankruptcy court orders. The primary beneficiaries of the ruling will be Chapter 11 debtors.

When the doctrine is applied, confirmation orders approving their plans of reorganization or liquidation will stand without appellate review. And, no doubt, the continued use of the doctrine will cause some judges, scholars and practitioners to keep finding flaws with it.

In KK-PB Financial, the debtor owned a single parcel of real property with an unfinished, nonoperational hotel. In its bankruptcy case, the debtor conducted a private sale of its assets and confirmed a plan. Two days later, the debtor announced the plan had gone effective.

An objecting creditor appealed and sought a stay from the district court, but soon after the debtor began making distributions to creditors. Both the district court and the U.S. Court of Appeals for the Eleventh Circuit refused to hear the appeal on the ground of equitable mootness.

In its cert petition, the creditor argued that equitable mootness "lacks a statutory basis, lacks any support in Supreme Court jurisprudence, is unconstitutional and allows federal judges to abdicate their responsibilities to adjudicate live controversies on the merits."

But the Supreme Court refused to take the case, a decision that will benefit debtors and disappoint those who dislike the doctrine.

Equitable mootness is a judge-made remedy, and one that's misnamed. The doctrine is designed by courts to seek equity in certain situations. It's misnamed because actual mootness, in the constitutional sense, is missing.

Typically, the term mootness refers to a matter where there's no live case or controversy. Article III, Section 2 of the U.S. Constitution bars courts from hearing matters that lack a case or controversy. The

prohibition is jurisdictional.

In contrast, equitable mootness is not jurisdictional. It's prudential, and is applied when courts voluntarily decline to hear matters, even when there's a case or controversy present.

Equitable mootness also differs from statutory mootness. Two examples of statutory mootness under the Bankruptcy Code are Section 363(m) — mootness following a debtor's court-approved sale or lease of property when, if the appellant doesn't obtain a stay or post a bond, or both, the sale will go forward — and Section 364(e), or mootness after a court allows a debtor to obtain new debt or grants the priority of a lien.

As the U.S. Court of Appeals for the Seventh Circuit said in In re: UNR Industries Inc. in 1994, "There's a big difference between inability to alter the outcome (constitutional or statutory mootness) and unwillingness to alter the outcome (equitable mootness)."[2]

Given that there's no case or controversy as with constitutional mootness, the Seventh Circuit has banished the term "equitable mootness" from the local lexicon.[3]

So, when do courts apply equitable mootness — and what exactly is it? Equitable mootness is applied when an appellate court declines to hear an appeal of a bankruptcy court's order.

The bankruptcy court's order is allowed to stand without appellate review. Equitable mootness is applied by district courts, bankruptcy appellate panels and courts of appeals.

Most often, equitable mootness arises when an appeal is filed after a Chapter 11 plan is confirmed. A debtor asks the appellate court to decline the appeal because reversal of the confirmation order would wreak havoc on the debtor's reorganization.

The debtor argues that unscrambling a complex bankruptcy reorganization would be too hard to do, particularly given the reliance by third parties and others on what's called for in the plan. This can include the sale of assets, the issuance of new debt and equity — including publicly traded securities — new contracts with customers and vendors, and more.

But those who favor equitable mootness argue that parties should be allowed to rely on the finality of a bankruptcy court's order approving a Chapter 11 plan because, upon plan confirmation, "relief on appeal becomes impractical, imprudent and therefore inequitable."[4]

In addition to appeals of Chapter 11 plans, equitable mootness has been applied to settlements, cash collateral orders and critical vendor orders.

Equitable mootness first arose in 1981 in a decision by the U.S. Court of Appeals for the Ninth Circuit following confirmation of a plan under the Bankruptcy Act of 1891, in Trone v. Roberts Farms Inc.[5]

In that case, the appellant had not sought a stay of the confirmation order. The Ninth Circuit observed that there had been "such a comprehensive change of circumstances ... as to render it inequitable for this court to consider the merits of the appeal."

The Ninth Circuit cited two grounds for refusing to hear the appeal: the failure of the appellant to obtain

a stay and futility of a remedy.

Since then, every U.S. court of appeals has recognized the doctrine of equitable mootness. And while the circuits have fashioned various tests, they typically consider the following factors:

- If an appellant has obtained a stay of the order at issue; and
- If a plan has been substantially consummated.

Substantial consummation is defined in Section 1101(2) of the Bankruptcy Code as when transfer of all or substantially all of the property proposed by the plan to be transferred is actually transferred; assumption by the debtor of by the successor under the plan of the business or management of all or substantially all of the property dealt with under the plan; and commencement of distribution under the plan.

If there's substantial consummation, then courts are more likely to find grounds for equitable mootness.

Whether courts apply the doctrine in a given instance will depend on the extent of the relief being sought: the unscrambling of a plan or, for instance, something more limited such as the reallocation of creditor distributions from one class to another.

That said, the U.S. Court of Appeals for the Second Circuit held in In re: Charter Communications Inc. in 2012 that substantial consummation creates a presumption that an appeal is equitably moot.[6] No other circuit's test has this presumption.

Circuits also consider whether it is practical and equitable to grant appellate relief by considering:

- The importance of the challenged issue to the plan — whether the appellant seeks a "piecemeal revision of the plan or a wholesale rewriting of it," as seen in In re: City of Detroit, Michigan in the U.S. Court of Appeals for the Sixth Circuit in 2016; and
- Whether what the appellant seeks would affect the reliance interests of other parties-in-interest who aren't involved in the appeal.

Some circuits, such as the U.S. Court of Appeals for the Tenth Circuit, also favor taking a quick look at the merits of an appeal to determine if the appellant's arguments are "legally meritorious or equitably compelling," as seen in Dill Oil Co. v. Stephens in 2013.[8]

Equitable mootness is controversial because it avoids appellate review when there's a case or controversy. Some appellate judges and academics have been highly critical of the doctrine.

In In re: One2One Communications LLC in the U.S. Court of Appeals for the Third Circuit in 2015, U.S. Circuit Judge Cheryl Ann Krause called the doctrine "a legally ungrounded and practically unadministrable judge-made abstention doctrine," adding that "the time has come to reconsider if the doctrine should exist at all."[9]

In In re: City of Detroit in 2016, U.S. Circuit Judge Karen Nelson Moore stated,

> [d]ivorced as it is from any statutory basis, equitable mootness is nothing but a prudential doctrine of "judicially self-imposed limits." However, "prudential" equitable mootness may be, it operates to cut off entirely a litigant's right to appeal in a case that would otherwise be within our appellate jurisdiction.[10]

Last year, in In re: VeroBlue Farms Inc., the U.S. Court of Appeals for the Eighth Circuit predicted that if

> equitable mootness ... becomes the rule of appellate bankruptcy jurisprudence, rather than an exception to the rule that jurisdiction should be exercised, we predict the Supreme Court ... will step in and severely curtail — perhaps even abolish — its use.[11]

In a panel discussion of the doctrine at a conference of the American Bankruptcy Institute in April, professor Ralph Brubaker of the University of Illinois College of Law said he would like to see the Supreme Court eliminate the doctrine. That comment was made about two months before the Supreme Court denied cert in the KK-PB Financial case.

Judicial and academic criticisms aside, federal district and appellate courts can and will continue to apply the equitable mootness doctrine in appeals of bankruptcy court decisions. This means Chapter 11 plans will be confirmed and appeals filed, but certain appeals won't be heard.

For those who dislike the doctrine, those cases would be few in number and limited to when stays have been obtained, plans haven't been substantially consummated, and the appellants have a good chance of prevailing on the merits.

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[1] KK-PB Financial LLC v. 160 Royal Palm LLC, No. 21-1197, 2021 WL 7247541 (petition), 2022 WL 1914118 (denying certiorari).

[2] In re UNR Indus., 20 F.3d 766 (7th Cir. 1994).

[3] UNR, 20 F.3d at 769.

[4] UNR, 20 F.3d at 769.

[5] Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.), 652 F.2d 793 (9th Cir. 1981).

[6] In re Charter Commc'ns, 691 F.3d 476 (2d Cir. 2012).

[7] In re City of Detroit, Michigan, 838 F.3d 792, 799 (6th Cir. 2016).

[8] Dill Oil Co. v. Stephens (In re Stephens), 704 F.3d 1279, 1282-83 (10th Cir. 2013).

[9] One2One Commc'ns, LLC, 805 F.3d 428, 438 (3d Cir. 2015) (concurring opinion).

[10] In re City of Detroit, Michigan, 838 F.3d 792, 810 (6th Cir. 2016) (dissenting opinion).

[11] In re VeroBlue Farms USA, Inc., 6 F.4th 880 (8th Cir. 2021).