In re Charter Communications: Driving the Equitable Mootness Wedge Deeper?

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On the heels of the Third and Ninth Circuits' equitable mootness rulings in *In re Philadelphia Newspapers, LLC*, 690 F.3d 161 (3d Cir. 2012), and *In re Thorpe Insulation Co.*, 671 F.3d 980 (9th Cir. 2012), *amended and superseded on denial of rehearing en banc*, 677 F.3d 869 (9th Cir. 2012), the Second Circuit issued its own decision in *In re Charter Communications, Inc.*, 691 F.3d 476 (2d Cir. 2012), which deepens a split among the circuit courts of appeal with respect to the standard of review and burden of proof to be applied in equitable mootness cases. In so ruling, the Second Circuit put itself at odds with several recent equitable mootness decisions from other circuits and made a number of equitable mootness issues ripe for review by the Supreme Court.

Equitable Mootness

"Equitable mootness" is a judge-made doctrine under which an appellate court may dismiss an appeal, even when effective relief could conceivably be fashioned, if it finds that implementation of that relief would be inequitable. In bankruptcy, equitable mootness issues often arise in appeals from orders confirming chapter 11 plans, where plan proponents attempt to preclude appellate review by arguing that the relief sought by the appellant would upset a "substantially consummated" plan and lead to an unraveling of a debtor's restructuring. In these cases, appellate courts have sought to strike the proper balance between the importance of finality in bankruptcy proceedings and a litigant's right to appellate review of, and relief from, a bankruptcy-court order.

The threshold inquiry in applying the equitable mootness doctrine is whether a chapter 11 plan has been "substantially consummated." Pursuant to section 1101(2) of the Bankruptcy Code, substantial consummation occurs when substantially all of the proposed transfers in a plan are consummated, the successor company has assumed control of the debtors' business or property, and the distributions called for by the plan have commenced. Once a plan has been substantially consummated, it often becomes difficult for an appeal to withstand dismissal on equitable mootness grounds.

Several circuit courts have adopted multifactored tests to determine whether the doctrine of equitable mootness should apply in appeals of confirmation orders. These factors typically include an examination of whether: (i) the appellant sought to stay the execution of the objectionable order; (ii) the plan has been substantially consummated; (iii) the court can still order some effective relief; (iv) parties who would be adversely affected by the relief sought in the appeal have notice of the appeal and an opportunity to participate in the proceedings; and (v) the relief would require the unraveling of complex transactions and/or affect the re-emergence of the debtor as a reorganized entity. *See*, *e.g.*, *Charter Communications*, 691 F.3d at 482; *Thorpe Insulation*, 677 F.3d at 881; *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). The circuits differ, however, with respect to the weight placed on these factors. *Compare Charter Communications*, 691 F.3d at 582 (appeal presumed moot where plan has been substantially consummated) *with In re Philadelphia Newspapers, LLC*, 690 F.3d 161, 168–69 (3d Cir. 2012) (foremost consideration is "whether allowing appeal to go forward will undermine the plan, and not merely whether the plan has been substantially consummated") *and In re*

Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009) (no mootness where there would be no significant adverse consequences to the reorganization from appellate review).

Prior to *Charter Communications*, the circuit courts of appeal uniformly required the party asserting equitable mootness to bear the burden of proof on appeal. *See Thorpe Insulation*, 677 F.3d at 880; *Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327, 1339–40 (10th Cir. 2009); *accord Ala. Dep't of Econ. & Cmty. Affairs v. Ball Healthcare-Dallas, LLC (In re Lett)*, 632 F.3d 1216, 1226 (11th Cir. 2011); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 210 (3d. Cir. 2000). With respect to the standard of review, however, the circuit courts have been split between applying a *de novo* or an abuse-of-discretion standard. In one of the earliest circuit-court cases addressing this issue, the Third Circuit in *Continental Airlines* adopted the abuse-of-discretion standard in reviewing a district court's equitable mootness decision. The Tenth Circuit later adopted the same approach in *Paige*.

In a dissenting opinion in *Continental Airlines*, however, then-circuit judge Samuel Alito "strongly disagree[d]" with the majority's adoption of the abuse-of-discretion standard, arguing that courts of appeal and district courts are equally fit to decide the mootness issue because they share the appellate function in bankruptcy cases. The Sixth Circuit later adopted Judge Alito's reasoning, and at least three other circuits also review equitable mootness dismissals under a *de novo* standard of review. *See Curreys of Neb., Inc. v. United Producers, Inc. (In re United Producers, Inc.)*, 526 F.3d 942, 946–47 (6th Cir. 2008); *Thorpe Insulation*, 677 F.3d at 880; *Liquidity Solutions, Inc. v. Winn-Dixie Stores, Inc. (In re Winn-Dixie Stores, Inc.)*, 286 F. App'x

619, 622 & n.2 (11th Cir. 2008); *United States v. GWI PCS 1 Inc. (In re GWI PCS 1 Inc.)*, 230 F.3d 788, 799–800 (5th Cir. 2000).

Charter Communications

In March 2009, Charter Communications, Inc., and its affiliates (collectively, "Charter"), the nation's fourth-largest cable television company and a leading provider of cable and broadband service, filed a pre-negotiated chapter 11 case in New York with more than $24 billion in debt. The effort to develop a plan of reorganization for Charter was led by a group of junior bondholders and Paul Allen, a major investor whose ownership stake gave him control of the company.

The reorganization strategy was driven by the goal of reinstating Charter's senior credit facility with J.P. Morgan, which required Charter to cure any of its defaults to ensure that J.P. Morgan would be classified as an unimpaired creditor. In order to avoid triggering a default under Charter's credit agreement with J.P. Morgan, however, Allen had to retain his voting power in the company despite the fact that most of his investment would be wiped out.

To induce Allen's participation in the plan, Charter and the junior bondholders agreed to a settlement with Allen (the "Allen Settlement"), whereby Allen agreed to retain his voting interests in Charter in exchange for $375 million and release of all liability. In contrast, Charter's other noteholders stood to recover only 32.7 percent of their claims under the proposed plan, and equity holders (other than Allen) would receive nothing. The bankruptcy court confirmed Charter's chapter 11 plan in November 2009.

Both the bankruptcy court and a district court later denied motions for a stay of the confirmation order pending appeal, and the plan became effective on November 30, 2009. Charter immediately took actions contemplated by the plan, including cancelling the existing equity, issuing shares in the reorganized company, converting pre-petition notes into new notes, and issuing new warrants.

The indenture trustee for certain of Charter's notes and one of Charter's equity holders separately appealed the confirmation order, including the provision approving the Allen Settlement, on the grounds that the plan violated the absolute-priority rule and included an impermissible third-party release for Allen. The appellants claimed that the court could award monetary damages without undoing the Allen Settlement or the bankruptcy case and that the third-party releases could be excised from the Allen Settlement and the chapter 11 plan. The district court disagreed, however, and dismissed the appeals as equitably moot.

The Second Circuit's Ruling

The Second Circuit upheld the district court's rulings on equitable mootness, but in so doing, it may have created a difficult standard for governing attempted appeals of orders confirming chapter 11 plans that have been substantially consummated. First, the Second Circuit held that once a chapter 11 plan has been substantially consummated, an appeal is presumed to be equitably moot unless the appellant can demonstrate that it has met all five of the criteria delineated in its previous ruling in *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944 (2d Cir. 1993). To avoid dismissal on the basis of equitable mootness under *Chateaugay*, an appellant must demonstrate that:

> (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.

Id. at 952–53 (internal quotation marks omitted).

The Second Circuit found that the appellants had satisfied several, but not all, of the *Chateaugay* factors. The court concluded that the appellants had diligently pursued a stay of the confirmation order and that it was possible to order some effective relief without harming innocent parties. The Second Circuit also determined that all of the parties that would be affected by the relief sought in the appeal—namely, Charter itself, Allen, and Charter's creditors—were either parties to the appeals or active participants in the bankruptcy case. In upholding the decision below, however, the Second Circuit ruled that the district court did not abuse its discretion in determining that the relief sought by the appellants would "seriously threaten[ ] Charter's ability to re-emerge successfully from bankruptcy." According to the Second Circuit, the appellees had established a factual record sufficient to demonstrate that Allen's compensation and the third-party releases were "critical to the bargain" and that altering such provisions could lead to Allen's reneging on the Allen Settlement, thus leaving Charter's future uncertain. *Compare with In re Pacific Lumber*, 584 F.3d at 252 (striking third-party releases in a plan and declining to adopt the "more lenient approach to non-debtor releases taken by other courts," including the

Second Circuit); *In re Hilal*, 534 F.3d 498 (5th Cir. 2008) (appellate review of nondebtor release not equitably moot where there would be no potential adverse effect on the plan or third parties from hearing the appeal).

The appellants moved for a rehearing en banc, challenging the Second Circuit's determination that the requested relief would require an unwinding of the chapter 11 plan. Among other things, the appellants cited the Second Circuit's own statements that requiring Allen or reorganized Charter to make a monetary payment "would not impact reorganized Charter's financial health" or "send it spiraling back into bankruptcy." Also, the appellants argued, the Second Circuit itself noted with respect to the third-party releases that the Allen Settlement "expressly provided that the debtors' failure to secure the releases as part of the approved Plan would not breach the Allen Settlement." Other than broad statements that revisiting the terms of the Allen Settlement could "throw into doubt the viability of Charter's chapter 11 plan," the appellants claimed, the Second Circuit panel did not explain how such facts and provisions in the Allen Settlement could be reconciled with the court's determination that the requested relief would somehow scuttle the Allen Settlement. The Second Circuit denied the petition for rehearing.

Outlook

Charter Communications represents a departure from equitable mootness rulings by other circuits. By requiring satisfaction of all five *Chateaugay* factors and shifting the burden of proof from the plan proponents to the appellants, the Second Circuit appears to have broadened the scope of the equitable mootness doctrine and created substantial obstacles to obtaining relief from a confirmation order following substantial consummation of a chapter 11 plan. This doctrinal expansion seems to be at odds, however, with the court's acknowledged duty to

“carefully balance the importance of finality in bankruptcy proceedings against the appellant’s right to review and relief.” By appearing to abandon the balancing approach employed by other circuits in this context, the Second Circuit now stands alone in presuming that an appeal is equitably moot following substantial consummation of a chapter 11 plan. Given the complexity of plans in most large chapter 11 cases, it is likely that *Charter Communications* will erect a significant hurdle for future litigants seeking to appeal the confirmation of a substantially consummated chapter 11 plan in the Second Circuit.

Additionally, *Charter Communications* deepens the divide between the circuits with respect to the appropriate standard of review for equitable mootness. This deepening rift may be a compelling invitation to review by the U.S. Supreme Court.

One important issue that is not addressed in any of the equitable mootness cases before the circuits is a litigant’s ability to seek a direct appeal to the relevant circuit court of appeal from a bankruptcy court’s confirmation order under the circumstances specified in 28 U.S.C. § 158(d)(2)(A). In light of the rapidity with which chapter 11 plans may be substantially consummated following plan confirmation—and the substantial risk that a stay pending appeal of a confirmation order may be denied—appellants seeking to avoid an equitable mootness ruling on the basis of substantial consummation may be well served by asking the bankruptcy court to certify a direct appeal.