EQUITABLE MOOTNESS IN THE SECOND CIRCUIT

TIFFANY CHANG*

I. INTRODUCTION

When facing bankruptcy, a debtor must choose between either a liquidation under Chapter 7 of the Bankruptcy Code or a reorganization under Chapter 11, Chapter 12, or Chapter 13.[1] In the debtor chooses a reorganization, they must propose a "plan of reorganization" that sets forth how they will pay some or all of their prebankruptcy debts over a period of time.[2] The process centers around a so-called plan of reorganization under which creditors will be paid from assets of the estate or postconfirmation earnings of the debtor.[3] Postconfirmation earnings include any income the debtor earns after the bankruptcy court confirms the plan.

Congress designed Chapter 11 reorganizations to be used by businesses rather than individuals. The goals of Chapter 11 reorganizations are to (1) preserve the business, (2) promote equality of distribution among creditors of equal priority, and (3) maximize distributions to creditors. Corporate reorganizations should balance the need of a corporate debtor to reemerge from bankruptcy as an economically sound entity with the preservation of the existing legal rights of creditors and stakeholders.[4] The corporate debtor can choose to reorganize its business or sell its assets for liquidated or going concern value.[5] On the one hand, going concern value increases an asset's worth because it assumes the company will remain in business indefinitely and continue to be profitable.[6] On the other hand, a corporation's liquidation value in a hypothetical Chapter 7 is lower because the company's assets would be valued in an immediate sale.[7] Allowing a

* Senior Notes and Submissions Editor, *Southern California Interdisciplinary Law Journal*; J.D. Candidate 2022, University of Southern California Gould School of Law. Thank you to Professor Robert K. Rasmussen and Professor Jonathan M. Barnett for their guidance throughout the drafting of this Note.

[1] DANIEL J. BUSSEL & DAVID A. SKEEL JR., BANKRUPTCY 20–21 (Robert C. Clark et al. eds., 10th ed. 2015).

[2] *Id.* at 21.

[3] *Id.* at 22.

[4] 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2020).

[5] *See* 2d Bankr. Serv. L. Ed. *Going concern value* § 24:276 (Westlaw Jan., 2022) ("For purposes of 11 U.S.C.A. § 506(a) valuation, fair market or going concern value, rather than liquidation value, is appropriate standard in valuing collateral that Chapter 11 debtor proposes to retain and use."); 2d Bankr. Serv. L. Ed. *Forced sale or liquidation value; foreclosure value* § 24:278 (Westlaw Jan., 2022) ("Liquidation value is appropriate measure of company's value, for purpose of determining allowed secured claim of creditor holding a security interest in company's stock, when company is dissolving, and not when company will continue operating.").

[6] *See* RICHARD A. BOOTH, FINANCING THE CORPORATION § 2:4, Westlaw (database updated December 2020) ("The value of a business ultimately lies in its ability to generate returns in the future."); Ashmika Agrawal, Liquidation As Going Concern Under Insolvency and Bankruptcy Law, 1-3 (Jan. 29, 2020) (unpublished manuscript) (on file with the Social Science Research Network), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3527389.

[7] *See id.*

debtor to continue operations or sell its business at going concern value preserves jobs for a longer period of time and can stimulate economic health.

A debtor in a Chapter 11 case is also known as a "debtor in possession" because, unlike in a liquidation, the debtor will retain its assets and continue to operate its business. Under § 541(a), filing for bankruptcy creates an estate,[8] and all of the the debtor's property falls within it.[9] As a debtor in possession, the debtor has the ability to use, sell, or lease property of the estate.[10]

Because a debtor can begin to implement its reorganization plan before an appeal, and the plan may be too far along to "unscramble," courts have developed the doctrine of equitable mootness.[11] Equitable mootness is a judicially created abstention doctrine that allows appellate courts to dismiss appeals of a bankruptcy court's confirmation order.[12] Generally, parties that disagree with the final order of a confirmed plan can appeal under § 158(a) of the Bankruptcy Code.[13] In complex Chapter 11 reorganization cases, debtors can prevent the appeal of a bankruptcy court's final order, which may take a long time to be heard[14], by invoking equitable mootness.[15]

The doctrine of equitable mootness is an equitable remedy by which an appeal will be dismissed as moot if implementation of that relief would be inequitable, "even though effective relief could be conceivably fashioned."[16] Where the doctrine applies, it prevents otherwise valid appeals.

Because the plan of reorganization sets forth how creditors will be paid, if at all, confirming a plan may be a contentious process. Creditors and stakeholders who hold an interest in a debtor's assets have an opportunity to vote on the plan.[17] Sometimes a bankruptcy court may approve the plan even if not all interested parties accept it.[18] Section 1126 of the Code governs Chapter 11 voting requirements. Under § 1126, a class of claims has accepted a plan if the plan has been accepted by creditors "that hold at least two[ ]thirds in amount and more than one[ ]half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan."[19] An unimpaired class has claims that are not altered by the plan, while an impaired class has contractual rights that will be modified or will be paid less than the full value of their claims under the plan. A class unimpaired under the plan is presumed to accept the plan.[20] The plan must classify all claims and must further specify how the claims will be treated.[21] It must give

[8] 11 U.S.C. § 541(a) (2018).
[9] *Id.*
[10] COLLIER, *supra* note 4.
[11] *See generally* R. Jake Jumbeck, "Complexity" as the Gatekeeper to Equitable Mootness, 33 EMORY BANKR. DEV. J. 171, 180 (2016) (discussing the equitable mootness docrine in Chapter 11 proceedings).
[12] *Id*. at 173–74.
[13] 28 U.S.C. § 158(a) (2018).
[14] Jumbeck, *supra* note 11, at 180.
[15] *Id.* at 173.
[16] *In re* Chateaugay Corp., 988 F.2d 322, 325 (2d Cir. 1993).
[17] BUSSEL & SKEEL, *supra* note 1, at 22.
[18] 11 U.S.C. § 1129(b)(1) (2018).
[19] 11 U.S.C. § 1126(c) (2018).
[20] 11 U.S.C. § 1126(f) (2018).
[21] 11 U.S.C. § 1123(a)(1)–(3) (2018).

equal treatment to all claims within each class.[22] Creditors must follow the plan if it is confirmed by the bankruptcy court, even if they object to its terms.

For a Chapter 11 reorganization, § 1129 of the Bankruptcy Code provides the requirements for consensual confirmation in § 1129(a) and nonconsensual confirmation in § 1129(b)(1).[23] In cases of consensual confirmation where all classes accept the plan, there may still be some dissent from creditors who do not agree with their class. Section 1129(b)(1) provides that in a nonconsensual confirmation or "cram down," the plan must not unfairly discriminate against dissenting classes, and the plan's treatment of dissenting classes must be "fair and equitable."[24] Although there is no need to approve each impaired class under the § 1129(b)(1) "cram down" provision, at least one impaired class must vote to accept the plan.[25] In either consensual or nonconsensual confirmation, an appellant may contend that a plan of reorganization is not fair and equitable, and the appellee may raise the doctrine of equitable mootness in response. If the court determines that equitable mootness applies, the appeal will be barred.

A confirmed plan affects all the creditors of the debtor but may fail to treat a creditor in accordance with the law. The doctrine of equitable mootness balances the rights of such unfairly treated creditors against other creditors who have relied on the plan.[26] Innocent third parties such as lenders and investors also rely on the plan.[27] Additionally, the application of equitable mootness curtails the right of a litigant to have their case heard by a judge on the merits.[28]

Chapter 11 cases involve a lot of money. Four hundred companies with over $10 million dollars in liabilities have filed under Chapter 11 in 2019.[29] Most Chapter 11 filings in 2019 for companies exceeding $10 million dollars in liabilities occurred in Delaware, the Southern District of New York, and the Southern District of Texas.[30] Despite a nationwide decrease in bankruptcy filings from 2014 to 2018, the number of bankruptcy cases increased in the Second Circuit by 6%.[31] In other words, New York is one of the major districts for Chapter 11 bankruptcy cases.

Since the Code was enacted in 1979, the Southern District of New York has continued to be an attractive venue in which to file bankruptcy cases. New York is the nation's financial capital, many Fortune 500 companies are

---

[22] 11 U.S.C. § 1123(a)(4) (2018).

[23] 11 U.S.C. § 1129 (2018).

[24] 11 U.S.C. § 1129(b)(1) (2018); Paul Leake & Cameron M. Fee, *Second Circuit Adopts Secured Creditor Cramdown Standard Based on Market Efficiency*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Jan. 17, 2019).

[25] *Id.*

[26] 7 COLLIER ON BANKRUPTCY ¶ 1129.09[1] (Richard Levin & Henry J. Sommer eds., 16th ed. 2020).

[27] 7 COLLIER ON BANKRUPTCY ¶ 1129.09[3][d] (Richard Levin & Henry J. Sommer eds., 16th ed. 2020).

[28] Katelyn Knight, *Equitable Mootness in Bankruptcy Appeals*, 49 SANTA CLARA L. REV. 253, 254 (2009).

[29] Charles M. Oellermann & Mark G. Douglas, *The Year in Bankruptcy: 2019*, JONES DAY (Feb. 2020), https://www.jonesday.com/en/insights/2020/02/the-year-in-bankruptcy-2019 [https://perma.cc/SH2K-LXTW].

[30] *Id.*

[31] *U.S. Bankruptcy Courts: Judicial Business 2018*, ADMIN. OFF. U.S. COURTS, https://www.uscourts.gov/statistics-reports/us-bankruptcy-courts-judicial-business-2018 [https://perma.cc/25PN-M7WF] (last accessed Oct. 26, 2021).

incorporated there, and bankruptcy judges in New York are experienced.[32] These circumstances allow attorneys to expect the Southern District of New York to produce better decisions.[33] Companies increasingly value getting out of court sooner, so lawyers also prefer judges who are used to handling complex cases.[34]

Adversary proceedings are separate lawsuits filed within bankruptcy cases and include actions to object to or revoke discharges, to obtain injunctions or other equitable relief, and to determine the dischargeability of debt. Adversary proceedings most commonly arise in cases filed under Chapter 11.[35] In 2018, filings of adversary proceedings in bankruptcy cases declined 13% to 24,166 nationwide.[36] Meanwhile, in 2018, the Southern District of New York reported the largest numeric growth in adversary proceedings.[37] Filings increased by four hundred—a significant increase of 81%—with most arising from cases involving a Chapter 11 bankruptcy.[38] Others have already examined Third Circuit cases of equitable mootness extensively.[39] In the following Note, I uniquely examine the doctrine in the Second Circuit, which includes New York. I argue that the Second Circuit's historically broad usage of equitable mootness should be limited. The doctrine should be more narrowly exercised because appellants have a right to review on the merits.

This Note examines the doctrine of equitable mootness in the Second Circuit and its implementation in New York district courts. Part II of this Note explores the origin of equitable mootness and its application in different circuits. Part III identifies the leading cases on equitable mootness in the Second Circuit. Specifically, this Note examines *In re Chateaugay Corp.*, in which the court established five factors with which to determine whether or not equitable mootness applies. Part IV and V look at how New York District Courts in the Second Circuit apply equitable mootness. Part VI explores the criticisms of equitable mootness and why the doctrine should be limited. Finally, Part VII proposes the blue pencil method as a better alternative to equitable mootness.

---

[32] Emily Chasan, Delaware, *NY Still Attracts Biggest Bankruptcies*, REUTERS (May 22, 2008, 7:16 AM), https://www.reuters.com/article/us-bankruptcy-courts/delaware-ny-still-attract-biggest-bankruptcies-idUSN2237982920080522 [https://perma.cc/VW4C-9XEF]; *New York City*, N.Y. STATE, https://esd.ny.gov/regions/new-york-city [https://perma.cc/X5KP-HXM7].

[33] Emily Chasan, *Delaware, NY Still Attract Biggest Bankruptcies*, REUTERS (May 22, 2008, 7:16 AM), https://www.reuters.com/article/us-bankruptcy-courts/delaware-ny-still-attract-biggest-bankruptcies-idUSN2237982920080522 [https://perma.cc/VW4C-9XEF].

[34] *See id*.

[35] ADMIN. OFF. U.S. COURTS, *supra* note 31.

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *See generally* Knight, *supra* note 28; George Klidonas, *Third Circuit Still Narrowly Applies the Equitable Mootness Doctrine*, 31 AM. BANKR. INST. J. 26 (2012); Charles Persons, *Equitable Mootness on Life Support: The Third Circuit Further Pares Back the Abstention Doctrine in One2One Communications*, WEIL RESTRUCTURING (Aug. 3, 2015), https://restructuring.weil.com/jurisdiction/equitable-mootness-on-life-support-the-third-circuit-further-pares-back-the-abstention-doctrine-in-one2one-communications [https://perma.cc/CF28-ARHU].

II. THE ORIGIN OF EQUITABLE MOOTNESS

Equitable mootness is different from Constitutional mootness, which originates from Article III. The doctrine of Constitutional mootness prevents courts from hearing cases when changed circumstances deprive the plaintiff of a stake in the action. Under Article III of the Constitution, the exercise of judicial power depends on "the existence of a case or controversy," so a real and substantial case or controversy must exist throughout the litigation.[40] In contrast, equitable mootness applies more broadly than constitutional mootness. In cases where equitable mootness applies, the requested relief is still legally possible, but offering the relief would be impractical and imprudent.[41]

The doctrine of equitable mootness originated in *Trone v. Roberts Farms, Inc.*, a case decided in 1981.[42] In *Roberts Farms*, the trustees in a Chapter 11 case appealed an order disallowing some claims, an order confirming the plan, and an order approving a settlement with the Federal Deposit Insurance Corporation ("FDIC").[43] In response to the trustees' appeal, the debtor and the FDIC moved to dismiss the appeal as moot on the grounds that the plan had been substantially carried out.[44] The district court granted the motion and dismissed the appeal. The Ninth Circuit agreed with the district court, stating that "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."[45] Many intricate and involved transactions were contemplated by the plan of reorganization, and stood solely on the order confirming the plan.[46] By the time of the appeal, it was no longer feasible to dismiss the confirmation order. The Ninth Circuit also emphasized that the doctrine of equitable mootness is an *equitable* remedy, pointing out that the trustees failed to pursue their available remedies to obtain a stay of the objectionable orders given by the Bankruptcy Court.[47]

Following *Roberts Farms*, all circuits adopted the doctrine of equitable mootness; most circuits apply a four- or five-factor test, while the Tenth Circuit applies a six-factor test.[48] The tests for equitable mootness tend to be substantially similar and look at (1) whether the appellant sought or obtained

---

[40] Jumbeck, *supra* note 11, at 182. *See* De Funis v. Odegaard, 416 U.S. 312 (1974).

[41] Jumbeck, *supra* note 11, at 182. *See also In re* UNR Indus., 20 F.3d 766, 769 (7th Cir. 1994) ("There is a big difference between inability to alter the outcome (real mootness) and unwillingness to alter the outcome ('equitable mootness').").

[42] Trone v. Roberts Farms, Inc. (*In re* Roberts Farms, Inc.), 652 F.2d 793 (9th Cir. 1981).

[43] *Id.* at 794–95.

[44] *Id.* at 795.

[45] *Id.* at 797.

[46] *Id.*

[47] *Id.* at 798.

[48] *See generally* Prudential Ins. Co. of Am. v. SW Boston Hotel Venture, LLC (*In re* SW Boston Hotel Venture, LLC), 748 F.3d 393 (1st Cir. 2014); Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944 (2d Cir. 1993); Nordhoff Invs., Inc. v. Zenith Elecs. Corp., 258 F.3d 180 (3d Cir. 2001); TNB Fin., Inc. v. James F. Parker Interests (*In re* Grimland, Inc.), 243 F.3d 228 (5th Cir. 2001); *In re* UNR Indus., 20 F.3d 766 (7th Cir. 1994); Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (*In re* Thorpe Insulation Co.), 671 F.3d 980 (9th Cir. 2012*)*, *amended and superseded on denial of rehearing en banc*, 677 F.3d 869 (9th Cir. 2012); Search Mkt. Direct, Inc. v. Jubber (*In re* Paige), 584 F.3d 1327 (10th Cir. 2009).

a stay pending appeal; (2) whether the plan has been substantially consummated; (3) whether the rights of third parties not before the court would be adversely affected; (4) the impact on the likelihood of a successful reorganization; (5) whether the appellant's challenge is legally meritorious or equitably compelling; and (6) public policy concerns.[49] Typically, the burden to prove equitable mootness falls on the party seeking dismissal of an appeal.[50]

Beyond the varying balancing tests for equitable mootness, the doctrine has created controversy because some circuits have applied it to relatively simple reorganizations.[51] The doctrine was designed to be expressly limited to complex reorganizations with intricate transactions.[52] In recent years, there has been increasing criticism on applying equitable mootness in simple reorganizations because there is less of a need to promote the finality of confirmation orders at the expense of the right of a party to seek review.[53] For example, in *One2One Communs., LLC v. Quad/Graphics, Inc.*, the Third Circuit found that the case "did not involve a sufficiently complex bankruptcy reorganization such that dismissal on the basis of equitable mootness would be appropriate."[54] The reorganization only involved a $200,000 investment, one secured creditor, and seventeen unsecured creditors.[55] However, despite the consensus that equitable mootness should only apply to complex reorganizations, in practice, the circuit courts do not employ a uniform formal assessment among the Circuit courts.[56]

Chapter 11 bankruptcy cases proceed much faster than routine civil litigation.[57] The speedy process was designed to maximize recovery for creditors, as finances may deteriorate quickly.[58] Bankruptcy inhibits a business's ability to operate normally. A long bankruptcy process would create a longer period of uncertainty for both creditors and the debtor in possession. In *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015), Judge Ambro explains, "[E]very day that a company remains in bankruptcy is a day when it will have a hard time attracting the investors, employees, and, in some industries, customers that it needs to exist and prosper."[59]

From a public policy perspective, courts must consider the need for reliance on confirmed bankruptcy plans and the need of creditors to be able to rely on bankruptcy court decisions. Creditors who carried the plan forward can be negatively affected if the order confirming the plan is dismissed. Granting equitable mootness prevents a court from unscrambling complex bankruptcy reorganizations, especially when the appealing party should have

[49] *See* cases cited *supra* note 48.

[50] 7 COLLIER ON BANKRUPTCY ¶ 1129.09[5][d] (Richard Levin & Henry J. Sommer eds., 16th ed. 2020) ("Equitable mootness is not, by definition, a trial court issue. It is one that is generally raised by motion of a party to an appeal.").

[51] *See* One2One Commc'ns., LLC v. Quad/Graphics, Inc., 805 F.3d 428 (3d Cir. 2015); Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 772 F.3d 102 (2d Cir. 2014).

[52] Jumbeck, *supra* note 11, at 187.

[53] *See Id.*; Tribune Media Co. v. Aurelius Cap. Mgmt., L.P., 799 F.3d 272, 283–84 (3d Cir. 2015).

[54] *One2One Commc'ns., LLC*, 805 F.3d at 436.

[55] *Id.* at 435.

[56] Jumbeck, *supra* note 11, at 187.

[57] Bruce A. Markell, *The Needs of the Many: Equitable Mootness' Pernicious Effects*, 93 AM. BANKR. L.J. 377, 378 (2019).

[58] *See id.*

[59] Tribune Media Co. v. Aurelius Cap. Mgmt., L.P., 799 F.3d 272, 289 (3d Cir. 2015) (Ambro, J., concurring).

acted before the plan became extremely difficult to retract.[60] However, parties should also have a right to seek review of a bankruptcy judgement that adversely affects them. Judges occasionally make mistakes, and appeals can correct errors and ensure that courts apply bankruptcy law uniformly.[61] A claim or interest holder who feels the plan treated them unfairly and not in accordance with the law needs to be able to appeal the decision. The doctrine of equitable mootness aims to strike a balance between the two of creditors' competing interests of finality and the right to review.

III. HISTORY OF EQUITABLE MOOTNESS IN THE SECOND CIRCUIT

A. BALANCING TEST: *IN RE CHATEAUGAY CORP.*

In *In re Chateaugay Corp.*, 10 F.3d 944 (2d Cir. 1993), the Second Circuit adopted a five-factor test for equitable mootness. In the Second Circuit, the first inquiry when determining if equitable mootness applies is whether the plan of reorganization has been "substantially consummated."[62] The Bankruptcy Code § 1101(2) defines "substantial consummation" as

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan.[63]

In *Chateaugay*, the plan went into effect on June 28, 1933 and was soon substantially consummated.[64] The *Chateaugay* court explained, however, that substantial consumation will not moot an appeal if each of the following exist:

> (a) the court can still order some effective relief; (b) such relief will not affect "the re-emergence of the debtor as a revitalized corporate entity"; (c) such relief will not unravel intricate transactions so as to "knock the props out from under the authorization for every transaction that has taken place" and "create an unmanageable, uncontrollable situation for the Bankruptcy Court"; (d) the "parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings"; and (e) the appellant "pursued with diligence all available remedies to obtain a stay of execution of the objectionable order . . . if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from."[65]

---

[60] *One2One Commc'ns, LLC*, 805 F.3d 428, 434 (3d Cir. 2015).
[61] Markell, *supra* note 57, at 379.
[62] *See* Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 948 (2d Cir. 1993).
[63] 11 U.S.C. § 1101(2) (2018).
[64] *In re Chateaugay*, 10 F.3d at 949.
[65] *Id.* at 952–53 (internal citations ommited) (quoting other sources).

In *Chateaugay Corp.*, Frito-Lay contested the confirmed plan because, *inter alia*, the plan did not afford their claims administrative priority.[66] Administrative expenses relate to the costs of managing the estate, including any tax incurred by the estate, after the filing of bankruptcy.[67] Claims are paid to creditors in the order of their priority; a junior category is not paid until a senior category is paid in full. Unsecured creditors tend to claim administrative priority because administrative expenses must be paid in full in cash on the date of the plan.[68] Frito-Lay therefore argued that their rights were not mooted by the substantial consummation of the plan.[69]

Before the bankruptcy, Frito-Lay and LTV, the debtor in possession, had entered into twenty-five tax benefit transfer agreements with an indemnity clause.[70] LTV agreed to indemnify Frito-Lay for any resulting tax losses if LTV's ownership decisions interfered with Frito-Lay's right to claim federal income tax deductions and credits on qualified assets.[71] LTV then retired two facilities included in the qualified assets, which compelled Frito-Lay to pay an additional $14 million in its 1987 tax year.[72] Frito-Lay argued that the indemnification claims should have been given administrative priority.[73]

Frito-Lay contended that if the court granted administrative priority to the indemnification, it would be entitled to $20 million.[74] Frito-Lay sought to recoup funds that were re-vested in LTV or distributed to parties represented in the appeal.[75] Frito-Lay also sought to stay confirmation of the plan before the bankruptcy court, but it did not prevail, thus fulfilling the requirement that the appellant pursue all available remedies to obtain a stay of execution of the objectionable order.[76] In response, LTV argued that an immediate payment of $20 million would severely deplete its working capital of $200 million upon which "other creditors have relied in approving and consummating the plan."[77]

After holding that the tax lessors' claims were not rendered moot by substantial consummation of the debtor's confirmed plan, the court emphasized that the only way Frito-Lay could win on the merits was upon a finding that the funds were wrongfully distributed to the entities before the court.[78] Although Frito-Lay did not prevail on the legal merits, the court would have been able to give effective relief by ordering that the wrongly distributed funds be returned to Frito-Lay.[79]

[66] *Id.* at 954.
[67] 11 U.S.C. § 503(b) (2018).
[68] 11 U.S.C. §§ 503(b), 507(a)(2), 1129(a)(9)(A) (2018).
[69] *In re Chateaugay*, 10 F.3d at 948.
[70] *Id.* at 950.
[71] *Id.* at 952.
[72] *Id.*
[73] *Id.*
[74] *Id.* at 953.
[75] *Id.*
[76] *See id.* at 954.
[77] *Id.* at 953.
[78] *Id.*
[79] *Id.*

B. PRESUMPTION OF MOOTNESS: *IN RE CHARTER COMMUNICATIONS, INC.*

The Second Circuit famously reaffirmed the doctrine of equitable mootness in *In re Charter Communications, Inc.*, 691 F.3d 476 (2d Cir. 2012), holding that once a Chapter 11 plan has been substantially consummated, an appeal is presumed to be equitably moot unless the appellant demonstrates that it has met all of the *Chateaugay* factors.[80] The Second Circuit stands alone in presuming that an appeal is equitably moot following substantial consummation of a Chapter 11 plan.[81]

In *Charter*, R2, a shareholder of Charter Communications, and LDT, an indenture trustee for certain notes issued by Charter Communications, objected to the plan of reorganization at every step.[82] Under the plan, the Charter Communications noteholders would receive only 32.7% of their claims, and R2, an equity holder, would receive nothing.[83] However, on November 17, 2009, the bankruptcy court overruled all objections and confirmed the plan of reorganization, leading R2 and LDT to file separate appeals.[84] Charter Communications argued that the relief R2 and LDT sought, a disgorgement of some or all of the related Allen Settlement, could not be granted without unravelling the confirmed plan of reorganization, and the doctrine of equitable mootness barred their appeals.[85] R2 and LDT had both sought to challenge a settlement with Paul Allen, a major investor. In exchange for $375 million, Allen agreed to retain a 35%voting interest in Charter Communications Operating and a 1% interest in Charter Communications Holding Company—a required condition for Charter to reinstate its senior debt and obtain tax savings.[86] The settlement with Allen was a cornerstone of the plan, and modifying the agreement would cast doubt on its viability.[87] The Second Circuit held that "[i]n this circuit, an appeal is presumed equitably moot where the debtor's plan of reorganization has been substantially consummated."[88] The presumption of equitable mootness could only be overcome if all five of the *Chateaugay* factors are met.[89]

The court went further and adopted an abuse of discretion standard for equitable mootness appeals.[90] Generally, in bankruptcy appeals, a district court reviews factual findings for clear error and reviews conclusions of law de novo.[91] The Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits review an equitable mootness determination de novo. The *Charter* court justified its

[80] *See* R2 Invs., LDC v. Charter Commc'ns., Inc. (*In re* Charter Commc'ns., Inc.), 691 F.3d 476, 482 (2d Cir. 2012).
[81] Shana A. Elberg, Amy Van Gelder & Jason M. Liberi, *Equitable Mootness Doctrine Persists in Bankruptcy Appeals*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Sept. 19, 2017), https://www.skadden.com/insights/publications/2017/09/insights-quarterly-september/equitable-mootness-doctrine-persists [https://perma.cc/T2BD-SBPC].
[82] *In re Charter Commc'ns., Inc.*, 691 F.3d at 481.
[83] *Id.* at 480–81.
[84] *Id.* at 481.
[85] *Id.*
[86] *Id.* at 480.
[87] *Id.* at 485.
[88] *Id.* at 482 (internal citations omitted).
[89] *Id.* at 482.
[90] *Id.* at 483.
[91] *Id.* at 482–83.

decision to join the Tenth Circuit in adopting an abuse of discretion standard rather than a de novo standard by comparing the nature of equitable mootness to constitutional mootness in cases where a defendant voluntary ceases the allegedly illegal conduct, which are reviewed with an abuse of discretion standard.[92]

Charter was a procedural decision that made it more difficult to appeal bankruptcy confirmation orders. By presuming equitable mootness when a plan of reorganization has been substantially consummated, the plan objector has the burden of proving all five *Chateaugay* factors. If the plan objector fails to prove even one factor, then the court will apply equitable mootness.

Adopting an abuse of discretion standard, which is more lenient than a de novo standard, in reviewing equitable mootness would make it more likely for a court to uphold a finding of equitable mootness. The new standard of review may dissuade appellants from seeking further review of an equitable mootness determination. Thus, the *Charter* presumption makes it more likely that a court will find equitable mootness, and its abuse of discretion standard makes it more difficult to overturn that finding.

While LDT and R2 met several *Chateaugay* factors, they failed to establish that the request for relief would not affect Charter's emergence as a revitalized entity and would not unravel complex transactions.[93] The district court ultimately dismissed LDT and R2's appeals because they failed to meet the second and third *Chateaugay* factors.[94]

In the petitioners' writ of certiorari to the Supreme Court, the petitioners argued that adopting an abuse of discretion standard would encourage debtors and insiders to rush to consummate a plan of reorganization with illegal provisions and benefit from their illicit bargain.[95] However, the respondent pointed out the complexity of the transactions involved in *Charter* and the high transaction costs that would be involved in unraveling Charter's reorganization.[96] Many transactions that relied on *Charter*'s confirmed reorganization plan had already been effective for over three years.[97] Because the Supreme Court denied certiorari on April 29, 2013, *Charter* still applies in the Second Circuit.

C. DEFINING INTRICATE TRANSACTIONS*: IN RE BGI, INC.*

The Robert Farms case first raised the complexity requirement of equitable mootness by justifying its grant of equitable mootness with the preservation of many intricate and involved transactions that stood solely on the order confirming the plan. *Chateaugay* then adopted this complexity requirement in the Second Circuit's equitable mootness test. The third *Chateaugay* factor requires that "such relief will not unravel intricate

[92] *Id.* at 483.
[93] *Id.* at 485.
[94] *Id.* at 487.
[95] *See* Petition for Writ of Certiorari at 3, Law Debenture Tr. Co. of New York v. Charter Commc'ns, Inc., 569 U.S. 968 (2013) (No. 12-847).
[96] Brian Wells, *Supremely Moot: SCOTUS Denies Challenge to Equitable Mootness Doctrine and Second Circuit's Charter Communications Decision*, WEIL RESTRUCTURING (May 3, 2013), https://restructuring.weil.com/jurisdiction/supremely-moot-scotus-denies-challenge-to-equitable-mootness-doctrine-and-second-circuits-charter-communications-decision [https://perma.cc/2GND-S7DU].
[97] *Id.*

transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court" before denying equitable mootness once the plan has been substantially consummated.[98] *In re BGI, Inc.*, 772 F.3d 102 (2d Cir. 2014), resolved the question of whether equitable mootness could apply to Chapter 11 liquidations or exclusively to Chapter 11 reorganizations.[99]

In *BGI*, Borders, a once prominent bookstore chain, was unsuccessful in its attempt to reorganize, and the bankruptcy court authorized Borders to proceed under a Chapter 11 liquidation to liquidate all assets and close its chain of stores.[100] One week after receiving authorization, Borders stopped accepting gift cards and shut down its e-commerce activities.[101] Holders of unredeemed consumer gift cards issued by BGI sought an order authorizing them to file untimely proofs of claim after BGI's plan of reorganization was confirmed and substantially consummated.[102]

The court held that the doctrine of equitable mootness also applies to appeals arising from Chapter 11 liquidation proceedings, in addition to Chapter 11 reorganization proceedings.[103] In a Chapter 11 liquidating plan, a debtor provides for the sale of all of its remaining assets.[104] A Chapter 11 liquidation allows the debtor to obtain a higher going concern value for its business to maximize distributions to creditors.

The court in *BGI* found that Chapter 11 liquidations still involve considerable time and effort.[105] The parties in a Chapter 11 liquidation "may have devoted months of time and resources toward developing an acceptable plan; creditors with urgent needs may have been stayed from accessing assets and funds to which they are entitled; and extensive judicial resources may have been consumed."[106] Because complexity arises from the time and effort spent in the liquidation, equitable mootness should apply.

The appellants argued that equitable mootness should not apply per se in Chapter 11 liquidation proceedings, but they did not prevail.[107] Other circuits have denied per se the application equitable mootness in Chapter 11 liquidation proceedings because they are less complex than Chapter 11 reorganization proceedings. Courts determine the complexity of a Chapter 11 based on the amounts at stake, number of creditors, and number of transactions, but they should also consider third party reliance on such transactions. There is less third party reliance in a Chapter 11 liquidation because there will be no new investors in the entity. The Second Circuit erroneously weighed the policy of preventing the disruption of a confirmed

[98] Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 953 (2d Cir. 1993).
[99] *See* Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 772 F.3d 102, 107 (2d Cir. 2014).
[100] *Id.* at 105.
[101] *Id.*
[102] *Id.* at 104.
[103] *Id.* at 107.
[104] 11 U.S.C. § 363 (2018).
[105] *See In re* BGI, 772 F.3d at 108.
[106] *Id.*
[107] *Id.* at 109.

and substantially consummated plan more heavily than the right to appeal in Chapter 11 liquidations.[108]

Since *BGI*, district courts have even applied the doctrine to Chapter 7, 9, and 15 cases.[109] The extensive application of equitable mootness outside of Chapter 11 reorganizations has been criticized for being misused and applied too widely.[110] For example, the Fifth Circuit has even applied equitable mootness to settlements and distributions in Chapter 7 liquidation cases.[111] Chapter 7 governs only simple liquidations in which all non-exempt assets are liquidated and distributed to creditors. In such cases, there are rarely intricate transactions that need to be unraveled.

In *Kmart*, a case involving a cash distribution to a pre-bankruptcy supplier, Judge Easterbrook of the Seventh Circuit explained, "[m]oney had changed hands and, we are told, cannot be refunded. But why not? Reversing preferential transfers is an ordinary feature of bankruptcy practice, often continuing under a confirmed plan of reorganization."[112] In other words, where there are simple transactions, reversal of such transactions should be allowed on the basis of their simplicity. Thus, courts should hear simple appeals on their merits.

IV. HOW NEW YORK DISTRICT COURTS IN THE SECOND CIRCUIT DEAL WITH EQUITABLE MOOTNESS AFTER *CHARTER*

In this Part, I will examine whether *Charter* makes it more likely that district courts in the Second Circuit will find equitable mootness. Since the *Charter* decision was given on August 31, 2012, three district court opinions in the Second Circuit that extensively discuss the doctrine of equitable mootness have been published. While not a large sample size, all three decisions resulted in determinations that the creditors' appeals were equitably moot. The district court decisions suggest that *Charter* has indeed made it more difficult to challenge equitable mootness.

A. *IN RE ION MEDIA NETWORKS, INC.*

On October 10, 2012, just two months following the *Charter* decision, the Southern District of New York considered the issue of equitable mootness in *In re ION Media Networks, Inc.*, 480 B.R. 494 (S.D.N.Y. 2012). Debtor ION Media Networks, Inc., a broadcasting company, borrowed $725 million in first lien debt and $405 million in second lien debt in 2005.[113] A first lien debt must be fully repaid before a second lien can receive a distribution.

[108] *See id.* at 108–09.

[109] *See, e.g.*, *In re* Ocean Rig UDW Inc., 585 B.R. 31 (S.D.N.Y. 2018) (applying equitable mootness to Chapter 15 case).

[110] *See* Jumbeck, *supra* note 11, at 205–06 ("[L]iquidation plans do not trigger third party reliance because the business does not exist anymore—the debtor does not need to attract new investors or enter into new contracts with third parties, the individuals or entities equitable mootness is supposed to protect.") (citing Duff v. Cent. Sleep Diagnostics, LLC, 801 F.3d 833, 840 (7th Cir. 2015); *In re* Cont'l Airlines, 91 F.3d 553, 560–61, 567 (3d Cir. 1996)).

[111] *See, e.g.*, Szwak v. Earwood (*In re* Bodenheimer, Jones, Szwak, & Winchell L.L.P.), 592 F.3d 664, 668–69 (5th Cir. 2009); Tech. Lending Partners v. San Patricio Cnty. Cmty. Action Agency (*In re* San Patricio Cnty. Cmty. Action Agency), 575 F.3d 553 (5th Cir. 2009) (applying equitable mootness to Chapter 7 cases).

[112] *In re* Kmart Corp., 359 F.3d 866, 869 (7th Cir. 2004).

[113] *In re* ION Media Networks, Inc., 480 B.R. 494, 495–96 (S.D.N.Y. 2012).

When the ION filed under Chapter 11 on May 19, 2009, it entered into an agreement with the first lien lenders.[114] The first lien lenders agreed to provide $150 million in debtor-in-possession ("DIP") financing in exchange for almost all of the debtor's common stock.[115]

The second lien lenders with second priority interest in ION's collateral objected to the DIP financing because the second lien lenders and unsecured creditors would only receive a pro rata share of a cash distribution and warrants to purchase 5% of common stock of the reorganized debtor.[116] All claims against the debtor from the bankruptcy proceedings would be released.[117] The bankruptcy court confirmed the plan of reorganization with DIP financing over the second lien lenders' objections, and the second lien lenders filed an appeal.[118] At the time of the appeal, the debtors had already taken steps to consummate the plan and argued that the issues raised by the second lien lenders were rendered equitably moot.[119]

Because the plan had been substantially consummated, there was a presumption of equitable mootness, and the second lien holders had the burden to show that all of the *Chateaugay* factors were met to overcome the presumption. The court focused on whether the appellant met the second and third *Chateaugay* factors.

The second *Chateaugay* factor requires a showing that the requested "relief will not affect the re-emergence of the debtor as a revitalized corporate entity."[120] The court found that the appellants did not satisfy the second *Chateaugay* factor because "[g]ranting relief in this case would require a reversal of the entire Confirmation Order, force fruitless renegotiation of the Plan, and thrust ION back into bankruptcy."[121] The first lien lenders' sole entitlement to the collateral, the FCC licenses held by ION, was a necessary bargaining chip in the negotiation, without which there would not be an agreement with the first lien lenders.[122] Invalidating the release of all claims against the debtor and keeping the rest of the plan intact would also have ignored the tradeoff that allowed the parties to settle in an intense multi-party negotiation.[123] Both elements were critical pieces to the plan of reorganization, and removal would have impacted other terms of the agreement because ION's asset value was insufficient to secure the first lien debt.[124]

The third *Chateaugay* factor requires a showing that "such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court."[125] The

[114] *Id.* at 496.
[115] *Id.*
[116] *See id.* at 496–97.
[117] *Id.* at 497.
[118] *Id.* at 496–97.
[119] *Id.* at 499.
[120] *Id.* (citing Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 953 (2d Cir. 1993)).
[121] *Id.* at 500.
[122] *Id.* at 499–500.
[123] *Id.* at 500.
[124] *Id.*
[125] *Id.* at 498 (citing *In re* Chateaugay, 10 F.3d 944 at 953).

court listed multiple steps that had already been implemented under the plan of reorganization:

> [A]ll outstanding debt had either matured or been extinguished; $4.9 million was distributed to the indenture trustee for allocation to the holders of second priority notes; general unsecured warrants for holders of general unsecured claims were issued; all previously issued shares of ION common and preferred stock were cancelled; new common stock was issued to holders of DIP financing claims and first lien debt claims following FCC approval of the transfer of control; a new certificate of incorporation was filed with the Secretary of State of Delaware; ION entered into a new shareholders agreement; and the company formed a new board of directors.[126]

Granting relief here would almost certainly have unraveled complex transactions and imposed great transactional burdens on the court. Thus, appellants failed to satisfy the third *Chateaugay* factor in addition to the second *Chateaugay* factor.

Because they failed to meet the second and third *Chateugay* factors, the appellants did not overcome the presumption of equitable mootness, and the appeal was dismissed. Just as the appellant in *Charter* failed to satisfy the second and third *Chateugay* factors, the appellants in *ION Media Networks* had difficulty showing that granting relief would not impact the success of reorganization or unravel intricate transactions.

B. *IN RE GRUBB & ELLIS CO.*

On December 15, 2014, the Southern District of New York decided *In re Grubb & Ellis Co.*, 523 B.R. 423 (S.D.N.Y. 2014), another case with a substantial analysis of equitable mootness. Grubb & Ellis, a commercial real estate and property management business, filed a voluntary petition for Chapter 11 bankruptcy on February 20, 2012.[127] The bankruptcy court approved the bidding procedures and sale of substantially all of the debtors' assets free and clear of any interests, claims, or liens under 11 U.S.C. § 363(b) to stabilize the debtor's financial condition and liquidity.[128] In an asset purchase agreement, "BGC agreed to purchase substantially all of the Debtors' assets for (a) $30,029,055.70 (the amount of prepetition secured obligations), plus (b) the principal amount of loans made under the debtor-in-possession financing, plus (c) any cure amount paid by BGC for the acquired assets, plus (d) $15,000,00 in cash."[129]

The appellants, former Grubb & Ellis brokers, objected to an order approving the sale of substantially all of the debtor's assets "free and clear of all claims, liens, rights, interests and encumbrances" to BGC Partners, Inc. ("BGC").[130] At the time of the sale, the debtor owed in unpaid commissions "about $5 million of commissions that would have been due in the normal course" and "approximately $12 million worth of commissions were

[126] *Id.* at 500–01.
[127] Carrega v. Grubb & Ellis Co. (*In re* Grubb & Ellis Co.), 523 B.R. 423, 427–28 (S.D.N.Y. 2014).
[128] *Id.* at 428.
[129] *Id.*
[130] *Id.* at 431.

outstanding for transactions that had not yet closed."[131] The appellants argued that the commissions belonged to former Grubb & Ellis brokers, but the bankruptcy court approved the sale.[132] In response, the appellants filed an appeal, requesting imposition of a constructive trust over the commissions or, in the alternative, that the court conduct an evidentiary hearing regarding the ownership of the commissions.[133]

The court determined that the appeals were statutorily moot under § 363(m) and equitably moot.[134] The sale of the debtor's assets was substantially consummated because the sale to BGC closed on April 13, 2012.[135] An appeal is presumed equitably moot once the debtor's plan of reorganization has been substantially consummated, so the appellants had the burden to overcome the presumption of mootness by satisfying all five *Chateaugay* factors.[136]

Appellants failed to prove the third and fifth *Chateaugay* factors. The monetary sum appellants sought was so large that any relief ordered would knock the props out from under the sale, failing the third *Chateaugay* factor.[137] The fifth *Chateaugay* factor requires that "the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order."[138] Here, appellants never sought a stay of the sale order, and on the same day that the sale order was issued, appellants filed instant appeals.[139]

The fifth *Chateaugay* factor can be easily satisfied and only requires that practitioners remember to request a stay prior to filing an appeal. Meanwhile, the third *Chateaugay* factor has been shown to be quite difficult to satisfy.

C. *IN RE FIORANO TILE IMPORTS, INC.*

In *In re Fiorano Tile Imports, Inc.*, 517 B.R. 409 (E.D.N.Y. 2014), the Eastern District of New York also published a decision on equitable mootness three months prior to *Grubb & Ellis.* On September 21, 2010, debtor Fiorano Tile Imports, Inc., a tile supplier for construction projects, filed a voluntary petition for relief under Chapter 11.[140] Fiorano submitted seven amended plans of reorganization because it failed to satisfy the § 1129 plan confirmation criteria; the debtor's earnings were unable to sustain the estimated monthly payments to its creditors proposed by the plan.[141] The bankruptcy court confirmed the seventh amended reorganization plan over the objections of the appellant, a general unsecured creditor, who contested the feasibility of the plan.[142] After the plan was confirmed, the appellant

[131] *Id.* at 434.
[132] *Id*. at 434–35.
[133] *Id.* at 436–37.
[134] Here, we will only be discussing the court's analysis on the equitable mootness issue.
[135] *Id.* at 442.
[136] *See id.* at 440–41.
[137] *Id.* at 442.
[138] Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 953 (2d Cir. 1993).
[139] *In re Grubb & Ellis*, 523 B.R. 423 at 436, 442.
[140] *In re* Fiorano Tile Imps., Inc., 517 B.R. 409, 411–12 (E.D.N.Y. 2014), *aff'd*, 619 F. App'x 33 (2d Cir. 2015).
[141] *Id.* at 413–14.
[142] *Id.*

appealed and moved to stay the confirmation order pending its appeal, but the stay was denied.[143]

Here, the plan was substantially consummated because the debtor had completed payment of priority and administrative claims to governmental agencies and had distributed almost all payments owed to unsecured creditors.[144] The inquiry thus turned on whether the appellant could satisfy the five *Chateaugay* factors to rebut the presumption of equitable mootness.

At the time of this appeal, the court could have effectuated relief by ordering the reversal of the confirmation order, and either dismissed or converted the case to a Chapter 7. This would have satisfed the first *Chateaugay* factor, which requires that the court can still order some effective relief.[145] The parties only disputed whether the second, third, and fourth *Chateaugay* factors were satisfied.

The appellant failed to satisfy the second *Chateaugay* factor—whether granting such relief would adversely affect the reemergence of the debtor as a revitalized entity—and the fourth *Chateaugay* factor—whether granting relief would affect the interests of parties who did not have an opportunity to participate in the proceedings. The plan at issue provided for a stay of action by taxing authorities and unsecured creditors, and cessation of payments would have allowed those creditors to bring claims against the debtor's principals.[146] The debtor owed significant assets to the highest-priority taxing authorities.[147] If those entities had exercised their respective statutory remedies in liquidation proceedings, there would be no funds left for payment of the general unsecured creditors. Reversing the confirmation order "would [have] eliminate[d] current requirements for the subrogation of internal salaries to repayment of outstanding claims, thus jeopardizing recovery for creditors now seeking repayment directly against the Debtor's principals."[148] The appellant's requested relief would have not only prevented the debtor from a successful reorganization, but would have also substantially implicated the interests of innocent third parties, the unsecured creditors not before the court.[149]

The appellant further failed to satisfy the third *Chateaugay* factor, because reversing the plan would have reversed the intricate transactions such as the completed payment of priority and administrative claims to governmental agencies made under the plan of reorganization.[150] Thus, the court found the appellant's appeal equitably moot.

---

[143] *Id.* at 414.
[144] *Id.* at 417.
[145] *Id.* (citing Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 953 (2d Cir. 1993)).
[146] *Id.* at 418.
[147] Brief for Debtor-Appellee at 18, *In re* Fiorano Tile Imps., Inc., 517 B.R. 409 (E.D.N.Y. 2014) (No. 14-3915).
[148] *In re Fiorano Tile Imps.*, 517 B.R. 409 at 418.
[149] *Id.*
[150] *See id.*

V. INCREASING FREQUENCY OF EQUITABLE MOOTNESS FINDINGS IN THE SECOND CIRCUIT

All three district court cases, *In re ION Media Networks, Inc.*, *In re Grubb & Ellis Co.*, and *In re Fiorano Tile Imports, Inc.*, in the Second Circuit since the 2012 *Charter* decision found appellants' appeals to be equitably moot. This can primarily be attributed to the Second Circuit's unique presumption of equitable mootness once a plan has been substantially consummated.

For example, the appellants in *ION Media Networks* and *Fiorano* filed motions for a stay pending appeal, but the stays were denied.[151] Soon after, the debtors implemented their plans of reorganization, and they was substantially consummated. The Second Circuit has a median filing time of 11.1 months.[152] Given the long waiting period, courts are often reluctant to grant motions for stay pending appeal in a Chapter 11 case. Granting such an extended stay would likely impair the success of a reorganization, and bankruptcy proceedings are designed to proceed fairly quickly. The longer a Chapter 11 case continues, the greater the direct costs, indirect costs, and the opportunities for redirection of finite assets from creditors to the pocketbooks of managers, professionals, shareholders, and others.[153] A petition for certiorari after *Charter* states that "stay requests halting bankruptcy reorganizations are rarely granted and, when granted, often require appellants to post substantial bonds."[154]

Moreover, the lengthy period of time between the confirmation of a plan and the appeal makes it more likely that plan proponents will substantially consummate the plan. In fact, plan proponents may even be incentivized to quickly implement a sophisticated corporate reorganization due to the presumption of equitable mootness. [155] In *Paige*, the Tenth Circuit explicitly rejected the presumption of equitable mootness and found that "the parties attempting to convince the court not to reach the merits have accelerated the consummation of the plan despite their knowledge of a pending appeal."[156] The party inviting the court not to reach the merits of an appeal should carry the burden of proof and be required to demonstrate why it would be unfair or impracticable for the court to reverse the confirmed plan.

In contrast to the Second Circuit, the Third Circuit emphasizes that the party raising equitable mootness has the burden of "overcoming the strong presumption" that confirmation appeals should be decided, even following substantial consummation.[157] It is easier for the party raising equitable mootness to satisfy the burden of proof that the appellant will fatally scramble the plan. This strikes the correct balance by giving the appellant a

---

[151] *Id*. at 414; *In re* ION Media Networks, Inc., 480 B.R. 494, 497 (S.D.N.Y. 2012).

[152] Jumbeck, *supra* note 11 (citing ADMIN. OFF. U.S. COURTS, U.S. COURTS OF APPEALS FEDERAL COURT MANAGEMENT STATISTICS: U.S. COURT OF APPEALS SUMMARY 2 (2016)).

[153] James J. White, *The Virtue of Speed in Bankruptcy Proceedings*, 40 L. QUADRANGLE NOTES 76, 77 (1997).

[154] Petition for Writ of Certiorari at 45, Law Debenture Tr. Co. of N.Y. v. Charter Commc'ns, Inc., 569 U.S. 968 (2013) (No. 12-847).

[155] *See id.* at 24–25.

[156] Search Mkt. Direct, Inc. v. Jubber (*In re* Paige), 584 F.3d 1327, 1340, 1343 (10th Cir. 2009).

[157] Tribune Media Co. v. Aurelius Cap. Mgmt., L.P., 799 F.3d 272, 277–78 (3d Cir. 2015).

right to review and relief, but also allowing a court to find mootness if too many intricate transactions would be unraveled.

In addition to having to overcome the presumption of mootness, appellants in the Second Circuit have difficulty proving that the requested relief will not unravel intricate transactions so as to knock the props out from under the authorization of every transaction that has taken place and create an unmanageable, uncontrollable situation for the court—the third *Chateaugay* factor. The chart below makes it clear that all three appellants in the district court cases failed to satisfy the third *Chateaugay* factor.

Table 1: Reasons Appellants Could Not Rebut the Presumption of Equitable Mootness[158]

District Court Cases	Failed Charter Factors				
	1. Relief Not Available	2. Debtor's Reemergence Affected	3. Intricate Transactions Unraveled	4. Affected Parties Can't Participate	5. Failed to Ask for Stay
In re ION Media Networks, Inc.		*X*	*X*		
In re Grubb & Ellis Co.			*X*		*X*
In re Fiorano Tile Imports, Inc.		*X*	*X*	*X*	

Chapter 11 bankruptcies involve intricate transactions and long-negotiated compromises between a debtor and multiple constituencies. Often, as in *Fiorano*, a creditor requests that a plan be reversed, which leads to "an unmanageable, uncontrollable situation" requiring a court to undo multiple transactions. This makes it difficult for the appellant to succeed in their appeal, even if the plan of reorganization contains provisions that do not comply with the Bankruptcy Code.

The third *Chateaugay* factor may be correlated with the second *Chateaugay* factor, requiring the requested relief to not affect a debtor's re-emergence from bankruptcy. According to Table 1, the appellants in *ION Media Networks* and *Grubb & Ellis* could not prove either the second or third *Chateaugay* factors. The ability to meet the second and third *Chateaugay* factors may be rooted in similar underlying components. For example, where a plan includes many different classes of creditors and debt priorities that can affect the debtor's reemergence if payment is immediately required, there also tends to be intricate transactions present. Such intricate transactions include a payment schedule based on the classes under which creditors fall. The court in *ION Media Networks* pointed to the negotiation between the first priority lien holders, second priority lien holders, and unsecured creditors as a key consideration.[159] Similarly, the court in *Fiorano*

[158] Table 1 was produced independently but relies on New York district court cases. *See In re* Carrega v. Grubb & Ellis Co. (*In re* Grubb & Ellis Co.), 523 B.R. 423 (S.D.N.Y. 2014); *In re* Fiorano Tile Imps., Inc., 517 B.R. 409 (E.D.N.Y. 2014), *aff'd*, 619 F. App'x 33 (2d Cir. 2015); *In re* ION Media Networks, Inc., 480 B.R. 494 (S.D.N.Y. 2012).

[159] *In re* ION Media Networks, Inc., 480 B.R. 494, 499–501 (S.D.N.Y. 2012).

emphasized the different priorities of the tax claims, salary claims, and general unsecured claims to justify not finding the two factors.[160] This suggests that New York district courts may heavily consider the existence of varying priorities of debt in finding equitable mootness.

VI. EQUITABLE MOOTNESS SHOULD BE FURTHER LIMITED IN THE SECOND CIRCUIT

Although there are some policy reasons to retain the doctrine of equitable mootness, there has been increasing criticism of the doctrine in recent years. The primary public interest in retaining the doctrine is to promote successful debtor reorganizations. According to *BGI*, the doctrine centers around "the need for finality, and the need for third parties to rely on that finality."[161] Unstayed bankruptcy court confirmation should not be routinely vulnerable to nullification because third parties have relied on a confirmed plan. Rather, these innocent third parties should be protected from the unfairness of a sudden reversal of the plan on appeal.

The doctrine of equitable mootness allows the reorganized entity to maximize value because third parties can be more confident in a reorganization plan knowing that the result of their extensive negotiations will not be reversed. The greater the chance that prior transactions and negotiations will be unraveled, the less money parties will pay for the debtor's securities or assets.[162] After all, uncertainty involves higher costs. The doctrine of equitable mootness should be retained because eliminating the doctrine would increase the transaction costs of Chapter 11 reorganizations when third parties price in the increased risk of a successful appeal.

Moreover, not only would the debtor and third-party creditors have to incur greater transaction costs from a reversed plan of reorganization, but the court would also have to expend more time and effort to deal with its aftermath. Thus, a test for equitable mootness that prevents a plan from unraveling into an unmanageable situation for the court would support the public interest.

In spite of the right to review, equitable mootness avoids the difficulty of unscrambling complex transactions. Too many reversals would make Chapter 11 cases chaotic and could lower the likelihood of successful reorganizations. The transaction costs of litigating equitable mootness is negligible in comparison to the benefits if the appeal is dismissed to preserve a reorganized business.[163] Thus, the doctrine should be preserved but limited for the public interest.

However, Judge Krause's scathing critique of equitable mootness in *In re One2One Communications*, LLC, 805 F.3d 428 (3d Cir. 2015) outlines the

[160] *In re* Fiorano Tile Imps., 517 B.R. at 418–19.
[161] Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 772 F.3d 102, 107 (2d Cir. 2014).
[162] Robert Miller, *Equitable Mootness: Ignorance is Bliss and Unconstitutional*, 107 KY. L.J. 269, 280 (2018).
[163] *Id.* at 272.

varying problems with equitable mootness.[164] Judge Krause argues that (1) equitable mootness is a "legally ungrounded and practically unadministrable judge-made abstention doctrine";[165] (2) the doctrine has been too broadly expanded to non-complex bankruptcy cases;[166] and (3) rather than promoting finality, equitable mootness has only "promote[d] uncertainty and delay."[167]

Bankruptcy disputes are generally governed by either the Bankruptcy Code or federal statute, but the doctrine of equitable mootness is not present in the Code.[168] Supreme Court Justice Samuel Alito, a notable critic of equitable mootness, condemned the doctrine for lacking a statutory basis in *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996).[169] This indicates that at least some conservative members of the current Supreme Court may oppose the application of equitable mootness.

The Supreme Court has also retreated from federal common law doctrines like equitable mootness over the years. Most recently, in February 25, 2020, the Supreme Court decided *Rodriguez v. FDIC*, 140 S. Ct. 713 (2020). The court unanimously invalidated the "Bob Richards rule," a federal common law rule that bankruptcy judges have used for decades to determine ownership of consolidated tax refunds.[170] Justice Neil Gorsuch, writing for the court, stated, "We took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking."[171] *Rodriguez v. FDIC* illustrates that the Supreme Court has pulled back on federal common law doctrines, which may not bode well for the doctrine of equitable mootness.

BGI exemplifies the increasingly broad application of equitable mootness to cases outside of complex Chapter 11 reorganizations. The court in *BGI* held that equitable mootness applies to Chapter 11 liquidations and Chapter 11 reorganizations.[172] Liquidation proceedings tend to reallocate distributions from one class of creditors to another.[173] Equitable mootness should not apply because third parties do not rely on the liquidated business's continued existence.[174] There are no creditors expecting long-term payments in a Chapter 11 liquidating plan, nor are there any investors in the nonexistent business.

The Third Circuit goes further and even applies the doctrine to class settlements. Judge Thomas Ambro's dissent criticized the application to class

---

[164] *See* One2One Commc'ns, LLC v. Quad/Graphics, Inc., 805 F.3d 428, 438 (3d Cir. 2015) (Krause, J., concurring).

[165] *Id.* (citing Samson Energy Res. Co. v. SemCrude, L.P. (*In re* Semcrude, L.P.), 728 F.3d 314, 317 (3d Cir. 2013)).

[166] *See id.* at 438–39 (Krause, J., concurring) ("[T]he doctrine . . . is limited in scope and should be cautiously applied . . . . Yet district courts have continued to invoke the doctrine in modest, non-complex bankruptcies and where appellants have sought limited relief.").

[167] *Id.* at 446–48.

[168] *See* Grupo Mexicano de Desarrollo, S.A. v. All. Bond Fund, Inc., 527 U.S. 308 (1999) (holding that the scope of federal equity jurisdiction extended only as far as traditional English courts of equity, limiting the general equitable powers of federal courts).

[169] *In re* Cont'l Airlines, 91 F.3d 553, 569–72 (3d Cir. 1996) (Alito, J., dissenting).

[170] Mitchell P. Reich, *A Swan Song for Federal Common Lawmaking in Bankruptcy Courts*, 39 AM. BANKR. INST. J 20, 20 (2020).

[171] Rodriguez v. FDIC, 140 S. Ct. 713, 718 (2020).

[172] Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 772 F.3d 102, 107 (2d Cir. 2014).

[173] Jumbeck, *supra* note 9, at 205.

[174] Jumbeck, *supra* note 9, at 205–06.

settlements in *In re Diet Drugs*, 582 F.3d 524 (3d Cir. 2009).[175] Judge Amrbro wrote, "[W]e extend beyond the bankruptcy context the controversial doctrine of equitable mootness, which applies only to attempts to 'unscramble complex bankruptcy reorganizations,' and 'even then is limited in scope and should be cautiously applied.' "[176]

Contrary to its design, in practice, equitable mootness may not be effective at promoting finality. The doctrine "promotes gamesmanship and encourages any party to invoke it no matter the chance of success."[177] Plan proponents use equitable mootness as a sword, rush to implement plans, and equitably moot any appeal.[178] The presumption of equitable mootness in the Second Circuit especially incentivizes appellees to rapidly implement the plan, because dismissing an appeal has many benefits. There are few risks but many benefits for the plan proponent in rushing to consummate the plan.

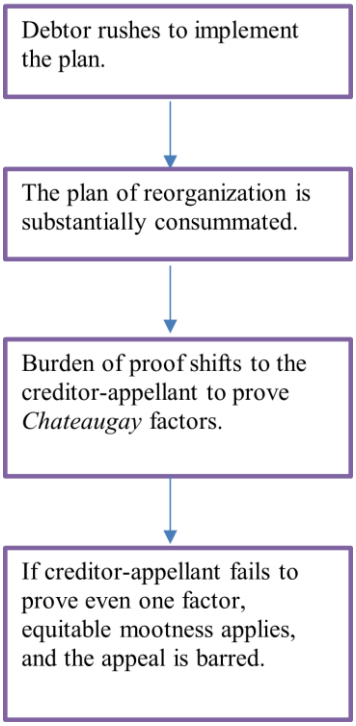
This gamesmanship leads to appellants almost certainly having to prove the *Chateaugay* factors to avoid the application of equitable mootness. If the lower court determines equitable mootness, the appellant may further need to file a second appeal, arguing that equitable mootness was applied erroneously. For example, in *Fiorano,* the appeal of the district court's application of equitable mootness extended the bankruptcy case by over a year. The district court delivered its decision on September 12, 2014.[179] In an unpublished opinion, the Second Circuit finally affirmed the district court's ruling on October 19, 2015.[180] Here, refusing to hear the merits of an appeal did not achieve finality, but in fact prolonged the case as much as entertaining an appeal would have. Delays in the bankruptcy process increase the direct costs, indirect costs, and the opportunities for redirection of finite assets from creditors to the pocketbooks of managers, professionals, shareholders, and others.[181] In this case, equitable mootness almost certainly increased the transaction costs of the bankruptcy case in the form of attorney's fees.

Although courts should continue applying the doctrine of equitable mootness because it is important to have successful reorganizations, Congress or the Supreme Court should limit the doctrine to minimize the risk of overlooking legal errors. First, the Second Circuit should eliminate the presumption of equitable mootness where a plan has been substantially consummated. The presumption increases the frequency at which a litigant's appeal rights are extinguished, and thus increases the risk of legal error. The presumption of equitable mootness shifts the burden of proof to the appellant, who can only rebut this presumption by successfully proving all five *Chateaugay* factors. If the appellant fails to prove even one factor, the court bars the appeal based on equitable mootness. As seen in the New York district court cases, the difficulty of proving all five *Chateaugay* factors acts at best as a deterrent for appeals of substantially consummated plans, and at worst it is an insurmountable barrier. As illustrated by Figure 1 below, by

[175] *See In re* Diet Drugs, 582 F.3d 524, 557 (3d Cir. 2009) (Ambro, J., dissenting).
[176] *Id.* (quoting *In re* PWS Holding Corp., 228 F.3d 224, 236 (3d Cir. 2000)).
[177] Miller, *supra* note 162, at 291.
[178] *Id.* at 292.
[179] *See In re* Fiorano Tile Imps., Inc., 517 B.R. 409 (E.D.N.Y. 2014), *aff'd*, 619 F. App'x 33 (2d Cir. 2015).
[180] *See id.*
[181] White, *supra* note 153.

placing the burden of proof on an appellant, the party who raises an appeal, it is more likely that the court will find equitable mootness.

Figure 1: Effects of Equitable Mootness Presumption



Second, the Second Circuit should join the Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits in adopting a de novo standard of review rather than an abuse of discretion standard in reviewing earlier determinations of equitable mootness. Because it is easier to overturn a decision when reviewing de novo, the court would further incentivize plan opponents to challenge an equitable mootness determination, increasing the likelihood of their success. Meanwhile, the current abuse of discretion standard in the Second Circuit makes it more difficult to challenge a district court's application of mootness.

Third, the doctrine of equitable mootness should be limited to Chapter 11 reorganizations. Applying the doctrine beyond Chapter 11 reorganizations to Chapter 11 liquidations or Chapter 7 cases sees decreased benefits because those cases involve less complex transactions. Finality can be seen as less important in simple bankruptcy cases because unraveling the plan of reorganization involves lower transaction costs and less reliance by third parties.

VII. THE BLUE PENCIL METHOD ALTERNATIVE

"Blue penciling" means striking or rewriting an unenforceable or illegal provision.[182] This solution is a fairer alternative to equitable mootness because it assimilates the concerns of finality with the appellant's right to review. Rather than dismissing appeals as equitably moot, courts have allowed parties to seek disgorgement of plan distributions or professional fees, or strike indemnification provisions or plan releases.[183] Blue penciling addresses the concerns central to equitable mootness by granting more limited relief to appellants where legal merit exists.

With no current congressional remedy or a decision from the Supreme Court on equitable mootness, judges should readily adopt blue penciling as a more flexible approach. The limited remedy of disgorgement may be able to preserve the intricate transactions of a confirmed plan and grant relief to an appellant. Requesting blue penciling seems to be most effective in large, complex reorganizations with large amounts of money at stake. The disgorgement of only a small percentage of the total assets allows judges to grant the remedy more easily because the debtor's operations will not likely be affected.

For example, the Third Circuit allowed parties to blue pencil specific plan provisions in *In re Tribune*. The appellants sought disgorgement from other creditors of thirty million dollars, which would not jeopardize the $7.5 billion-dollar plan of reorganization or harm third parties.[184] The court found that "it would not be inequitable to require the parties to an illegal agreement to disgorge their ill-gotten gains, participation in the appeal or not," and granted disgorgement.[185] Requesting blue penciling as relief allows a court to use a scalpel to decrease legal errors and preserve the right to review.

More recently, the Second Circuit has also shown support for blue penciling. It elected for the blue penciling of an interest rate in a confirmed plan rather than finding the appeal to be equitably moot in *In re MPM Silicones, L.L.C.*[186] Its analysis focused on the fifth *Chateaugay* factor, requiring "the appellant [to] pursue with diligence all available remedies to obtain a stay of execution of the objectionable order."[187] Interestingly, the court read the fifth *Chateaugay* factor to mean that if a stay is sought, the court should provide a different form of relief if at all feasible.[188]

In *MPM Silicones*, the senior lien noteholders contended that there should be a new interest rate provision based on the market rate.[189] The confirmed plan gave the senior-lien note holders an interest rate based on the formula rate.[190] Formula rates are calculated from the prime rate, usually the interest rate at which banks lend to customers with good credit, with an

---

[182] Elberg et al., *supra* note 81.
[183] *Id.*
[184] Tribune Media Co. v. Aurelius Cap. Mgmt., L.P., 799 F.3d 272, 274 (3d Cir. 2015).
[185] *Id.* at 278.
[186] *See* Apollo Glob. Mgmt., LLC v. Bokf, NA (*In re* MPM Silicones, L.L.C.), 874 F.3d 787, 791 (2d Cir. 2017).
[187] Chateaugay Corp. v. LTV Steel Co. (*In re* Chateaugay Corp.), 10 F.3d 944, 953 (2d Cir. 1993).
[188] *In re* MPM Silicones, 874 F.3d at 804–05.
[189] *Id.* at 798.
[190] *Id.* at 798–800.

adjustment upwards for risk.[191] Because the formula rate starts off at the lower prime rate percentage, in practice, the resulting interest tends to be lower than the market rate even after adjusting for risk.

Based on the noteholders' objections, the Chapter 11 debtor argued that the appeal should be dismissed as moot.[192] The debtor contended that granting relief would alter a critical piece of the confirmed plan after intense multi-party negotiation and that "such relief would cause debilitating financial uncertainty to the emergent Debtor."[193]

Equitable mootness is an all-or-nothing remedy that prevents any appeal of the plan if granted. In *In re MPM Silicones, L.L.C.*, the Second Circuit wrote,

> Equitable mootness issues only arise in earnest following a judicial determination that some facet of a reorganization plan violates the Code. It is generally considered inappropriately harsh to deny relief to which one is entitled on the purportedly equitable ground that the unfair (or illegal) plan has been put into effect, especially where a creditor took all appropriate steps to secure judicial relief. In such a case, we have held that it is proper to provide relief if it is at all feasible.[194]

The court criticized the harshness of equitable mootness because it terminated the appellant's right to review and relief.

In effect, the court endorsed blue penciling as an alternative form of relief and substituted the market rate of interest for the formula rate.[195] In this case, blue penciling of the interest rate would, at most, disgorge the debtor of thirty-two million dollars in additional annual payments to the noteholders over seven years.[196] Given that the scale of the reorganization was over a billion dollars, thirty-two million dollars would not unravel the plan or threaten the debtor's emergence from bankruptcy.[197]

The decision in *MPM Silicones* indicates that invoking the doctrine of equitable mootness may have become more difficult in the Second Circuit, especially where appellants have diligently sought a stay. There, MPM had substantially consummated its confirmed plan, but the court still emphasized alternative forms of relief based on the fifth *Chateugay* factor. Going forward, practitioners representing appellants should be sure to suggest blue penciling as a feasible form of relief. This is especially true in large Chapter 11 cases in which sophisticated parties have likely sought a stay and some disgorgement would probably not threaten a debtor's emergence.

[191] *Id.* (citing Till v. SCS Credit Corp., 541 U.S. 465, 478–79 (2004)).
[192] *Id.* at 805.
[193] *Id.*
[194] *Id.*
[195] *Id.* at 805–06.
[196] *Id.* at 805.
[197] *Id.*

VIII. CONCLUSION

The Supreme Court has repeatedly declined to address the issue of equitable mootness. On October 5, 2015, the Supreme Court denied certiorari for *BGI.*[198] On March 21, 2016, the Supreme Court denied certiorari for *In re Tribune*.[199] On June 18, 2018, the Supreme Court denied certiorari for *MPM Silicones*.[200] But there still remain substantive differences in how Circuit courts apply the the doctrine of equitable mootness. Different Circuit courts currently consider different factors and have different standards of review.

If the Supreme Court chooses to review the issue of equitable mootness, there may be a concern that equitable mootness is a judge-made doctrine unsupported by statute. Justice Alito's strong opposition to the doctrine during his tenure in the Third Circuit could suggest that the current Supreme Court would limit the doctrine.

New York district court cases after *Charter* heavily weighed the presumption of equitable mootness after substantial consummation of a plan. Appellants have had difficulty overcoming the presumption of mootness because it is difficult to prove the third *Chateaugay* factor. The third *Chateaugay* factor requires that the requested relief would not unravel intricate transactions set forth by a confirmed plan.

However, the Second Circuit's most recent decision in *MPM Silicones* appeared to signal a retreat from its historic broad application of equitable mootness. The court in *MPM Silicones* focused on the fifth *Chateugay* factor's implication of finding an alternative form of relief "if it is at all feasible." As a result, the court allowed the blue penciling of an interest rate. Judges typically grant the remedy of blue penciling and disgorgement in large, complex reorganizations. Consequently, because this remedy harmonizes an appellant's right to review with the need for finality in a bankruptcy case, it should be used more expansively.

[198] Beeman v. BGI Creditors' Liquidating Tr. (*In re* BGI, Inc.), 772 F.3d 102 (2d Cir. 2014), *cert denied*, 577 U.S. 827 (2015).

[199] Tribune Media Co. v. Aurelius Cap. Mgmt., L.P., 799 F.3d 272, 274 (3d Cir. 2015), *cert denied*, 577 U.S. 1230 (2016).

[200] Apollo Glob. Mgmt., LLC v. BOKF, NA (*In re* MPM Silicones, L.L.C.), 874 F.3d 787 (2d Cir. 2017), cert. denied, 138 S. Ct. 2653 (2018), *cert denied sub nom*, BOKF, N.A. v. Momentive Performance Materials, Inc., 138 S. Ct. 2653 (2018).