ALERTS

Split Sixth Circuit Dismisses Appeal from Detroit's Confirmed Plan

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"Equitable mootness" prevented the U.S. Court of Appeals for the Sixth Circuit from "unravel[ing] the entire Plan, … forc[ing] the City [Detroit] back into emergency oversight, and requir[ing] a wholesale recreation of the vast and complex web of negotiated settlements and agreements." *In re City of Detroit*, 2016 U.S. App. LEXIS 17774, *14, *17 (6th Cir. Oct. 3, 2016) (2-1). Affirming the district court's dismissal of an appeal by a group of pensioners from an order confirming Detroit's Chapter 9 plan ("Plan"), the Sixth Circuit agreed that the pensioners failed to "obtain a stay," the Plan had "been substantially consummated," and that "reversal of the Plan would adversely impact third parties and the success of the Plan." *Id.* at *9. The pensioners had unsuccessfully challenged "the [Plan's] reduction in their pensions" and, among other things, "a release provision … [preventing] retirees from asserting claims against the State of Michigan." *Id.* at *8.

The dissenting Sixth Circuit judge forcefully argued that the majority had "brush[ed] aside the retirees' legal claims[, leaving] them with the impression that their rights do not matter." *Id.* at *17-18. In the dissent's view, equitable mootness is a "judicial invention with almost no legal basis." *Id.*

Relevance

The dissent conceded that "the doctrine of equitable mootness has been adopted" not only by the Sixth Circuit, but also by "every other circuit to consider its vitality … ." *Id.* at *18. The doctrine prevents appellate courts

from "unscrambling complex ... reorganizations." *In re Nordhoff Invs. v. Zenith Elecs. Corp.*, 258 F.3d 180, 185 (3d Cir. 2001). Nevertheless, appellate courts recently have been wrestling with the limits on this judicial doctrine, requiring that an appellant must "diligently" seek a stay pending appeal, and that the appeals court must be able to grant effective relief without unraveling the reorganization plan, which would unfairly affect third parties. See, e.g., *Transwest Resort Properties*, 801 F.3d 1162 (9th Cir. 2015) (2-1); *One 2 One Communications, LLC*, 805 F.3d 428 (3d Cir. 2015); *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015); and *In re NICA Holdings*, 810 F.3d 781 (11th Cir. 2015).

These courts have expressed concern about whether the equitable mootness doctrine enables parties to implement a questionable reorganization plan favoring certain creditors over others without any oversight by an Article III court (a district court or a Court of Appeals). The pensioners here argued, among other things, that Detroit could not, as a matter of Michigan law, impair their pension rights in a municipal bankruptcy, but the bankruptcy court rejected that argument. *In re City of Detroit*, 504. B.R. 191, 194-195 (Bankr. E.D. Mich. 2013). Some judges also have been concerned whether the doctrine enables courts to abdicate their responsibilities.

Courts still view equitable mootness as a limited doctrine. *In re SemCrude, LP*, 728 F.3d 315, 323 (3d Cir. 2013) (dismissal of appeal "should be the rare exception and not the rule"). *In re Pacific Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009) ("equitable mootness should be applied with a scalpel rather than an axe").

Facts

The city of Detroit, in its huge "municipal bankruptcy under Chapter 9 of the Bankruptcy Code" ("Code"), had "crafted a complex network of settlements and agreements with its thousands of creditors and stakeholders" that had been incorporated in a comprehensive Plan confirmed by the bankruptcy court. Several municipal employee pensions opposed "any reduction in their benefits" and opposed confirmation of the Plan. As a result of agreements "by and among the City, the State of Michigan, and certain philanthropic foundations," the Plan reduced the pensions here "by 4.5% and eliminated cost-of-living increases; reduced retiree healthcare coverage and eliminated dental, vision, and life insurance," among other things. *Id.* at *3-4. The class of claimants that

included the appealing pensioners "voted 73% in favor of accepting the Plan … ." *Id.* at *4. The Sixth Circuit never discussed the substance of the pensioners' objections, but stressed that "the Plan eliminated approximately $7 billion in debt and freed approximately $1.7 billion in revenue for reinvestment in City services and infrastructure … ." *Id.* at *4.

Analysis

The Court of Appeals avoided any discussion of the merits of the underlying appeal. Instead, it was "concerned with protecting the good faith reliance interests created by implementation of the [City's] plan from being undone … ." *Id.* at *6. "Stated bluntly, equitable mootness negates appellate review of the confirmation order or the underlying plan, regardless of the problems therein or the merits of the appellant's challenge." *Id.* at *7. The court's "three-part test" looked at whether the appellant had obtained a stay, whether the plan had been "substantially consummated," and "whether the relief requested would significantly and irrevocably disrupt the implementation of the plan or disproportionately harm the reliance interests of other parties not before the court." *Id.* But the "most important factor is whether the relief requested would affect the rights of third parties or the overall success of the plan." *Id.*

Applying these criteria, the court noted that the petitioners had not obtained a stay, the plan had been substantially consummated ("numerous significant — even colossal —actions had been undertaken or completed, many irreversible"), and the requested "pension reduction would necessarily rescind" the basis of the Plan, "its $816 million in outside funding, and the series of other settlements and agreements … , thereby unravelling the entire Plan and adversely affecting countless third parties, including, among others, the entire City population." *Id.* Finding that this case was "not a close call," the court stressed that the doctrine of equitable mootness was meant to apply to "exactly this type of scenario … ." *Id.* "Given the immensity of the Grand Bargain [underlying the Plan], even within this enormous bankruptcy, such a drastic action would unavoidably unravel the entire Plan, likely force the City back into emergency oversight." *Id.* at *8. Moreover, reasoned the court, the "harm to the City and its dependents — employees and stakeholders, agencies and businesses and 685,000 residents — so outweighs the harm to these [pensioners] that granting their requested relief and unravelling the Plan would be 'impractical, imprudent, and therefore inequitable.'" *Id.*, quoting *In re United Producers, Inc.*, 526 F.3d 942, 947 (6th Cir. 2008).

Equitable Mootness Viable

The court rejected the pensioners' argument that equitable mootness is no longer a viable doctrine. First, the Supreme Court has not yet abolished the doctrine, nor has any other Court of Appeals. Indeed, the equitable mootness doctrine "is the law of the Sixth Circuit." *Id.* at *9, citing *United Producers*, 526 F.3d at 947, and *In re Schwartz*, 636 F. App'x 673 (6th Cir. 2016).

Equitable Mootness Applies in Chapter 9

The court further rejected the pensioners' argument that the equitable mootness doctrine did not apply in Chapter 9 cases. Other courts have, in fact, applied the doctrine to Chapter 9 cases, "with little analysis." *Id.* at *9, citing *Alexander v. Barnwell Cnty. Hosp.*, 498 B.R. 550 (D.S.C. 2013); *In re City of Vallejo*, 551 F. App'x 339 (9th Cir. 2013); and *In re City of Stockton*, 542 B.R. 261, 273-74 (9th Cir. BAP 2015). The only decision holding that equitable mootness does not apply in Chapter 9 cases, *Bennett v. Jefferson County*, 518 B.R. 613 (N.D. Ala. 2014), is currently pending on appeal in the Eleventh Circuit. Municipal ratepayers there "claimed that the increase in rates — without vote or voter approval — violated the state constitution," but the Sixth Circuit stressed that they were not creditors, investors or shareholders whose interest in the case was defined by the amount of their investment. *Id.* at *18. Because the "potential harm to third-party reliance interests from unravelling the Jefferson County plan would not outweigh the harm inflicted on those captive Ratepayer 'creditors' by allowing the plan's drastic rate increase to go unchallenged," equitable mootness was not an appropriate doctrine in that case. Unlike the captive customers "like the Ratepayers in *Bennett*, at risk of being subjected to an unlimited financial obligation, namely, a 365% rate increase to continue forever," the pensioners in *Detroit* "were given a vote on the pension reduction and 73% of the Class voted for it … ." *Id.* at *11.

The doctrine of equitable mootness, reasoned the Court, is "outside of the Code entirely, both Chapters 11 and 9." *Id.* at *14. On the "particular facts of this case," it said, "equitable mootness … applies 'with greater force to the City's Chapter 9 Plan, which affects thousands of creditors and residents.'" *Id.* at *15, quoting *City of Detroit*, 2015 WL 5697702, at *5.

Municipal Status Irrelevant

Nor does it matter whether the debtor is a business enterprise or a municipality. "The fact that the debtor is a municipality, with state sovereignty, rather than a business enterprise does not reduce the municipal debtor's rights in bankruptcy"; in fact, "the opposite is true." *Id.* Here, the debtor "not only had numerous stakeholders and employees [but] also had over 100,000 creditors and 685,000 residents relying on its Plan." *Id.* at *13. In this context, the equitable mootness doctrine is meant "to achieve finality in [the] bankruptcy [case] and to protect the good faith reliance interests created by implementation of the bankruptcy plan." *Id.* at *13.

Dissent

Judicial Abdication

Accusing the majority of "judicial abdication," the dissent argued that the majority had extended "an already questionable prudential doctrine to a context in which it has no place" in order "to avoid the merits of this case." *Id.* at *16-17. The retiree pensioners in this case "spent their lives serving the people of Detroit through boom and bust, and … feel that the City's bankruptcy was resolved through a game of musical chairs in which they were left without a seat," believing that "their rights were violated by the agreement that resulted in the settlement of Detroit's bankruptcy …. " *Id.* at *17. According to the dissent, the district court and the majority of the Sixth Circuit panel ensured that the pensioners' claims "will never be heard by an Article III judge," something that is "no mere formality." The protections of Article III 'help to ensure the integrity and independence of the Judiciary' … and Article III supervision of bankruptcy judges is key to the constitutionality of the bankruptcy-court system that adjudicated the retirees' claims." *Id*

Equitable Mootness Unjustified

First, argued the dissent, the Code does not justify the application of the equitable mootness doctrine here. The Sixth Circuit, it said, has "never examined the legal basis for" the doctrine. "Indeed, '[a]lthough the equitable mootness doctrine is embraced in every circuit, the rationale underlying the doctrine is unsettled at best.'" *Id.* at *21, citing *In re SemCrude, L.P.*, 728 F.3d 314, 317 (3d Cir. 2013) and quoting *R. Murphy*, "Equitable Mootness Should Be Used As A Scalpel Rather Than An Axe In Bankruptcy Appeals," 19 J. Bankr. L & Pract. 1 Art. 2 (2010).

Equitable Mootness Inappropriate

Equitable mootness is also an inappropriate prudential doctrine upsetting the constitutional balance of the bankruptcy court system, argued the dissent. *Id.* at *23. The doctrine is "nothing but a prudential doctrine of 'judicially self-imposed limits.'" *Id.*, quoting *Allen v. Wright*, 468 U.S. 737, 751 (1984). "The problem with equitable mootness is not only that it cuts off entirely the right to appeal to an Article III court, but that 'it effectively delegates the power to prevent that review to the very non-Article III tribunal whose decision is at issue' because 'bankruptcy courts control nearly all of the variables' that are considered in assessing whether an appeal is equitably moot." *Id.* at *25.

Pensioners' Objections Warrant Judicial Review

Finally, argued the dissent, there is no legal basis for applying the equitable mootness doctrine in Chapter 9 cases. Because the panel here was "bound by [6th Circuit] precedent applying the doctrine of equitable mootness, … it is high time for us to review the doctrine's basis as a full court sitting on en banc." *Id.* at *26. In the dissent's view, the Plan here "is known to be subject to significant challenge on appeal," but the majority has ensured that the appellants "may never have their claims heard by an Article III judge, … all in the name of protecting reliance interests." *Id.* at *29.

Comment

The appealing pensioners in *Detroit* will most likely seek a petition for rehearing en banc. If that fails, in view of the recent spate of decisions debating the wisdom of the equitable mootness doctrine, they will most likely seek review by the Supreme Court. Unfortunately, the Supreme Court, like many of the courts of appeals, will be in no hurry to review difficult cases, particularly when there is apparently no split among the circuits on the substantive merits of this particular case.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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