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Equitable Mootness in the Municipal Bankruptcy Context

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Earlier this month, the Sixth Circuit provided to creditors of municipalities emerging from bankruptcy proceedings additional assurance that they can rely on the bankruptcy plan approved by a court.[1] In a 2-1 decision, the Sixth Circuit dismissed multiple appeals brought by approximately 135 participants in the city of Detroit's General Retirement System (GRS), or about 1.5 percent of the 8,541 GRS participants that voted on the plan (the "retirees"), seeking to challenge the city's approved bankruptcy plan because it altered benefits that they had pre-bankruptcy. Specifically, the Sixth Circuit found that because significant portions of the plan had already been implemented by the city, reversing certain terms of the plan would unavoidably unravel the entire plan. This would have significant negative impacts on the city and its over 100,000 creditors and 685,000 residents relying on the plan. Applying the doctrine of "equitable mootness," the Sixth Circuit dismissed the retirees' appeals.

The doctrine of equitable mootness protects the need for finality in bankruptcy proceedings. The doctrine supports the bankruptcy theme that third parties should be able to rely on the finality of an order confirming a bankruptcy plan without fear that after its implementation a court will later unscramble the often complex terms and agreements included in such bankruptcy plan. As explained in the decision, equitable mootness is concerned not with the court's ability or inability to grant relief, but instead with protecting the good-faith reliance on interests created by implementation of a bankruptcy plan from being undone afterward.

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Equitable mootness is more commonly seen in the context of appeals from a bankruptcy plan in a Chapter 11/ business reorganization case. Only a handful of courts have considered the doctrine in the municipal bankruptcy context. Prior to this ruling, the only circuit court to issue an opinion as to whether equitable mootness is applicable in a Chapter 9 proceeding was the U.S. Court of Appeals for the Ninth Circuit.[2] An appeal, however, is pending in the U.S. Court of Appeals for the Eleventh Circuit with respect to a finding by the U.S. District Court for the Northern District of Alabama in Bennett v. Jefferson County, 518 B.R. 613 (N.D. Ala. 2014), that equitable mootness does not apply in the Chapter 9 context.

In applying equitable mootness to the Detroit appeals, the Sixth Circuit panel saw no less interest in finality or good-faith reliance on the effectuation of a municipality's plan of adjustment than on that of a Chapter 11 private business entity, distinguishing itself from the U.S. District Court for the Northern District of Alabama's decision in Bennett. As stated above, the Bennett decision is currently on appeal to the Eleventh Circuit. Background and Application of the Doctrine of Equitable Mootness

On Nov. 12, 2014, the city of Detroit obtained approval of its bankruptcy plan, which represented the "Grand Bargain" orchestrated by the city with the vast majority of its creditors. The plan provided, among other things, for much-needed new funds from the state of Michigan and certain philanthropic foundations, reductions of existing debts, and cuts to the benefits provided to the employees and retirees in the GRS. As it played out in court and in the press, both during and after confirmation, it is clear the Grand Bargain was a hard-fought settlement affecting most creditors, obtained as a result of extensive court hearings and difficult settlement negotiations.

Following confirmation of the plan, the retirees filed appeals challenging the provisions of the plan that reduced their pensions and eliminated certain other benefits and cost-of-living increases. The district court dismissed the appeals as equitably moot, and appeals were taken to the Sixth Circuit.[3] As stated above, the panel majority dismissed the appeals as equitably moot.

Courts analyze equitable mootness under a three-part test:

1. whether a stay of the order confirming the plan has been obtained;
2. whether the plan has been "substantially consummated"; and
3. whether the relief would significantly and irrevocably disrupt the implementation of the plan or disproportionately harm the reliance interests of other parties not before the court.

The court found all three factors favored dismissal of the appeals.

First, the retirees had not obtained a stay of the plan. Second, the plan had been substantially consummated in that many significant — "even colossal" — actions had been taken since the plan went into effect on Dec. 10, 2014. A few examples cited in the decision included the city's issuance of over $1 billion in bonds and $720 million in new notes, the transfer of all Detroit Institute of Art assets to a perpetual charitable trust, and the transfer of certain real property interests, as well as the payment of many claim holders pursuant to settlements provided for under the plan.

Last, the panel majority found that the "Grand Bargain" reflected in the plan was contingent on the reductions to the GRS as negotiated and approved by the vast majority of the participants in the GRS. The Sixth Circuit panel believed that altering the pension reductions as requested by the retirees would nullify the Grand Bargain, unravel the plan, and harm the city, its creditors and its residents.

In writing for the majority, Sixth Circuit Judge Alice M. Batchelder stated that the appellants' cases were "not a close call." Further, the Sixth Circuit held that the doctrine of equitable mootness was created and intended exactly to prevent the unscrambling of such complex plans after they have been implemented. The court found that the "Grand Bargain" had already been implemented.

There was one dissenting judge. Sixth Circuit Judge Karen Nelson dissented from the majority opinion, questioning the appropriateness of the doctrine of equitable mootness in any bankruptcy case, including Chapter 9. Judge Nelson did not challenge the majority's finding of substantial consummation, or the finding that granting the appeal will significantly harm third parties. Rather, she opined that the application of equitable mootness is a derogation of the judicial obligation to decide cases. Judge Nelson stated:

> equitable mootness suggests that the importance of adjudicating the retirees' rights pales in comparison to the importance of protecting the expectations of lenders and others who have chosen to rely on Detroit's bankruptcy plan before appellate challenges to it were resolved.

The dissent, however, does not discuss the potential impact of an appellate process that can take years, particularly where no stay has been obtained. Even without delving into the merits of the appellants' claims, nearly two years have already passed since confirmation and implementation of the city's plan.

Conclusion

The Sixth Circuit's decision would not prevent well-meaning and concerned creditors from appealing an order confirming a Chapter 9 bankruptcy plan that they believe was confirmed in bad faith or in contravention to the requirements of the Bankruptcy Code and state law, but it does provide additional protection for creditors who have relied on the entry and substantial consummation of a municipality's bankruptcy plan. In order to do so, however, appellants will still be required to seek a stay of the order (which may require the posting of a substantial bond) or argue that the appeal is not equitably moot by showing that the plan has not been substantially consummated or that the requested relief will not significantly disrupt implementation of the plan or disproportionally harm other parties. In the absence of a stay, any appellant is at an increasing risk of finding its appeal is equitably moot as the plan becomes substantially consummated.

A petition for an en banc hearing of the Sixth Circuit is anticipated and, with a potential conflicting decision from the Eleventh Circuit, an appeal to the U.S. Supreme Court. Completion of the appellate process could therefore be a long way off.

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1. In re City of Detroit, Michigan, 2016 WL 5682704 (6th Cir. Oct. 3, 2016).

2. See In re City of Vallejo, 551 F. App'x 339 (2013), and In re City of Stockton, 542 B.R. 261, 273-74 (9th Cir. BAP 2015) (each applying the doctrine of equitable mootness); but see Bennett v. Jefferson County, 518 B.R. 613 (N.D. Ala. 2014) (declining to apply the doctrine of equitable mootness).
3. The multiple appeals filed by the retirees were consolidated into one case before the Sixth Circuit.

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