Rochelle's Daily Wire

August 10, 2021

Eighth Circuit Comes Near to Abolishing Equitable Mootness

Circuit Judge Loken predicts the Supreme Court will abolish equitable mootness if the lower courts don't cut back and start reviewing the merits of confirmed chapter 11 plans.

The Eighth Circuit has come one step short of altogether abolishing the judge-made doctrine of equitable mootness. Strictly speaking, the appeals court barred dismissal of an appeal from confirmation of a chapter 11 plan without

> at least a preliminary review of the merits of [the appellant's] appeal to determine the strength of [the appellant's] claims, the amount of time that would likely be required to resolve the merits of those claims on an expedited basis, and the equitable remedies available — including possible dismissal — to avoid undermining the plan and thereby harming *third parties*. [Emphasis in original.]

The St. Louis-based court of appeals did ban further use of the term "equitable mootness" in the Eighth Circuit, telling courts instead to say "equitable dismissal."

The Complex, Hard-Fought Chapter 11 Case

The case was a typical blood-and-guts reorganization of a large company. The original start-up capital was $63 million in debt and equity, with further investments down the road. At filing, the first-lien debt was $54 million, more than the assets were worth. The debt was secured by all the assets.
creditors' objection.

The official creditors' committee lodged a timely objection, demanding that the debtor initiate an adversary proceeding against the secured lender and the dominant equity holder. The next day, an unofficial, *ad hoc* group of equity holders joined in the creditors' objection.

The creditors' committee reached a settlement on a chapter 11 plan. In return for a dollop of consideration for unsecured creditors, the committee dropped its objection to the secured claim. The bankruptcy court soon after ruled that secured debt was sacrosanct because there had been no timely objection.

Then, one of the smaller equity holders objected to the disclosure statement and to allowance of the secured claim. The bankruptcy court confirmed the plan and denied the objection to the secured claim.

You know what happened next, and quickly. The plan was consummated. Among other things, the dominant equity holder funded the plan with $13.5 million, existing stock was cancelled, cash distributions were made to creditors, and the secured lender received $6 million.

Having objected unsuccessfully to the secured claim, the smaller equity holder appealed the confirmation order, claiming unfair discrimination between creditors of the same class, violation of the absolute priority rule, bad faith, and failure to meet the best interests test.

The district court dismissed the appeal as equitably moot, but the equity holder appealed to the circuit.

Predicting the Demise of Equitable Mootness

In his 16-page opinion on August 5, Circuit Judge James B. Loken reversed and remanded for reconsideration of the merits, at least to a limited extent. His opinion is a "must read" for anyone involved in chapter 11 practice. He wrote a compendium of the best objections to the survival of equitable mootness.

If the doctrine becomes embedded in appellate jurisdiction, "rather than an exception to the Article III-based rule that jurisdiction should be exercised," he "predict[ed] [that] the Supreme Court, having up to now denied petitions for *certiorari* to review the doctrine, will step in and severely curtail – perhaps even abolish – its use, just as the Court curtailed lower courts' excessive use of the '*Rooker-Feldman* doctrine' to avoid difficult claim and issue preclusion analysis."

Insiders Aren't Protected by Equitable Mootness

Judge Loken began his analysis by saying that equitable mootness "is misleading." Consequently, "we banish 'equitable mootness' from the (local) lexicon," he said.
Judge Loken explained that an appeal is "moot, that is, beyond a federal court's Article III jurisdiction, only if 'it is impossible for a court to grant any effectual relief whatsoever,'" quoting Mission Prod. Holdings Inc. v. Tempnology LLC, 139 S. Ct. 1652, 1660 (2019).
As for equitable mootness, he said the doctrine has been "adopted by our sister circuits (though not uniformly)." The Eighth Circuit had not taken a position except in a nonprecedential opinion upholding the doctrine without discussion. Equitable mootness, Judge Loken said, "has been thoughtfully criticized by many judges." He heaped praise on the concurrence by Circuit Judge Cheryl Krause in In re One2One Communications LLC, 805 F.3d 428 (3d Cir. 2015), where the Third Circuit reversed an equitable mootness dismissal and remanded for reconsideration of the merits. Judge Loken quoted Judge Krause as follows:

> [A] motion to dismiss an appeal as equitably moot has become "part of the Plan." Proponents of reorganization plans now rush to implement them so they may avail themselves of an equitable mootness defense, much like Appellees did here. Rather than litigate the merits of an appeal, parties then litigate equitable mootness. And even if an appeal is dismissed as equitably moot by a district court, that dismissal is appealed to our Court, often resulting, in turn, in a remand and further proceedings . . . . Without the equitable mootness doctrine, on the other hand, the District Court would have ruled on the merits long ago. Id. at 446-7.

In the case before him, Judge Loken said that half of the cash distribution went to the secured lender whose lien was being challenged by the minority shareholder. The lender and the plan sponsor, he said, "are not third parties that the equitable mootness doctrine is intended to protect."

Again quoting Judge Krause, Judge Loken said that the case on appeal dealt with complex questions like compliance with cramdown provisions and claims of conflict of interest or preferential treatment "that go to the very integrity of the bankruptcy process." *Id*. at 454. The appeal before him, Judge Loken said, "takes on the look of the type of Chapter 11 plan that Judge Krause defined as one needing review on the merits by an Article III appellate court."

Judge Loken reversed on equitable mootness and remanded. He did not tell the district court how to rule on the merits of the plan, saying that we only "decide that the inquiry must be made."

However, Judge Loken did say that "if the confirmed plan must be set aside on the merits, the district court may be able to fashion effective relief for those whose rights were impaired by the plan even if the business assets have been sold to a third party purchaser relying on the confirmed plan, such as disgorgement of the proceeds."

Observations

Judge Loken seems to require that appellate courts take four steps on appeal from confirmation of a chapter 11 plan: The appellate court must (1) accelerate the appeal; (2) undertake a preliminary review of the objections to confirmation;(3) decide how long it would take to resolve the merits of the appeal on an expedited basis; and (4) evaluate available remedies that would not harm third parties.

The opinion could mean that parties central to the reorganization, including plan sponsors and major secured creditors, are not entitled to protection by equitable dismissal. The doctrine in the Eighth Circuit seems to protect only true third parties not involved in maneuvering to confirm the plan.

The opinion will have its effects. Sad to say, the Eighth Circuit may take on a stigma worse than those (increasingly fewer) circuits proscribing non-debtor, third-party releases.
The divergence among the circuits on equitable mootness is good reason for the Supreme Court to grant certiorari in the next term and resolve the issue once and for all. As it stands now, many of the most consequential questions about chapter 11 plans defy appellate review on authority of equitable mootness.
The two petitions now before the Court on equitable mootness are GLM DWF Inc. v. Windstream Holdings Inc., 21-78 (Sup. Ct.); and Hargreaves v. Nuverra Environmental Solutions Inc., 21-17 (Sup. Ct.). Click here to read yesterday's Rochelle's Daily Wire regarding the certiorari petitions.

Case Details

Case Citation

FishDish LLP v. VeroBlue Farms USA Inc. (In re VeroBlue Farms USA Inc.), 19-3413 (8th Cir. Aug. 5, 2021).

Case Name

FishDish LLP v. VeroBlue Farms USA Inc. (In re VeroBlue Farms USA Inc.)

Case Type

Business
Court
8th Circuit
Bankruptcy Tags
Plan Confirmation
Practice and Procedure
Business Regorganization

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