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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@portfoliomedia.com

New Standards For Equitable Mootness?

Law360, New York (April 14, 2010) -- Once a plan of reorganization has been confirmed and steps have been taken to implement it, district courts have generally been loathe to upset the apple cart and grant appeals that would "undo" the plan or impact creditors and other third parties.

Thus, appeals that would affect the plan or other orders once consummated have typically been dismissed at the district court level as equitably moot. However, two recent decisions from the Fifth and Tenth Circuits change the analysis for deciding equitable mootness and may signal heightened scrutiny in this area.

Equitable mootness is a doctrine recognized by federal circuits whereby appeal of a bankruptcy court decision that is not constitutionally moot may still be dismissed due to pragmatic considerations.

District courts have seemingly dismissed most appeals of bankruptcy court orders as equitably moot in cases where the plan has been substantially consummated,[1] reasoning that after a plan has been substantially consummated, it would be impractical or impossible to unwind the transactions that occurred under the plan. Both the Fifth and the Tenth Circuit recently ruled, however, that while substantial consummation is an important factor in determining equitable mootness, it is not the only factor to be considered.

Recently, in Search Market Direct Inc. v. Jubber, the Tenth Circuit looked beyond substantial consummation in determining whether an appeal of a plan confirmation order should have been dismissed as equitably moot.[2]

In Search Market, two separate groups of creditors bought up large blocks of claims in the bankruptcy, allowing each to propose competing plans of reorganization. Each group hoped to gain ownership of the FreeCreditScore.com domain name, which was the only valuable asset in the estate.

The trustee supported the plan of reorganization proposed by Consumer Info, which ultimately was confirmed by the bankruptcy court. Search Market, the competing plan proponent, appealed the plan's confirmation and moved for a stay pending the appeal, which was denied by the district court.

On appeal, the Tenth Circuit formally adopted the doctrine of equitable mootness and outlined a six-factor test for district courts to apply to determine whether an appeal should be considered 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 the reversal of the consummated plan?

4) Will the public-policy need for reliance on the confirmed bankruptcy plan — and the need for creditors generally to rely on bankruptcy court decisions — be undermined by reversal of the plan?

5) If the appellant's challenge was upheld, what would be the likely impact upon a successful reorganization of the debtor?

6) Based on a quick look at the merits of appellant's challenge to the plan, is appellant's challenge legally meritorious or equitably compelling?[3]

The appeals court then concluded that the most important factor among these was the effect on third parties, finding that, due to the nature of dispute over the domain name between the two plan proponents, the other creditors would not be impacted by the appeal.[4]

Furthermore, in its "quick look" at the merits of the case, it noted that the allegations presented by Search Market regarding whether the trustee had cooperated inappropriately with Consumer Info was a serious allegation that should be examined if possible.[5]

Accordingly, the appeals court reversed and remanded the case so that the district court could analyze the merits of Search Market's appeal consistent with its opinion.

In Alberta Energy Partners v. Blast Energy Svcs Inc., the Fifth Circuit reversed and remanded a district court dismissal of an appeal regarding the rejection of an executory contract.[6]

Blast Energy had entered into a contract with Alberta Energy Partners regarding a technology developed by Alberta, which Blast Energy intended to use. Upon Blast Energy's bankruptcy filing, Alberta sought to compel rejection of the contract, which was ultimately denied by the bankruptcy court. Blast Energy's plan, with the assumption of the Alberta contract, was approved.

Alberta appealed the bankruptcy court's dismissal of its motion to compel rejection to the district court, which did not rule on the appeal before the plan was confirmed. Alberta then filed an appeal of the confirmation order, as well as an emergency motion for a stay pending appeal, which was denied. Alberta and Blast Energy then entered into a stipulation stating that the confirmation would not have a res judicata effect on Alberta's appeal.

Furthermore, Blast Energy's counsel admitted that the contract in question was not essential to the reorganization and if the appeal were granted, it would not require a modification to the plan. Despite the agreement that the contract was not essential, the district court still dismissed Alberta's appeal as equitably moot.

Alberta appealed to the Fifth Circuit, which examined the doctrine of equitable mootness and determined that it should only decline to hear appeals in cases where the relief would be likely to unravel the plan.[7] Based on the record, it found no evidence that the contract was significant to the plan, and could not find that allowing rejection would harm third parties or the reorganization itself.[8]

As such, despite the fact that the parties agreed that the plan had been substantially consummated, the appellate court reversed and remanded to the district court for further consideration of equitable mootness and a fuller explanation as to why the appeal was or was not equitably moot.[9]

While both Blast Energy and Search Market appear to require a more detailed analysis of bankruptcy appeals, and an examination of factors beyond substantial consummation, it is unclear what practical effect the new tests will have on district court review.

In a subsequent case remanded by the Tenth Circuit under the Search Market criteria, the district court re-examined a consummated plan using the new factors, and still dismissed the appellant's appeal as equitably moot.[10]

Blast Energy and Search Market also present factually unique circumstances where the appeals in question were not likely to have a significant impact on the debtor's reorganization. Thus, the impact of these decisions remains to develop.

--By Ann Marie Uetz (pictured) and Tamar N. Dolcourt, Foley & Lardner LLP

Ann Marie Uetz (auetz@foley.com) is a partner with Foley & Lardner and chair of the Detroit office litigation department and vice-chair of the firm's national bankruptcy and business reorganizations practice. Tamar Dolcourt (tdolcourt@foley.com) is an associate with Foley & Lardner and a member of the firm's bankruptcy and business reorganizations practice.

[1] The Bankruptcy Code defines substantial consummation as: (A) the transfer of all or substantially all of the property proposed by the plan to be transferred, (B) assumption by the debtor or the successor to the debtor under the plan of the business or the management of all or substantially all of the property dealt with by the plan, and (C) commencement of distribution under the plan. 11 U.S.C. §1101(2).

[2] Search Market Direct Inc. v. Jubber (In re Paige), 584 F.3d. 1327 (10th Cir. 2009) (adopting equitable mootness doctrine and laying out a six factor test, of which substantial consummation is one factor only).

[3] Id. at 1339.

[4] Id. at 1343.

[5] Id. at 1348.

[6] Alberta Energy Partners v. Blast Energy Svcs Inc. (In re Blast Energy Svcs Inc.), 593 F.3d 418, 421 (5th Cir. 2010).

[7] Id. at 425.

[8] Id. at 426.

[9] Id. at 428.

[10] Judgment, Sutton v. Weinman, (In re: Centrix Financial LLC), Case No. 08-cv-1130, Dkt.# 83 (D. Colo. Feb. 17, 2010) (dismissing the remanded appeal as equitably moot after applying Search Market criteria).