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PRO BANKRUPTCY

Bankruptcy Appeals Are Dismissed Too Quickly, Appellate Court Says

Setting aside bankruptcy appeals without meaningful review under the legal doctrine of "equitable mootness" shouldn't become the norm, an appeals court says.

By Andrew Scurria

Federal judges shouldn't be too quick to dispense with appeals that challenge the approval of a chapter 11 plan, a U.S. appeals court said.

The U.S. Court of Appeals for the Eighth Circuit released a decision Thursday critiquing the application of "equitable mootness," a legal doctrine developed over years that shields many bankruptcy-court rulings from appellate review.

While the standard varies among federal appeals courts, equitable mootness generally holds that certain aspects of chapter 11 proceedings are effectively unreviewable on appeal, because to reverse them would require unwinding transactions that have already

occurred.

Equitable mootness was developed by bankruptcy judges to assure creditors, investors and buyers involved in a bankruptcy that, once confirmed, a chapter 11 plan can be relied on as final. When a bankruptcy plan can be undone on appeal, the business remains vulnerable and might have a tougher time getting financing.

In recent years, however, some appeals courts have expressed concern that applying equitable mootness too broadly can cut off legitimate appellate rights after a chapter 11 plan is confirmed and takes effect. At a House committee hearing last week, Georgetown University law Professor Adam Levitin said bankrupt companies have "weaponized" it, "taking care that plans go effective—and money starts changing hands—as soon as possible after confirmation."

The Eighth Circuit underscored that requests to shut down an appeal based on equitable mootness "should be granted only in extremely rare circumstances."

The decision revived a shareholder challenge to the 2018 chapter 11 filing of VeroBlue Farms USA Inc., a fish-farming business in Iowa that owed more than it could pay its secured creditor, Broadmoor Financial LP.

Kenneth Lockard, a preferred shareholder through his investment vehicle FishDish, objected to the company's bankruptcy plan, which wiped out his $6 million investment.

Alder Aqua Ltd., an investor that sponsored the plan, took control of VeroBlue in exchange for $13.5 million in funding that was used to make distributions to other creditors and capitalize the business, according to court papers.

FishDish appealed, saying the plan unfairly discriminated between shareholders and wasn't proposed in good faith. In court papers, FishDish said it was denied the opportunity to investigate the secured lender's ties to other parties in the bankruptcy and potentially challenge its claim.A federal judge dismissed the appeal, citing equitable mootness and declining to address the merits of FishDish's complaints.

The Eighth Circuit, however, said equitable mootness wasn't justified in this instance, while cautioning that its widespread application could prompt the U.S. Supreme Court to "severely curtail—perhaps even abolish—its use." A suitable remedy for FishDish might be fashioned in the event it prevailed in its appeal, according to the appeals court.

"We do not assume how these factual inquiries may be resolved," the decision said. "We decide only that the inquiry must be made."