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Eighth Circuit Adopts Rigorous Standard for "Equitable Mootness" Dismissal

On August 5, 2021, the Eighth Circuit reversed a district court's decision to dismiss a confirmation order appeal as equitably moot.[1] The doctrine of equitable mootness can require dismissal of an appeal of a bankruptcy court decision – typically, an order confirming a chapter 11 plan – on equitable grounds when third parties have engaged in significant irreversible transactions in good faith reliance on that order. In a departure from the less rigorous equitable mootness standard typically applied by appellate courts, the Eighth Circuit held that the substantial consummation of the debtors' plan did not, standing alone, justify dismissal and that the district court should have undertaken "at least a preliminary review" of the appeal's merits.[2]

Background

On September 21, 2018, VeroBlue Farms USA, Inc. and its debtor affiliates (collectively, the "Debtors") commenced chapter 11 cases in the United States Bankruptcy Court for the Northern District of Iowa, listing an undisputed $54 million obligation to Broadmoor Financial, L.P. ("Broadmoor") under a credit facility (the "Credit Facility").[3] During the chapter 11 cases, FishDish LLP ("FishDish"), a minority shareholder, sought to investigate Broadmoor's relationship with Alder Aqua, Ltd. ("Alder Aqua"), the Debtors' dominant shareholder, which held a participation interest in the Credit Facility.[4] Specifically, FishDish sought to "uncover evidence which would justify subordinating or recharacterizing [Broadmoor's] prepetition claim" in an effort to obtain a recovery on account of its equity interests – which the Debtors proposed to cancel as part of their plan of reorganization (the "Plan").[5]

After its discovery requests were denied by the Bankruptcy Court, FishDish objected to confirmation of the Debtors' Plan.[6] However, the Bankruptcy Court overruled FishDish's objections and entered an order confirming the Plan.[7] FishDish appealed

1 *FishDish LLP* v. *VeroBlue Farms USA Inc.*, 6 F.4th 880 (8th Cir. 2021).

2 *Id*. at 890.

3 *Id*. at 884.

4 *Id*.

5 Brief of Appellant/Cross-Appellee, *FishDish, LLP* v. *Broadmoor Financial, L.P.*., No. 19-3413, No. 19-3487, 2019 WL 7376893 at *i (8th Cir. Dec. 18, 2019).

6 *VeroBlue*, 6 F.4th at 886–87.

7 *Id*. at 887.

the confirmation order, arguing that the Plan improperly favored Alder Aqua and was proposed in bad faith.[8] Without considering the merits, however, the District Court dismissed FishDish's appeal as equitably moot.[9]

The District Court's Dismissal of FishDish's Objection on Equitable Mootness Grounds

Courts sometimes dismiss matters on appeal without a review of the underlying merits based on a recognition that "even when the moving party is not entitled to dismissal on Article III grounds, common sense or equitable considerations may justify a decision not to decide a case on the merits."[10] Debtors and other plan proponents often argue that this "equitable mootness doctrine" should be applied to shield a bankruptcy court order from substantive review on appeal if the underlying plan has been "substantially consummated" and granting relief would harm third parties who relied on the finality of confirmation.[11] Although the doctrine has never been adopted by the Supreme Court, equitable mootness has been applied by many courts of appeal to dismiss confirmation order challenges.[12]

Applying the equitable mootness doctrine to FishDish's appeal, the District Court determined that the Debtors' plan had been substantially consummated after noting that: (a) Alder Aqua funded the Plan with $13.5 million; (b) the Debtors cancelled all of their outstanding stock and re-issued stock to Alder Aqua; (c) Broadmoor received $6 million from the Debtors and (d) Alder Aqua released its $5,025,000 claim under the Credit Facility, as well as its $2 million claim for debtor-in-possession financing.[13] The District Court accordingly concluded that it would be inequitable to unwind the underlying transactions and dismissed FishDish's appeal.[14]

The Eighth Circuit Reverses the District Court's Equitable Mootness Dismissal

Before *VeroBlue*, the Eighth Circuit had not addressed the equitable mootness doctrine.[15] After considering the history of the equitable mootness doctrine and its application by other courts, the Eighth Circuit cited concerns that "[p]roponents of reorganization plans now rush to implement them so they may avail themselves of an equitable mootness defense" and suggested that the Debtors' cases may have followed a similar pattern.[16] In addition, the Court observed that the only transfer contemplated by the Plan that had not yet taken place was Alder Aqua's commitment to invest substantial working capital in the Debtors.[17] The Court expressed concern that if this transfer did not take place because the reorganized Debtors were preparing for a quick asset sale in lieu of resuming operations, the case "takes on the look of the type of Chapter 11 plan [in need of] review on the merits by an Article III appellate court."[18]

Accordingly, the Eighth Circuit reversed the District Court's decision after concluding that "an inquiry into these issues" was required before equitable dismissal could be considered.[19] On remand, the Eighth Circuit instructed the District Court to

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8 *Id.* at 886.

9 *See FishDish, LLC* v. *VeroBlue Farms USA, Inc.*, No. 19-CV-3026, 2019 WL 4918758, at *4 (N.D. Iowa Oct. 4, 2019).

10 *VeroBlue*, 6 F.4th at 888 (citing *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994)).

11 *See In re Paige*, 584 F.3d 1327, 1339 (10th Cir. 2009).

12 *VeroBlue*, 6 F.4th at 883.

13 *Id*. at 886.

14 *Id*.

15 The Eighth Circuit had previously upheld a lower court's invocation of the doctrine without discussion in an unpublished, non-precedential opinion. *See In re President Casinos, Inc.*, 409 F. App'x. 31, 31–32 (8th Cir. 2010).

16 *VeroBlue*, 6 F.4th at 889 (citing *In re One2One Commc'ns, LLC*, 805 F.3d 428, 446–47 (3d Cir. 2015)).

17 *Id*. at 890.

18 *Id*.

19 *Id*.

undertake "at least a preliminary review of the merits" of FishDish's appeal as well as the equitable remedies that could be implemented (including possible dismissal) without undermining the Plan.[20]

Conclusion

Although *VeroBlue* did not expressly reject the equitable mootness doctrine, the Court's decision may curtail its application in the Eighth Circuit by requiring courts to review the merits of an appeal before invoking the doctrine. In addition, the Eighth Circuit cautioned that the doctrine should only be invoked in "extremely rare circumstances," predicting that the Supreme Court could limit its use "if equitable mootness instead becomes the rule of appellate bankruptcy jurisprudence, rather than an exception to the Article III-based rule that jurisdiction should be exercised."[21] The Supreme Court may indeed decide to clarify the doctrine, although it has thus far refused to do so – recently denying two petitions regarding the validity of the doctrine with respect to bankruptcy appeals.[22]

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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[20] *Id*.

[21] *Id*. at 891.

[22] *See Hargreaves* v. *Nuverra Envtl. Sols.*, No. 21-17, 2021 WL 4733333 (U.S. Oct. 12, 2021); *GLM DFW, Inc.* v. *Windstream Holdings, Inc.*, No. 21-78, 2021 WL 4508598 (U.S. Oct. 4, 2021).