

Alert

Appeal From Reorganization Plan Order Not Moot Despite Lack of Stay Pending Appeal

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The U.S. Court of Appeals for the Tenth Circuit held on Nov. 3, 2009, that a district court had improperly dismissed, on mootness grounds, an appeal from a bankruptcy court's order confirming a reorganization plan. According to the Tenth Circuit, the appeal was reviewable because reversal of the plan confirmation order (1) would not unduly affect innocent third parties, and (2) would not undo any complex transactions. Because the appellant had also raised serious allegations of bad faith, the court reversed and remanded the case to the district court "for consideration of the merits of" the appeal. *In re Paige*, ___ F.3d ___, 2009 WL 3584940, *17 (10th Cir. Nov. 3, 2009).

Relevance

This case is important for every participant in reorganization cases—lenders, investors, and the debtor itself. An exit financier, for example, has to know whether to close a contemplated loan.

Courts routinely hold that an appellant's failure to obtain a stay pending appeal from a Chapter 11 reorganization plan confirmation order will moot an appeal from the order. *See, e.g., In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143-45 (2d Cir. 2005) (*held*, appeal of confirmation order dismissed as equitably moot when appellants did not obtain stay pending appeal and reversal would unravel substantially consummated plan). In this case, however, the Tenth Circuit held that the appeal was not moot, despite the appellant's failure to obtain a stay pending appeal. The particular facts here, discussed below, show why the court ordered the district court to review the merits of the appeal.

Facts

The individual debtor, Paige, filed a Chapter 7 petition in 2005. When the case was later converted to Chapter 11, a trustee ("Trustee") was appointed. *Id.* at *2. Five years prior to bankruptcy, Paige had registered the domain name, "FreeCreditScore.com." *Id.* Paige later sold the domain name to a third party, who then sold it to Search Market Direct, Inc. ("SMDI") for \$350,000. *Id.*

The Trustee learned of the estate's possible interest in the domain name (estimated to be worth upwards of \$5-25 million), and sued SMDI to avoid Paige's sale of the domain name as a fraudulent transfer, among other things. *Id.*

The Trustee sought leave from the bankruptcy court to sell Paige's interest in the domain name while his suit against SMDI was still pending. Over SMDI's objection, the court approved the sale of the domain name to a company called ConsumerInfo.com ("CI") in exchange for CI's agreement to provide the Trustee with enough cash to pay most of Paige's liabilities. *Id.*

Competing Reorganization Plans

CI also purchased some claims against Paige in order to gain standing to propose a reorganization plan. *Id.* at *3. The Trustee endorsed CI's proposal, and filed a joint plan ("Joint Plan") with it, providing that the sale proceeds from CI would pay creditors. CI also agreed to fund the litigation costs entailed in the suit against SMDI. *Id.*

SMDI also bought claims against Paige and proposed a competing reorganization plan. Under its plan, SMDI promised to pay all of Paige's liabilities. In exchange, however, the SMDI plan provided for the dismissal of the Trustee's suit against SMDI, leaving SMDI with ownership of the domain name. *Id.*

Bankruptcy Court Ruling

After a seven-day trial, the bankruptcy court rejected SMDI's plan and confirmed the Joint Plan. *Id.* It reasoned that SMDI's plan (i) violated Code § 1129(a)(1) because it placed CI into a separate class from other similarly situated creditors, and (ii) violated Code § 1129(a)(3) because it inappropriately compelled settlement of the Trustee's suit. *Id.* The bankruptcy court also rejected SMDI's claim that Paige had engaged in inappropriate negotiations with CI. *Id.*

No Stay Pending Appeal

The Joint Plan became effective, by its terms, only after "any pending appeals were resolved." *Id.* at *4. The Trustee and CI, however, waived that requirement and began implementing the Joint Plan. *Id.* Fearing substantial consummation of the Joint Plan, SMDI sought a stay pending appeal. *Id.* The bankruptcy court denied the stay pending appeal because "SMDI's appeal would not be rendered moot...since 'there is a possibility that SMDI could use [the money it set aside to fund its plan] to fund the repayment to [CI].'" *Id.* The district court affirmed the denial of SMDI's motion for a stay pending appeal. *Id.* SMDI failed to seek a stay in the Tenth Circuit. *Id.*

Despite failure to obtain a stay pending appeal, SMDI appealed the order confirming the Joint Plan to the district court. *Id.* at*5. The Trustee and CI argued that SMDI's appeal was moot because the Trustee "had taken many steps to effectuate the Joint Plan that could not be undone." *Id.* Agreeing with the Trustee and CI, the district court held that SMDI's appeal was both constitutionally and equitably moot. *Id.*

Not Constitutionally Moot

The Tenth Circuit reversed. First, SMDI's appeal was not constitutionally moot. "An appeal is [constitutionally] moot if the court can fashion no meaningful relief...At the same time, if a court can fashion some form of meaningful relief, even if it only partially redressed the grievances of the prevailing party, the appeal is not moot." *Id.* at *6, quoting *In re W. Pac. Airlines*, 181 F.3d 1191, 1195 (10th Cir. 1999). Here, the Trustee and CI argued SMDI lacked sufficient funds to implement its proposed plan. The circuit court disagreed, noting that SMDI is requesting not only confirmation of its plan, but also the dismissal of the Joint Plan. *Id.* at *7. "Therefore, even if SMDI's lack of funds would prevent the district court from confirming SMDI's plan, the court could still reverse confirmation of the Joint Plan..." *Id.*

Not Equitably Moot

SMDI's appeal was also not equitably moot. Referring to factors considered by other circuits, the Tenth Circuit applied a six factor test to determine whether an appeal was 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?" *Id.* at *9.

Here, the "six factors do not all point in one way or the other," stated the court. *Id.* at *17. On the one hand, SMDI sought a stay pending appeal with the bankruptcy court and district court, but not from the Tenth Circuit. *Id.* at *11. "Thus, while SMDI made some effort to obtain a stay, it did not pursue 'with diligence *all available remedies* to obtain a stay of execution.'" *Id.* (emphasis in original), quoting *In re Chateaugay Corp.*, 10 F.3d 944, 953 (2d Cir. 1993). "Thus, this factor weighs somewhat against proceeding to the merits of SMDI's

appeal..." *Id.*

No Unraveling Necessary

On the other hand, though the Joint Plan had been substantially consummated, "many of the concerns that motivate courts not to decide the merits of an appeal of a substantially consummated bankruptcy plan do not apply." *Id.* at *12. Here, reversal of the Joint Plan would not undo any complex transactions, explained the Tenth Circuit: "SMDI primarily seeks to undo the sale of the domain name to [CI], which is not likely to be particularly complex or troublesome." *Id.* The Tenth Circuit also noted that the Trustee and CI knowingly "accelerated the consummation of the [Joint Plan] despite their knowledge of a pending appeal...[W]e are less inclined to grant their wish that the court abstain from reaching the merits on appeal," explained the circuit court. *Id.* at *13.

No Burden to Third Parties

According to the Tenth Circuit, the Trustee and CI also failed to show that the relief SMDI sought unduly burdened innocent third parties. Both plans provided for full payment to creditors. The Trustee and CI again argued that SMDI lacked sufficient cash to fund its plan, but SMDI had previously placed \$2.6 million in a special account to demonstrate its ability to fund its plan. *Id.* at *15. Additionally, if SMDI's plan were confirmed, it would own the valuable domain name. *Id.* CI may be negatively affected if SMDI obtains its relief, explained the court, but because of its role in the bankruptcy, "it is hard to consider it a 'third party' or at least an innocent third party." *Id.* at *13.

Public Policy Favored Review on the Merits

Next, public policy favored resolving SMDI's appeal, for it raised "serious allegations" of "bad-faith dealings between [Paige, CI, and the Trustee]..." *Id.* at *16. Here, SMDI alleged, among other things, "that [CI] had engaged in unethical communications with [Paige], which led to its paying [Paige] \$20,000 and convincing him to abandon his support for SMDI's plan; that the [Trustee] was not 'disinterested' in his dealings with [CI]; [and] that the [Trustee's] interest in the disposition of the estate's assets inappropriately influenced his dealings in this case...." *Id.* at *4. Reversal of the Joint Plan confirmation order would not create an "unmanageable situation." *Id.* at *16. Both the Joint Plan and SMDI's plan contemplate full payment to creditors; there will be no need for creditors to disgorge payments received. *Id.* On these facts, the Tenth Circuit held that the Trustee and CI failed to meet their burden of showing equitable mootness of SMDI's appeal. *Id.* at *17.

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