

Bankruptcy Alert

Third Circuit Narrowly Construes Doctrine of Equitable Mootness

August 10, 2012

On July 26, 2012, the bankruptcy-influential United States Court of Appeals for the Third Circuit (the “Third Circuit”) determined in *In re Philadelphia Newspapers, LLC*, __ F.3d __, 2012 WL 3038578 (3d Cir. 2012) (“*Philly News*”) that the doctrine of equitable mootness should be construed narrowly. The doctrine of equitable mootness permits a court to dismiss an appeal even when the court has jurisdiction and can grant relief if “implementation of that relief would be inequitable.”¹ The doctrine has, from time to time, been used successfully to curtail appeals that, if granted, could upset a carefully balanced Chapter 11 plan of reorganization. The Honorable Thomas L. Ambro, a leading bankruptcy jurist and member of the Third Circuit, authored the *Philly News* opinion and explained that an appeal cannot be dismissed as equitably moot solely on the grounds that a Chapter 11 plan has been substantially consummated, but, nonetheless, denied an appeal from denial of an administrative expense claim in this case on the merits.² While the decision does not alter the multi-factor test that courts within the Third Circuit apply to determine the applicability of the equitable mootness doctrine, the court stated that the application of the doctrine by lower courts has become “far too expansive,” and that it should be “limited in scope and cautiously applied.”³ The decision is a clear directive to lower courts to apply the doctrine narrowly, and analyze carefully whether a successful appeal would, in fact, truly unscramble a complex reorganization.

The appeal in *Philly News* arose out of the bankruptcy court’s denial of an administrative expense claim in connection with an alleged postpetition act of defamation. Before the bankruptcy court, the debtors sought and received an expedited hearing on the administrative claim, and the bankruptcy court determined that the claimants had failed to demonstrate entitlement to the administrative claim. Following the ruling, however, the claimants failed to seek any stay pending appeal. Subsequently, a sale of the debtors’ assets occurred and their plan of reorganization, pursuant to which the sale took place, went effective. As part of the purchase agreement, the buyer agreed to assume certain administrative expense claims, but not the claim at issue in this case.

The claimant appealed the bankruptcy court’s denial of its claim, but the district court held that the appeal was equitably moot because “the plan had been substantially consummated and no stay was sought.”⁴ Notwithstanding its determination with respect to equitable mootness, however, the district court went on to evaluate the merits of the case and affirmed the bankruptcy court’s conclusion that the claimants had failed to demonstrate entitlement to the administrative claim.

In reversing the decision of the district court with respect to equitable mootness, the Third Circuit explained that courts apply certain bankruptcy-specific “prudential” considerations to determine whether an appeal is equitably moot following the confirmation of a plan of reorganization. Specifically, courts consider the following factors: (1) whether the plan at issue has been substantially consummated; (2) whether the moving party has obtained a stay; (3) whether the relief requested would affect the rights of parties not before the court; (4) whether the relief requested would affect the

¹ *In re Phila. Newspapers, LLC*, __ F.3d __, 2012 WL 3038578, at *3 (3d Cir. 2012) (internal citations omitted).

² Akin Gump Strauss Hauer & Feld LLP represented the debtors in the appeal.

³ *In re Phila. Newspapers, LLC*, __ F.3d __, 2012 WL 3038578, at *5.

⁴ *Id.* at *3.



success of the plan; and (5) the public policy implications of “affording finality to bankruptcy court judgments.”⁵ After considering each factor, the Third Circuit concluded that “[t]aken together, these factors recognize that a court should only apply the equitable mootness doctrine if doing so will unscramble complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract.”⁶

Applying this principle, Judge Ambro held that allowing the appeal in this case to proceed would not risk uprooting the debtors’ plan, which had long since gone effective. Further, Judge Ambro criticized the district court for failing to look beyond the fact that the plan had gone effective and no stay had been sought, noting that the decision was devoid of any specific analysis regarding whether a favorable ruling would, in fact, upset the plan. Judge Ambro also observed that the equitable mootness doctrine has become “unjustifiably expansive” and, in its present form, could “easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization plans. It thus places far too much power in the hands of bankruptcy judges.”⁷

In distinguishing the facts of *Philly News* from the Third Circuit’s decision in *In re Continental Airlines*,⁸ the last significant pronouncement by the Third Circuit on the doctrine of equitable mootness, Judge Ambro observed that in *Continental*, there was an express agreement between the debtor and investors premised on a limitation of the amount of administrative expense claims the investors would assume, which agreement was explicitly incorporated into the confirmed plan. Accordingly, a holding in favor of the appellant would have resulted in an additional and significant administrative expense claim that the buyer would be obligated to assume, which, in turn, would have uprooted the plan of reorganization. In the present case, by contrast, there was no such express limitation. Indeed, the administrative expense claim in this case did not factor into the buyer’s calculus at the time of the sale, and the expedited hearing regarding the allowance of such claim provided the buyer with the certainty necessary to close the transaction. Therefore, Judge Ambro found that the administrative claim amounting to 1.7% of the purchase price would not risk unraveling the sale or the plan and, accordingly, held that the appeal was not equitably moot.

CONTACT INFORMATION

If you have any questions concerning this alert, please contact—

Fred S. Hodara
fhodara@akingump.com
212.872.8040
New York

Sara L. Brauner
sbrauner@akingump.com
212.872.7453
New York

Abid Qureshi
aqureshi@akingump.com
212.872.8027
New York

⁵ See *id.* at *4.

⁶ *Id.* (internal citations omitted).

⁷ *Id.* at *11, n.12 (quoting *Nordhoff Investments, Inc. v. Zenith Electronics Corp.*, 258 F.3d180, 191 (3d Cir. 2001) (Alito, J., concurring)).

⁸ *In re Cont’l Airlines*, 91 F.3d at 560 (holding that reversal of the plan’s confirmation would “create an unmanageable, uncontrollable situation for the Bankruptcy Court”).