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PERSPECTIVE

Ruling limits 'equitable mootness' doctrine in bankruptcy

By David M. Reeder

When a Chapter 11 plan of reorganization is confirmed over the objection of a creditor, the next phase of the contest is often a race. The debtor attempts to reach "base" via substantial consummation of the plan in order to, arguably, render any appeal of the confirmation by an objecting creditor "equitably moot." At the same time, the creditor is often seeking a stay pending appeal enjoining the debtor from carrying out the terms of the plan.

Until a recent line of cases from the 9th U.S. Circuit Court of Appeals — the most comprehensive of which was its decision last week in *In re Transwest Resort Properties Inc.*, 2015 DJDAR 10624 (Sept. 15, 2015) — the conventional wisdom in the bankruptcy world was that once the debtor took concrete steps to put the plan in place, known as "substantial consummation," and the objecting creditor failed to gain a stay of the plan confirmation order pending appeal, then any appeal of the confirmation of the plan was presumed to be "equitably moot" and subject to dismissal by the appellate court.

Not so, said the 9th Circuit in *Transwest Resort Properties*. The court first explained the distinction between Article III mootness, which "causes federal courts to lack jurisdiction and so to have an inability to provide relief" and equitable mootness which is a "judge-created doctrine that reflects an unwillingness to provide relief."

Equitable mootness is a doctrine that is almost exclusive to bankruptcy cases.

The 9th Circuit stated that it uses four considerations to determine whether a bankruptcy appeal is equitably moot:

(1) Whether a stay was sought. Failure to seek a stay indicates that the appellant has slept on its rights and equitable mootness will likely be found;

(2) If a stay was sought and not gained, then the court will then consider whether the plan has been substantially consummated;

(3) Then, the court will consider the effect that a remedy may have on third parties who are not before the court;

(4) Finally, the court will determine whether, on remand, the bankruptcy court can fashion effective and fair relief without "knocking the props out from under the plan and creating an uncontrollable situation in the bankruptcy court."

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A tall order, but there's more: In determining the existence of equitable mootness, the appellate court must apply these four considerations to each objection raised by the creditor on appeal.

The court went on to parse out the facts of the underlying case, which involved multiple related debtors which owned multiple resort properties. The creditor, a first mortgage lender, had objected to the proposed Chapter 11 plan, which was subsequently confirmed by an order of the bankruptcy court. The creditor, the holder of a secured claim fixed at $242 million, had specifically objected to the plan based on: (1) provisions of the plan that improperly modified its due on sale clause, and (2) failure of the debtor to have at least one impaired class consent to the plan.

After the plan was confirmed, the creditor diligently sought, but failed to gain, a stay pending appeal, having brought such request before both the bankruptcy court and the district court which was hearing the appeal. In the meantime, the debtor achieved "substantial consummation of its plan. (Per 11 U.S.C. Section 1101(2), a case has been *substantially consummated* upon all of the following having taken place: (A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan.)

The district court dismissed the creditor's appeal base on equitable mootness. The 9th Circuit reversed the district court's dismissal based on equitable mootness and remanded to the bankruptcy court. In reaching its decision, the 9th Circuit, in a thorough analysis, determined first that to properly invoke the equitable mootness doctrine it is not enough that the creditor has not gained a stay and that the plan has been substantially consummated. The court looked very closely at the inter-related considerations of the rights of third parties not before the court, and whether the bankruptcy court could, on remand, fashion relief without doing violence to the already substantially consummated plan.

The 9th Circuit showed that an equitable mootness analysis is highly fact dependent, and allows, if not requires, substantial creativity on the part of the appellate court and counsel. Specifically, regarding the third consideration mentioned above, the court determined that a particular vocal third party who succeeded to the interests of two of the related debtors, and had been active throughout the case, and even appeared in the appeal arguing how its rights would be trampled if any variance was made to the plan after appeal, was not the "innocent" third party whose position should not be upset. Instead, the third party was a sophisticated, able and vocal player able to fend for itself. The court found the same regarding other third parties; that the case had not gone so far that any relief granted by the bankruptcy court would be unduly disruptive. As for the fourth consideration, whether the bankruptcy court could fashion effective relief without eviscerating the plan, the 9th Circuit gave examples of relief that might be fashioned by the bankruptcy court involving only a slight, or not so slight, adjustment of time or money in the plan, showing that relief can be fashioned in a substantially consumed case in a manner that does not require "unscrambling the eggs."

The takeaway here is that there is running room for creditors to effectively appeal Chapter 11 plan confirmation in a substantially consummated case. The creditor must make immediate efforts to gain a stay of the confirmation order pending appeal. The inevitable equitable mootness argument that will be raised by the debtor on appeal will be fact-intensive, and gives both sides ample opportunities for creativity regarding the effect of the appeal on innocent third parties, and on forms of relief that could be fashioned by the bankruptcy court upon remand that would not decimate the plan.

David Reeder *practices with the firm of Valensi Rose PLC in Century City.*

DAVID REEDER
Valensi Rose

His practice focuses on bankruptcy cases, business reorganization and bankruptcy litigation. You can reach him at dmr@vrmlaw.com.