AMERICAN BANKRUPTCY INSTITUTE

2019 Southwest Bankruptcy Conference

Chapter 11 Cases in the Headlines

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AMERICAN BANKRUPTCY INSTITUTE

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Chapter 11 Cases in the Headlines

Moderated by:
The Honorable Hannah L. Blumenstiel
United Stated Bankruptcy Court for the Northern District of California

Panelists:*
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*The views and opinions expressed herein are the personal views of the individual panelists and do not necessarily reflect the views of any law firm or other organization with which such panelist may be affiliated.

Sears Holding Corporation

Sears Holding Corporation

Overview

- Sears Holdings Corporation and certain of its affiliates ("Sears") filed for chapter 11 in October 2018 in the United States Bankruptcy Court for the Southern District of New York (Judge Drain).
- Shortly after the petition date, the Debtors filed bidding procedures to market the company's "go forward retail footprint" to potential bidders, including to ESL Investments Inc. (with its affiliates, "ESL") – a hedge fund owned by former Sears CEO Eddie Lampert.
- Early in the cases, a restructuring subcommittee comprised of two independent directors of the Sears board was appointed to, among other things, (a) evaluate whether the proposed transaction with ESL was in the best interests of the Sears debtors' estates and (b) investigate potential claims against ESL and Lampert, including claims for fraudulent transfer, recharacterization, and equitable subordination.
- In connection with its duties, the restructuring subcommittee retained a full team of independent advisors, including Paul Weiss, Evercore, Stout Risius, and Alvarez & Marsal.

Sears Holding Corporation

ESL's Bid

- In December 2018, ESL disclosed its indicative bid to purchase Sears' go-forward assets for a purchase price of $4.6 billion, which was later revised up to $5.2 billion.
- The revised bid included, among other consideration, a $1.3 billion credit bid and provided that, in exchange for a one-time cash payment of $35 million, ESL would receive a release of "all Claims and causes of action of the Debtors and their estates against [ESL] . . . arising under . . . equitable principles of subordination or recharacterization."
- In January 2019, the debtors accepted the new bid and entered into an asset purchase agreement ("APA") with ESL on the terms thereof. On February 7, 2019, Judge Drain approved the sale.

Restructuring Subcommittee

- The restructuring subcommittee supported the going-concern transaction with ESL, including the accompanying limited releases to ESL and Lampert.
- The committee noted that the transaction preserved certain causes of action that would not disrupt the finality of the sale transaction, including (i) fraudulent conveyance (estimated at $3.7 billion), (ii) breach of fiduciary duty, (iii) illegal dividends, and (iv) the Lands' End and Seritage transactions.

Sears Holding Corporation

Objections to ESL Sale Transaction

- Given Lampert's insider status, ESL's involvement in Sears' restructuring was immediately scrutinized by the company's other creditors, many of whom felt that the sale was a thinly veiled scheme to hand the company to Lampert at a deflated price.
- For instance, the UCC argued that the rushed sale process was designed to block creditors from investigating and pursuing substantial claims against ESL and Lampert, including claims for fraudulent transfer, equitable subordination or recharacterization of the insider claims that comprised ESL's credit bid.
- The UCC also argued that the consideration provided under the APA for the release of claims for equitable subordination and recharacterization against ESL was "woefully inadequate."
- Further, the UCC argued that the sale left the estate administratively insolvent and that the debtors' exclusive focus on soliciting "going concern" bids would deprive the estates of potentially value maximizing alternatives.
- The sale also drew objections from Sears' landlords and other counterparties.

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Sears Holding Corporation

Takeaways

- Sears presents a rare case of a major insider sale transaction that was consummated over the objection of the UCC where significant potential claims remained unresolved.
- Citing *In re Orion Pictures Corp.*, 4 F.3d 1095, 1098-99 (2d Cir. 1993), Sears and ESL were able to deflect many of the UCC's objections at the sale hearing stage by noting that the sale hearing was a "summary proceeding" and not a "mini-trial on the merits."
- The involvement of the independently advised restructuring subcommittee, which blessed the releases granted to the credit-bidding purchaser, provided important support to the sale.
- The bankruptcy court was also keenly focused on preserving jobs of Sears' employees.

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Nevada Marijuana Cases

Nevada Marijuana Cases

CW Nevada, LLC (US Bankr. Crt., D. NV, Case No. 19-12300-MKN)

- Judge Nakagawa granted a motion to dismiss the bankruptcy filing of an entity in the business of cultivating, producing, and distributing medical and recreational marijuana, producing and distributing products that contain cannabidiol ("CBD"), operates marijuana cultivation, production, or dispensary facilities. Debtor's business operations apparently are authorized under Nevada law.
- Nevada is one of many states that has enacted legislation to decriminalize marijuana. Debtor's Marijuana Business is prohibited under federal law by provisions of the Controlled Substances Act, 21 U.S.C. § 841(a)(1) and 21 U.S.C. § 812(c), Schedule I(c)(10) [Marihuana] and Schedule. I(c)(17) [Tetrahydrocannibinols].
- Debtor's CBD Business, however, may no longer be prohibited under federal law as a result of the Agriculture Improvement Act of 2018, Pub. L. 115-334, 132 Stat. 4490.
- The Agriculture Improvement Act became effective on December 20, 2018, when the bill was signed into law. The Act amended the term "Marihuana" under the Controlled Substances Act to exclude hemp "as defined under section 1639 of Title 7." See 21 U.S.C. § 802(16)(B).

Nevada Marijuana Cases

CW Nevada, LLC (US Bankr. Crt., D. NV, Case No. 19-12300-MKN) (Cont.)

- Portion of the Debtor's operations devoted to the Marijuana Business appears to be in violation of federal law, while the portion devoted to the CBD Business might be excluded from the Controlled Substances Act if the CBD products sold by the Debtor are derived from the type of hemp permitted under federal law.
- 9th Cir. Decision: *Garvin v. Cook Investments NW, SPNWY, LLC (In re Cook Investments NW)*, 922 F.3d 1031 (2019).
- *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012).
- *In re Arm Ventures, LLC*, 564 B.R. 77 (Bankr. S.D. Fla. 2017).
  - Willingness of the bankruptcy court to allow the voluntary debtor to propose a feasible plan that does not rely on income received through a violation of the Controlled Substances Act.
  - After dismissal, case has been placed in receivership.

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Nevada Marijuana Cases

Involuntary Chapter 7 of Howard Misle

- Involuntary Chapter 7 petition filed against putative Debtor Howard Misle; Judge Beesley maintained jurisdiction over bankruptcy case notwithstanding that a portion of the debtor's assets are marijuana derived assets.
- The court bifurcated the debtor's non-marijuana assets as assets of the estate under section 541 and this matter is currently on appeal before the 9th Circuit BAP.
- Recreational marijuana is legal in Nevada, and trustees in this district have presumably administered cases in which individual debtors possessed and/or used marijuana during the bankruptcy case.
- In such circumstances, is the court required to dismiss every individual bankruptcy case upon the debtor's admission that he or she possesses and/or uses marijuana for personal use?
- That is the natural progression of the Alleged Debtor's proposed per se rule and would only serve to invite abuse by opportunistic debtors who could simply use this mandatory 'get out of bankruptcy' card at any time they see fit. [NTD: can we provide additional color on the "per se rule" referenced in this bullet?]

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Nevada Marijuana Cases

Involuntary Chapter 7 of Howard Misle (Cont.)

- While Misle was an involuntary proceeding filed against an individual, it illustrates the prospect of more voluntary bankruptcy petitions being filed under any chapter by individuals and non-individuals solely for the purpose of triggering the automatic stay under section 362(a).
- If the disclosure of marijuana-related assets or activities requires a bankruptcy court to dismiss a case after a petition is filed, the debtor may have obtained temporary protection from creditors without any intention of obtaining a bankruptcy discharge of debts.
- While Congress has provided a partial solution for individuals who repeatedly file consumer bankruptcy petitions, *see* 11 U.S.C. §§ 362(c)(3) and (c)(4), it has provided no meaningful solution for non-individual debtors that repeatedly file Chapter 11 petitions.

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Opioid / Mass Tort in Chapter 11

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Mass Tort in Chapter 11

Asbestos & section 524(g) of the Bankruptcy Code

- Section 524(g) enacted post-*Johns-Manville.*
- Tool to manage asbestos liabilities in chapter 11 by channeling all present and future claims to a trust and issuing a channeling injunction in favor of the debtor and other parties.

Section 105 for Non-Asbestos Mass Tort

- More recently, companies have successfully used the section 524(g) framework to manage non-asbestos liabilities in chapter 11.
  - *E.g., Imerys Talc* (2019, ongoing, talc liabilities including both asbestos and non-asbestos based claims); *Takata* (2017, defective airbag inflator litigation liabilities); *Blitz* (2012, exploding gas can litigation).
- Companies may also utilize section 105 to channel opioid related liabilities, see most recently the *Insys* bankruptcy filing in Delaware.

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Mass Tort in Chapter 11

Key Aspects of 524(g)/105(a) Mass Tort Case

- Trust is set up to liquidate Debtors' mass tort litigation post-emergence.
- Channeling injunction protects debtor, non-debtor affiliates, and other settling third parties.
- Negotiations take place between key parties.
- Bankruptcy court may also estimate liabilities for purposes of plan confirmation / trust funding.

Key Parties

- Future Claimant's Representative (FCR): appointed by bankruptcy courts in mass tort cases to represent the interests of unidentified "future" claimants (*i.e.*, claimants who will have claims in the future arising from pre-bankruptcy exposure but have not yet manifested an injury).
  - FCR must participate for a court to approve an injunction that enjoins "future" claims.
- Tort Claimants: Predominant firms representing tort claimants will organize into a committee (may be *ad hoc* prepetition or appointed by the UST).
- Co-defendants / Existing Insurers / Indemnitors: may be "settling parties" who contribute to an ultimate trust and seek the benefit of a channeling injunction (*e.g.*, OEMs in Takata bankruptcy).

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Mass Tort in Chapter 11

A successful plan structure will include a channeling injunction and releases protecting certain parties from claims arising from pre-confirmation exposure under sections 524(g) and/or 105(a).

- Debtors and non-debtor parent/affiliates may be protected parties to the extent there is potential for derivative liability.
- Settling insurers/indemnitors may also receive the benefit of an injunction in exchange for making trust contributions; rights against non-settling insurers/indemnitors are transferred to/pursued by the trust.
- Other third parties, such as co-defendants, may also become protected parties upon an economic contribution to the trust.
- Under 524(g), controlling equity in the Debtors must vest in the trust (may give an equity-backed note).

Scope of Channeling Injunction

- Bankruptcy law limits the extent to which "direct" tort claims against third parties may be channeled to a trust.
- The injunction only channels liability against debtors arising from pre-confirmation exposure; companies cannot channel liabilities arising from post-emergence actions.

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Mass Tort in Chapter 11

Trust Structure

- The plan can create one or more trusts, which are funded by trust assets and which liquidate channeled claims.
- Trusts are governed by a Trust Agreement and "Trust Distribution Procedures" or "TDPs," which govern the allowance, liquidation, and payment of channeled claims.
- Claimants will typically liquidate their claims through the trust system pursuant to the TDPs and will generally have an option to resort to the tort system; trustee may "step into the shoes" of debtor if necessary to litigate channeled claims.

Additional Requirements

- In 524(g), 75% of voting asbestos claimants that are subject to the channeling injunction must vote in favor of the plan.
- District court approval of plan confirmation is required to issue the channeling injunction in section 524(g) and is often sought out of an abundance of caution under 105(a) for non-asbestos mass tort claims.
- An extensive noticing program is necessary to ensure due process.

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Mass Tort in Chapter 11

Insys Therapeutics

- Insys Therapeutics (with certain of its affiliates, "Insys") filed for chapter 11 in Delaware on June 10, 2019, to facilitate the sale of substantially all of the company's assets and address legacy legal liabilities.
- Insys is advised by Weil Gotshal as counsel, Lazard as investment banker and FTI as financial advisor.
- Prior to the petition date, Insys agreed to a $225 million global settlement of the U.S. government's criminal and civil investigations into the company's promotion of opioid painkiller Subsys.
- The company and the Department of Justice have agreed that the United States will have an allowed unsecured claim of $243 million in the chapter 11 cases as the "sole remedy" for the conduct covered in the prepetition litigation and for any breach by Insys of the prepetition settlement agreement.
- A 9-member UCC has been appointed in the chapter 11 cases, several members of which are individual prepetition litigation plaintiffs against Insys.
- According to its first day declaration, the company is subject to investigations in more than 15 states, is a defendant in 10 attorney general actions and has reached settlements with four states – Oregon, New Hampshire, Illinois and Massachusetts.
- In addition, four cities – including the City of Prescott, Ariz.; City of Surprise, Ariz.; Carroll County, Md.; and Henry County, Mo. – have called for the appointment of a separate "public entities committee" who were allegedly excluded from the unsecured creditor's committee despite their efforts.

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Mass Tort in Chapter 11

Insys Therapeutics (Cont.)

- The debtors have sought to establish estimation procedures for certain material categories of unliquidated litigation claims against the debtors, of which there are approximately 1,000, including the governmental actions, personal injury actions and actions by insurance companies, among others.
- The majority of these litigation claims have been consolidated in a multidistrict litigation currently pending before Judge Dan Polster in the U.S. District Court for the Northern district of Ohio.
- According to the Debtors' filings, they are not presently seeking to determine the allowed amount of any particular claim or the allocation of value among creditors in any particular category. Instead, according to their claims estimation procedures motion, the debtors will propose such allocation at a future date.
- The debtors have not yet filed a proposed plan, and the claims estimation procedures motion remains pending before the bankruptcy court.

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Equitable Mootness

Equitable Mootness Cases

- **Roots of Equitable Mootness Doctrine**
  - *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (9th Cir. 1981)—appeal from orders approving settlement of disallowing claims, approving settlement with FDIC, and confirming Chapter XI Plan of Arrangement
    - Among earliest "equitable mootness" cases
    - Recognized impracticability of reversing unstayed confirmation order:
      - "Are we not quite patently faced with a situation where **the plan of arrangement has been so far implemented that it is impossible to fashion effective relief for all concerned**? Certainly, reversal of the order confirming the plan of arrangement, which **would knock the props out from under the authorization for every transaction that has taken place**, would do nothing other than **create an unmanageable, uncontrollable situation for the Bankruptcy Court**."
        - Above language appears in numerous subsequent equitable mootness opinions.
      - Also noted that appellants' failure to pursue "stay of the objectionable orders … permitted such a comprehensive change of circumstances to occur as to render it inequitable for this court to consider the merits of the appeal."

Equitable Mootness Cases

- **Roots of Equitable Mootness Doctrine**
  - *In re Thorpe Insulation Co.*, 677 F.3d 869, 878 (9th Cir. 2012). Asbestos litigation channeling injunction cases involving ~ $600 million in insurance settlement pool. Enumerated factors for determining whether appeal equitably moot:
    - Whether appellant sought stay;
    - Whether plan has been substantially consummated;
    - Effect of appellate remedy "on third parties not before the court."
    - Whether "the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court."

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Equitable Mootness Cases

- **Recent Trends in Equitable Mootness**
  - Overall, trend is toward holding appeals are not equitably moot, unless the appeal involves an extraordinarily complex bankruptcy case with large number of third parties that would be affected by appellate relief– particularly large Chapter 9 cases.
  - Some judges have expressed hostility to equitable mootness to the point of calling for abolition of the doctrine.
- **Cases Holding Appeals Equitably Moot**
  - *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015). Chapter 11 cases involving competing Chapter 11 plans filed by holder of $2B in pre-LBO debt and by debtor/committee/lenders.
    - Notable concurring opinion (Ambro and Vanaskie, JJ.): "we should always presume that appeal merits be reached and act with the utmost care when we turn aside an appeal, equitable mootness remains a last-ditch discretionary device for protecting the finality of an unstayed plan that has been consummated."
  - *In re City of Detroit, Michigan*, 838 F.3d 792 (6th Cir. 2016)
  - *In re City of Stockton, California*, 542 B.R. 261 (B.A.P. 9th Cir. 2015)
  - *In re Mortgages Ltd.*, 771 F.3d 1211 (9th Cir. 2014)

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Equitable Mootness Cases

- **Cases Holding Appeals Not Equitably Moot**
  - *In re One2One Communications, LLC*, 805 F.3d 428 (3d Cir. 2015):
    - Majority declined to abrogate equitable mootness doctrine but only in "limited circumstances," generally involving complex cases, e.g., those with "multiple related debtors, hundreds of millions of dollars in assets, liabilities and claims, and hundreds or thousands of creditors."
    - Krause, J., concurred in judgment but would have eliminated equitable mootness doctrine, asking "what is the constitutional or statutory anchor for declining to exercise jurisdiction over bankruptcy appeals dubbed 'equitably moot'? Simply put, there is none."
  - *In re Paige*, 584 F.3d 1327 (10th Cir. 2009) – Court adopted equitable mootness but declined to apply it to dismiss appeal based upon facts of the case.
  - *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405 (5th Cir. 2019) – Sale of substantially all of Debtor's assets. Court refused to apply equitable mootness outside of confirmed plan.
  - *In re Thorpe Insulation Co.,* 677 F.3d 869, 878 (9th Cir. 2012)
  - *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161 (9th Cir. 2015)

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Altadena Lincoln Crossing

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Altadena Lincoln Crossing

In re Altadena Lincoln Crossing, LLC, ___ B.R. ___, 2018 Bankr. LEXIS 2018 (Bankr. C.D. Cal. July 3, 2018)

- Court disallowed default interest rate as unenforceable penalty. The debtor's loan agreement provided a default interest rate of 5% over the nondefault rate.
- The debtor and the bank did not negotiate over the default rate, and the bank made no effort when it issued the loan to determine what its damages, such as administrative or funding costs or loss in the loan's value, might be if the debtor defaulted or whether the default interest rate bore any relation at all to anticipated damages resulting from a default.
- After bankruptcy, the debtor in possession objected to the allowance of default interest.
- Applicable nonbankruptcy law requires that a liquidated damages amount "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained."
- An amount disproportionate to that amount is an unenforceable penalty. Because the bank here made no effort to estimate damages or loss resulting from the default, the default interest rate is an unenforceable penalty. The court disallowed the claim to that extent.

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1075 S Yukon and Daff v. Good (In re Swintek)

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1075 S Yukon and Daff v. Good (in re Swintek)

In re 1075 S Yukon, LLC, 590 B.R. 527 (Bankr. D. Colo. 2018)

- In *Yukon,* the debtor had an option to purchase real property, which expired one hour after the commencement of the case and which it was unable to exercise timely because it lacked sufficient financing.
- Section 108(b) extends for at least 60 days a deadline fixed under an agreement that has not expired by the commencement of the case to "file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act."
- "Similar" means having common characteristics or very much alike or comparable.
- The court found that exercising an option and purchasing property is not similar to filing a pleading, notice, demand, or claim or curing a default. Because the agreement permitted but did not require the debtor to purchase by the deadline, the debtor's failure to do so was not a "default" that could be cured with the 60-day period. Therefore, the court determined that section 108(b) does not extend the time for the debtor in possession to exercise the option.

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1075 S Yukon and Daff v. Good (in re Swintek)

Daff v. Good (In re Swintek), 906 F.3d 1100 (9th Cir. 2018)

- In *Daff v. Good*, the creditor obtained a judicial lien against the debtor to enforce a judgment. By its term, the lien expired one year after it arose, unless renewed.
- The debtor filed bankruptcy within the one-year period. The creditor did not renew the lien.
- Section 108(c) extends until 30 days after notice of termination or expiration of the automatic stay any "period for commencing or continuing a civil action … on a claim against the debtor" that has not expired before the date of the filing of the petition.
- Section 362(a)(1) stays "the commencement or continuation" of an action "that was or could have been commenced before bankruptcy to recover a prepetition claim;" section 362(a)(2) stays "the enforcement against the debtor … of a judgment obtained before" bankruptcy; and section 362(a)(4) stays "any act to … enforce any lien against property of the estate."
- The court determined that the attempt to enforce a judgment is a continuation of the civil action. Therefore, the renewal of the judicial lien is a continuation of the action, and section 108(c) extends the renewal deadline. A dissent argues that a judgment terminates the civil action, that the automatic stay deals separately with continuation and enforcement, and section 108(c) covers only continuation.

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Is This the End of Equitable Mootness as We Know It? Recent Circuit Court Trends

By Bradley D. Pack
Engelman Berger, P.C.

I. Overview of Equitable Mootness
   a. Origins in Ninth Circuit:
      i. *Valley Nat. Bank of Arizona v. Tr. for Westgate-California Corp.*, 609 F.2d 1274, 1283 (9th Cir. 1979) – Chapter X reorganization proceedings under Bankruptcy Act resulted in merger of two corporations, which resulted in stock in public company held by secured creditor as collateral being converted into stock in new, private company. Secured creditor and certain shareholders appealed. *Held*:
         1. In addition to affirming on the merits, the Ninth Circuit considered whether "consummation of the merger, coupled with inaction on the part of all three appellants, cause[d] this appeal to become moot."
         2. The court noted that "The vast majority of persons who were affected by [the merger] are not subject to the jurisdiction of either this court or the Reorganization Court" and that the merged company "has been operating for over two years," which facts "make it difficult, if not impossible, to fashion an equitable remedy that would restore appellants to their former positions."
         3. The court quoted an earlier Ninth Circuit opinion, which held that "the practical necessities involved in a successful reorganization require that unless an order of the bankruptcy judge or the district judge is stayed pending appeal, the trustee's acts in accordance with that order should not thereafter be subject to reversal, even if the order is subsequently overturned on appeal." *In re Combined Metals Reduction Co.*, 557 F.2d 179, 189 (9th Cir. 1977)
         4. The court also noted that two of the three appellants had failed to seek a stay pending appeal, and the third (Valley National Bank of Arizona) "was quite relaxed in its attempts to block or delay the merger" and did not seek a stay until just prior to consummation of the merger.
         5. But, the court declined to dismiss the appeal on grounds of mootness, holding that its opinion affirming on the merits should "govern our order on appeal."

ii. *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (9th Cir. 1981)—appeal from orders approving settlement with FDIC, disallowing claims, and confirming Plan of Arrangement under Chapter XI of Bankruptcy Act. *Held*:
    1. The court dismissed the appeal as moot.
    2. Citing *Combined Metals*, the court held that "many intricate and involved transactions … were contemplated by the plan of arrangement ... Were we to deny the motion to dismiss for mootness and on consideration of the merits reverse the order of the District Court, what would be the result? Are we not quite patently faced with a situation where **the plan of arrangement has been so far implemented that it is impossible to fashion effective relief for all concerned**? Certainly, reversal of the order confirming the plan of arrangement, which **would knock the props out from under the authorization for every transaction that has taken place**, would do nothing other than **create an unmanageable, uncontrollable situation for the Bankruptcy Court**."
        a. The emphasized language appears in numerous subsequent equitable mootness opinions.
    3. Citing *Valley National Bank*, the court held that "An entirely separate and independent ground for dismissal has also been established because Appellants have failed and neglected diligently to pursue their available remedies to obtain a stay of the objectionable orders of the Bankruptcy Court and have permitted such a comprehensive change of circumstances to occur as to render it inequitable for this court to consider the merits of the appeal."

b. Development of test for equitable mootness.
    i. *In re Thorpe Insulation Co.*, 677 F.3d 869, 878 (9th Cir. 2012). Bankruptcy court confirmed plan that provided for § 524(g) channeling injunction of asbestos litigation involving debtor and establishment of trust to oversee allowance and valuation of claims and distributions to claimants. Plan was funded in part through settlements with 13 insurers that provided over $600 million in cash and securities in exchange for releases of claims and protection of the channeling injunctions. Non-settling insurers appealed. *Held*: Appeal would <u>not</u> be dismissed at moot, and would be remanded to bankruptcy court to permit insurers opportunity "to be heard, to present evidence, and to participate in the proceedings culminating in approval of the § 524(g) plan."
        1. In refusing to dismiss for equitable mootness, the court established the following test:

a. We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court.
b. Applying the test, the court held that appellants had diligently sought a stay from Ninth Circuit and Circuit Justice but were denied; plan had not been substantially consummated because only $135 million of contemplated $600 million in funds had been transferred into plan trust; although "plan has proceeded and third party rights have intervened to some extent," it would still be possible to fashion relief "in a way that does not affect third party interests to such an extent that the change is inequitable;" and "[t]here are several ways here that Appellants could get some relief without completely upsetting the plan."
    i. Bankruptcy court "could require Appellees to contribute more to the trust."
    ii. Bankruptcy court could clarify "that the trust distribution procedures are not binding on direct suits filed against Appellants."
    iii. Bankruptcy court could "allow Appellants to present evidence and argue for modification of the trust distribution procedure" or could place the trust under new governance if it finds that "the trust is in the hands of biased parties."

II. Recent Equitable Mootness Decisions Outside the Ninth Circuit
    a. Cases Holding Appeal Equitably Moot
        i. *Bennett v. Jefferson County, Alabama*, 899 F.3d 1240, 1242 (11th Cir. 2018). Jefferson County confirmed Chapter 9 plan that provided, *inter alia,* for retirement of about $3.2 billion in sewer debt and issuance of $1.8 billion in new sewer warrants, with agreement to raise sewer utility rates over 40 years. Ratepayers objected but did not seek or obtain stay pending appeal. *Held:*
            1. Equitable mootness applies in Chapter 9 cases

2. Appeal was equitably moot in light of ratepayers failure to seek or obtain stay pending appeal and impracticability of unwinding actions taken in reliance upon confirmed Chapter 9 plan, including issuance of over $1 billion in new sewer warrants. And, while ratepayers raised valid concerns on the merits that setting rates year in advance bypasses usual political procedures, approval of Chapter 9 plan did not *per se* violate ratepayers constitutional rights.

ii. *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015). Following leveraged buyout of Debtor's equity, Debtor filed Chapter 11 petition. Competing plans were filed by holder of $2B in pre-LBO debt and by debtor/committee/lenders. Bankruptcy court approved the latter, which provided for settlement of LBO-related claims. Holder of pre-LBO debt appealed and obtained order granting stay conditioned upon posting of $1.5B bond, which holder did not post. After substantial confirmation, appeals were filed by: (1) holder of pre-LBO debt, which objected to plan's settlement of LBO-related claims; and (2) holders of claims that alleged they were entitled to payment ahead of other unsecured creditors under subordination agreement. *Held*: Appeal from portion of plan settling LBO-related claims was equitably moot, but appeal from portion of plan effectively negating subordination agreement was not.

1. Regarding the LBO claims settlement, the court held that settlement was a central component of the Debtor's plan, and while it might be possible to sever the settlement "from the Plan and keep the rest of the Plan in place—thereby not attempting to 'unscramble the eggs,' or turning a court into a 'Humpty Dumpty repairman,' or any other ovoid metaphor—allowing the relief the appeal seeks would effectively undermine the Settlement (along with the transactions entered in reliance on it) and, as a result, recall the entire Plan for a redo."
2. Third party reliance weighed in favor of equitable mootness, "as returning to the drawing board would at a minimum drastically diminish the value of new equity's investment. That investment no doubt was in reliance on the Settlement, as indeed was the reliance of those who voted for the Plan."
3. But, disgorgement of distributions to creditors whose claims were purportedly subordinated could be accomplished without unraveling the plan, and therefore, appeal by beneficiaries of subordination would not be dismissed as equitably moot.
4. Judges Ambro and Vanaskie wrote concurring opinion defending continued application of equitable mootness in

appropriate circumstances, and holding "we should always presume that appeal merits be reached and act with the utmost care when we turn aside an appeal, equitable mootness remains a last-ditch discretionary device for protecting the finality of an unstayed plan that has been consummated."

iii. *In re City of Detroit, Michigan*, 838 F.3d 792 (6th Cir. 2016). Bankruptcy court confirmed Detroit's Chapter 9 reorganization plan. Pensioners appealed plan provisions reducing overall pension payments and precluding them from suing Michigan. Held: Appeal dismissed as equitably moot.

1. *"*All three factors favor the application of equitable mootness: the appellants did not obtain a stay; the Plan has been substantially consummated, inasmuch as numerous significant—even colossal—actions have been undertaken or completed, many irreversible; and the requested relief of omitting the bargained-for (and by majority vote agreed-upon) pension reduction would necessarily rescind the Grand Bargain, its $816 million in outside funding, and the series of other settlements and agreements contingent upon the Global Retiree Settlement, thereby unravelling the entire Plan and adversely affecting countless third parties, including, among others, the entire City population."
2. Court held that "This is not a close call. In fact, the doctrine of equitable mootness was created and intended for exactly this type of scenario."
3. Court rejected appellants' call to abolish equitable mootness doctrine in light of developing Supreme Court case law favoring "virtually unflagging" obligation of federal courts to review appeals within their jurisdiction, and rejected argument that doctrine should not extend to Chapter 9 cases.

iv. *In re Charter Communications, Inc*., 691 F.3d 476 (2d Cir. 2012). Bankruptcy court confirmed "perhaps the largest and most complex prearranged bankruptcies ever attempted, and in all likelihood ... among the most ambitious and contentious as well.". Creditors appealed. *Held:* Creditors' appeals were equitably moot, as creditors "failed to establish that the relief they request would not affect Charter's emergence as a revitalized entity and would not require unraveling complex transactions undertaken after the Plan was consummated."

b. Cases Holding Appeal Not Equitably Moot

i. *In re One2One Communications, LLC*, 805 F.3d 428 (3d Cir. 2015). Bankruptcy Court confirmed plan that provided for new LLC to purchase 100% of Debtor's membership interests for $200,000.

Appellant, an unsecured creditor with a $10MM claim, objected to confirmation and filed appeal, but did not seek stay. District court dismissed appeal as equitably moot. *Held*: Case was not sufficiently complex to warrant application of equitable mootness doctrine. But, majority rejected Appellant's request to abrogate Third Circuit's adoption of equitable mootness doctrine completely in light of *Stern*. Judge Krause, concurring, urged abrogation of equitable mootness.

1. "[W]e have emphasized that the doctrine must be construed narrowly and applied in limited circumstances."
2. Prior cases dismissing appeals as equitably moot "involved complex bankruptcy reorganizations that included multiple related debtors, hundreds of millions of dollars in assets, liabilities and claims, and hundreds or thousands of creditors."
3. "In contrast here, the Debtor's reorganization involved a $200,000 investment in the reorganized debtor and only one secured creditor that held a blanket lien on the Debtor's assets for less than $100,000. Further, the Debtor had only seventeen unsecured creditors, not including insiders. In addition, the Plan did not provide for new financing, mergers or dissolutions of entities, issuance of stock or bonds, name change, change of business location, change in management or any other significant transactions."
4. Krause, J., concurred in judgment but would have eliminated equitable mootness doctrine, asking "what is the constitutional or statutory anchor for declining to exercise jurisdiction over bankruptcy appeals dubbed 'equitably moot'? Simply put, there is none."

ii. *In re Paige*, 584 F.3d 1327 (10th Cir. 2009). Creditors filed competing plans in effort to acquire rights to use domain name owned by Debtor. Court confirmed one plan and denied the other; losing creditor appealed. Held: Court formally adopted doctrine of equitable mootness, but declined to dismiss appeal in this case as moot.

1. Factors a court should consider in determining whether appeal is equitably moot: "(1) Has the appellant sought and/or obtained a stay pending appeal? (2) Has the appealed plan been substantially consummated? (3) Will the rights of innocent third parties be adversely affected by reversal of the confirmed plan? (4) Will the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy court decisions—be undermined by reversal of the plan? (5) If appellant's challenge were upheld, what would be the likely impact upon a successful reorganization of the debtor? And (6) based upon a

quick look at the merits of appellant's challenge to the plan, is appellant's challenge legally meritorious or equitably compelling?"

2. "[R]eversal of the Joint Plan will not undo any complex transactions," and appellate relief would not unfairly upset the expectations of third parties who relied on bankruptcy court order; parties that would be most affected were those that proposed the competing plans, and their participation in bankruptcy was so "pivotal" they could not be considered "an innocent third party."

iii. *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405 (5th Cir. 2019). *Held*: Appeal from bankruptcy court order approving sale of substantially all of Debtor's assets and approving settlement was not equitably moot. Court would not apply equitable mootness outside context of substantially consummated reorganization plan, and "this settlement and sale were not sufficiently complex."

III. Recent Equitable Mootness Decisions Within the Ninth Circuit

a. Cases Holding Appeal Equitably Moot

i. *In re City of Stockton, California,* 542 B.R. 261 (B.A.P. 9th Cir. 2015). Bankruptcy court confirmed city's Chapter 9 plan over objection by municipal bond funds. *Held:* Appeal of confirmation order generally was equitably moot, but Court would not dismiss appeal of objection to treatment of fund's claims.

1. While fund attempted to obtain stay, it failed, and Plan was substantially consummated. "To reverse the Confirmation Order at this point would have a potentially devastating impact on creditor constituencies whose settlements with the City were incorporated in the Plan and who are not appearing before us in this appeal. Reversing the Confirmation Order would knock 'the props out from under the' Plan and would leave the bankruptcy court with an unmanageable situation on remand."
2. But, "to the extent Franklin seeks through its appeal only a greater payment on its unsecured claim … an effective remedy is theoretically possible, and that claim is not equitably moot."

ii. *In re Mortgages Ltd.*, 771 F.3d 1211 (9th Cir. 2014). Bankruptcy Court confirmed Chapter 11 plan in case where debtor was a private lender that raised money from investors to fund commercial mortgages. Plan established ML Manager as agent for investors with respect to mortgage loans remaining in ML's portfolio. Some investors (the "Rev Op Group") objected to ML Manager's authority to take actions on their behalf and objected to plan provisions concerning allocation of costs of exit financing and distributions to

investors. Bankruptcy court overruled objections. *Held*: Appeal dismissed as equitably moot.

1. The Ninth Circuit relied heavily on Rev Op Group's failure to seek a stay pending appeal as basis for its equitable mootness decision. But, because other Ninth Circuit decisions did not hold failure to obtain a stay was dispositive, court stopped short of establishing bright line rule that failure to seek a stay will render appeal equitably moot.
2. Other factors supporting mootness determination: plan was substantially consummated, appellate relief "would bear unduly on the innocent," primarily investors who had already received distributions, because they "would have to return distributions from the estate or sell property back to ML Manager," and it would not be possible to devise an equitable remedy. "While the bankruptcy court could withhold proceeds from future property sales and reallocate those proceeds based on a revised formula, because many investors have likely already received all of the distributions owed to them, withholding the proceeds of future sales would not allow the bankruptcy court to reallocate the money proportionally. Clawing back money from those investors who already paid their full allocation would be either impossible or inequitable. Even if these steps were possible, the costs of implementing such a remedy would probably exceed the amount of redistributed funds."

b. Cases Holding Appeal Not Equitably Moot
   i. *Thorpe Insulation* (see above)
   ii. *In re Transwest Resort Properties, Inc*., 801 F.3d 1161, 1169 (9th Cir. 2015). Five debtors (including two operating resort hotels, the two holders of the equity interests in the operating companies (the "Mezzanine Debtors"), and the holding company for the Mezzanine Debtors filed joint plan that cancelled Mezzanine Debtors' equity and sold equity interests in operating companies to Southwest Value Partners Fund. Plan crammed down claim of Lender, which held mortgage loan and which also acquired mezzanine loan. Lender made § 1111(b) election. Plan proposed to make balloon payment to Lender within 21 years and retained due on sale provision of DOT, subject to exceptions within years 5-15. Court confirmed plan over Lender's objections that due on sale exception violated rights under § 1111(b) and that plan violated confirmation requirements because each debtor did not have impaired accepting class, and thus, Lender could have effectively vetoed plan at confirmation stage by voting mezzanine loan to reject plan. *Held*: Appeal was not equitably moot.

1. Lender diligently sought stay of confirmation order in bankruptcy and district courts.
2. Although plan was substantially consummated, rights of third parties not affected. “In light of SWVP's participation at every stage of these proceedings, we hold that SWVP is not an innocent third party.”
3. Bankruptcy court could fashion equitable relief on remand, such as by reducing window for exception to due on sale clause or ordering Debtors to pay Lender the value of its mezzanine loan.