ALERTS

Eighth Circuit Scales Back Equitable Mootness Doctrine for Dismissing Confirmation Appeal

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Courts frequently dismiss creditor appeals of bankruptcy confirmation orders as equitably moot. However, the Eighth Circuit Court of Appeals recently departed from this historic practice. In reversing a District Court determination that confirmation of a plan rendered a creditor's appeal equitably moot, the Eighth Circuit held that motions to dismiss for equitable mootness should be "rarely granted," and it reversed and remanded the lower courts' dismissal of a creditor's appeal of a Plan Confirmation Order on equitable mootness grounds. With an appellate court taking a strong stand against equitable mootness, other courts will have to examine the issue closely. A circuit split on the issue could end up before the Supreme Court in the coming years. *FishDish LLP v. VeroBlue Farms USA Inc.*, No. 19-3413, No. 19-3487, 2021 WL 3411834 at *7 (8th Cir. Aug. 5, 2021).

Equitable Mootness

Courts apply equitable mootness when they deem a plan "substantially consummated." This occurs when transactions contemplated by the plan — like issuing new debt and making distributions — have already occurred, and, it would be prejudicial to third parties to "unscramble the egg." It is an equitable doctrine that, when "limited in scope and cautiously applied," may prevent substantial harm to numerous parties after confirmation of a bankruptcy plan. However, debtors and parties obtaining superior treatment under a plan often invoke equitable mootness as a

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strategy to avoid litigating the merits of claims after rushing a plan through confirmation.

Factual Background

FishDish LLP — a preferred shareholder of the fish-farm Debtor companies, VeroBlue Farms USA Inc. and affiliates — appealed the District Court's order that relied on equitable mootness to dismiss FishDish's appeal of the Bankruptcy Court's Plan Confirmation Order. FishDish argued that the Plan violated various provisions of the Bankruptcy Code, including the absolute priority rule, the feasibility requirement and the best interest of creditors test. Alder Aqua — the plan sponsor and sole shareholder of Reorganized Debtors who was slated to assume management — argued that FishDish's appeal was equitably moot.

In accordance with the Plan, Alder Aqua funded the Plan with $13.5 million dollars, $12 million of which was distributed to creditors. Alder Aqua also agreed to invest $21 million in working capital but deferred making that payment. In addition, all common and preferred stock in the Debtors was cancelled and stock was re-issued to Alder Aqua, which became the sole shareholder. Alder Aqua also assumed management of the Reorganized Debtors and released the Debtors from various claims. *Id.* at *3.

Analysis

The Eighth Circuit reversed the District Court's order dismissing the appeal as equitably moot, finding that the District Court made no inquiry into whether the record supported its holding that the Court could not "grant relief without undermining the plan and, thereby, affecting third parties." *Id.* at *6 (citing *In re SI Restructuring Inc.*, 542 F.3d 131, 136 (5th Cir. 2008); *In re Paige*, 584 F.3d 1327, 1337 (10th Cir. 2009)).

The Eighth Circuit agreed with other circuits that the "most important factors are whether the confirmed plan has been substantially consummated and, if so, what effects reversal of the plan would likely have on third parties." *Id.* It also cautioned that equitable mootness often results in arbitrary "refusal of the Article III courts to entertain a live appeal over which they indisputably possess statutory jurisdiction and in which meaningful relief can be awarded." *Id.* at *1 (citing *In re Cont'l Airlines*, 91 F.3d 553, 571 (3d Cir. 1996)).

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In holding that Article III appellate courts have "a virtually unflagging obligation" to exercise subject matter jurisdiction, the Eighth Circuit concluded that a sufficiently rigorous test must be applied prior to a determination that "bankruptcy equities and pragmatics justify foregoing Article III judicial review of a bankruptcy court order confirming a Chapter 11 plan." *Id.* The Eighth Circuit echoed concerns raised by the Third Circuit Court of Appeals in *In re One2One Communications LLC*, 805 F.3d 428, 446—50 (3rd Cir. 2015), finding that several facts on the record should have given the District Court pause before granting the motion to dismiss.

Specifically, the Eighth Circuit noted that equitable mootness was not intended to protect third-party plan sponsors, like Alder Aqua, and Debtor's management — especially when the plan sponsor will assume management of the Reorganized Debtors. The Court of Appeals also expressed concern that Alder Aqua's decision to defer committing working capital — which was the only transfer to not yet occur under the Plan — could have been motivated by a desire to force the Reorganized Debtors to pursue a quick asset sale, rather than resume operations. Finally, the Eighth Circuit held that the District Court could plausibly fashion effective relief for the impaired creditor appellants, even if the business assets had already been sold to a third-party purchaser relying on the confirmed Plan. The Court noted that disgorgement of proceeds is a possible remedy that would not frustrate the Plan's consummation or the success of the Reorganized Debtors.

The Eighth Circuit held that, on remand, the District Court must make at least a preliminary review of the merits of FishDish's appeal "to determine the strength of FishDish's claims, the amount of time that would likely be required to resolve the merits of those claims on an expedited basis, and the equitable remedies available — including possible dismissal — to avoid undermining the plan and thereby harming *third parties*." *Id.* at *7 (emphasis in original).

Takeaways

- The Eighth Circuit joins the Second, Third, Fifth and Tenth Circuits in requiring that District Courts conduct a review of an appeal's merits to consider whether equitable remedies that avoid undermining the plan and harming good faith purchasers could obviate equitable mootness.

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- Creditors should remind courts that issues relating to Article III standing and jurisdiction (such as real mootness) are distinct from equitable mootness doctrine, which involves a court's unwillingness to alter the outcome of a case — even where a case is not moot and the Court has Article III standing.

- The Eighth Circuit warned that, should equitable mootness become a rule of appellate bankruptcy jurisprudence, rather than an exception, the "Supreme Court, having up to now denied petitions for certiorari to review the doctrine, would likely curtail sharply – perhaps even abolish — its use."

- While decisions curtailing dismissals of appeals on equitable mootness grounds could benefit creditors by giving them greater leverage, it could also make confirmation more difficult because investors in a post-reorganization company may shy away from the uncertainty created by additional appeals.

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

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