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January 5, 2016 Opportunities for Our Clients

11th Circuit Restricts Equitable Mootness

The Eleventh Circuit has become the latest federal appellate court to evidence a reluctance to dismiss appeals stemming from bankruptcy court decisions involving consummated plans and settlements based on notions of futility or equitable mootness. On Dec. 17, 2015, in In re Nica Holdings Inc.,[1] the Eleventh Circuit found that an appeal of a bankruptcy court decision was not equitably moot where the underlying litigation in the bankruptcy proceeding — which constituted the debtor's entire estate — had been settled and settlement funds had been transferred to the estate. After finding that the appeal was not equitably moot, the Eleventh Circuit took to the unusual action of remanding the proceeding and directing bankruptcy court dismissal of the case, after determining that the individual filing the Chapter 7 petition lacked the authority to put the debtor into bankruptcy.

Background

Nica Holdings co-owned a Nicaraguan tilapia farm with a Norwegian firm and an individual named Peter Ulrich. In 2007, the fish farm's business began to tank, and its owners found themselves fighting over the limited assets of the enterprise. The parties were faced with two viable options — filing a petition under the federal Bankruptcy Code, or entering into an assignment for the benefit of creditors (an "ABC") under Florida Law. An ABC is a state law creation that in many situations offers a streamlined and cheaper alternative to a bankruptcy proceeding, but without bankruptcy's privileges and protections. To enter into an ABC, the parties irrevocably assign their assets to a third party (an assignee) who disposes of those assets in accordance with state law.

In the case of Nica Holdings, the owners opted on July 12, 2012, to execute an ABC and the parties irrevocably assigned the enterprise's assets to an individual named Kenneth Welt, as assignee. Welt, in turn, hired an attorney from a large firm to assist him in the ABC liquidation. Due to apparent disputes among the parties, the case floundered in the ABC process and Nica Holdings was unable to effectively liquidate. And, as the Eleventh Circuit noted, "there [was] no shortage of finger-pointing" as to who prevent an "effective liquidation."[2]

Not surprisingly, lawsuits commenced. Ulrich blamed Welt and brought a civil suit against him in state court. In turn, Welt filed a malpractice claim in state court against the law firm. The only important undisputed fact was that Nica Holding's business had run dry, and that as a result, these two lawsuits were the only things of value held by the company.

In an apparent effort to tackle all the litigation issues in a single forum, Welt, purportedly on behalf of Nica Holdings, filed a petition under Chapter 7 of the Bankruptcy Code. Welt asserted that bankruptcy was "'the most expeditious and effective means of administering the remaining assets of Nica'" Holdings — namely the litigation assets.[3] Ulrich objected to the bankruptcy proceeding and asserted that Welt filed the action merely to block his removal as the ABC assignee and to protect himself from personal liability. Ulrich moved to dismiss the case, asserting that Welt lacked the authority to file a bankruptcy petition on behalf of Nica Holdings. The court denied Ulrich's request, and denied his motion to take an interlocutory appeal of the denial.[4]

Using the hook of the pending bankruptcy proceeding, the Chapter 7 trustee removed Ulrich's state court action against Welt to the bankruptcy court, and the Chapter 7 trustee moved to intervene as the sole plaintiff, claiming that the adversary proceeding was an estate asset. Once the case was removed to the bankruptcy court, the Chapter 7 trustee quickly moved to settle the action. Ulrich objected to the settlement of the adversary proceeding and filed a competing settlement offer with the court that he maintained was more beneficial to the estate. Despite this competing offer and objection by Ulrich, the bankruptcy court approved the trustee's settlement. Ulrich appealed to the district court, and the district court upheld the bankruptcy court's decision. As described by the Eleventh Circuit, the settlement of the adversary proceeding had the effect of shutting down the proceeding against Welt in favor of the malpractice claim against the law firm that had represented him.

Having settled with Welt, and with his motion for approval of that settlement pending, the Chapter 7 trustee then moved to settle the malpractice litigation against the law firm that had represented Welt. That lawsuit had also been removed to the bankruptcy court. Ulrich moved to stay this settlement, but the bankruptcy court approved the settlement anyway and denied his motion for stay, twice. The bankruptcy court first determined in a written order that Ulrich's oral motion to stay the malpractice settlement at the settlement hearing was premature. Once the settlement was approved, Ulrich then filed a written motion for stay pending appeal. This time, the

bankruptcy court determined that his motion for stay was too late because the parties had already consummated the malpractice settlement.

Apparently troubled by the lower court's bait-and-switch, the Eleventh Circuit allowed Ulrich's appeal.

Discussion

On appeal, the Eleventh Circuit followed a growing number of circuit courts that have questioned whether the doctrine of equitable mootness should cast quite as wide of a net as suggested by earlier cases.[5] Equitable mootness is a court-made doctrine under which an appellate court is permitted to dismiss an appeal of a bankruptcy court decision, where "even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable" because it would "unjustly upset[] a debtor's plan of reorganization."[6]

The classic example of a case where the doctrine might apply would be where, under a plan, substantial distributions of cash or stock have been made to a large, disparate group of "mom-and-pop" creditors, where recovering those distributions would be either legally impossible or practically unfeasible. In such cases, it is hard to conceive of relief for an appellant that would be both workable and would not upset the reasonable expectations of multiple innocent parties. But beyond that situation, the precise parameters of the doctrine have remained a matter for litigation.

The Eleventh Circuit effectively recognized in Nica Holding that whether or not an appeal is equitably moot is a fact-intensive determination that depends on the specific circumstances and issues presented in the case. The doctrine is not a license for debtors to leave their objecting creditors high and dry, without any rights of appeal. The court also noted that it was an open question whether the doctrine even applies in Chapter 7 cases, where there are no plans of reorganization, but was willing to assume that the doctrine does apply to Chapter 7 for the purpose of its analysis.

In Nica Holdings, the appellees (which included Welt and another individual) had asserted that the controversy was equitably moot because both the adversary proceeding and the malpractice claim, which constituted the only assets of Nica Holdings, had been settled.[7] The Eleventh Circuit, however, determined that this was not the proper analysis, but that "[c]entral to a finding of mootness is a determination by an appellate court that it *cannot* grant effective judicial relief."[8] The Eleventh Circuit then identified a multifactor analysis of whether a case is equitably moot or not, noting that no single factor is definitive.[9] The Eleventh Circuit identified the following questions as important to the equitable mootness inquiry:

> Has a stay pending appeal been obtained? If not, then why not? Has the plan been substantially consummated? If so, what kind of transactions have been consummated? What type of relief does the appellant seek to appeal? What effect would granting relief have on the interest of third parties not before the court? And, would relief affect the re-emergence of the debtor as a revitalized entity.[10]

In examining these factors, the Eleventh Circuit noted first that it could not fault Ulrich for not seeking relief from the stay at every conceivable point in the bankruptcy proceeding, finding that despite the multiple motions of Ulrich, "apparently there was never a time when Mr. Ulrich *could* file a motion to stay."[11] Moreover, while the settlement funds had been paid into the estate, no creditor had been paid from the estate from the settlement funds, and even if creditors had been paid, the settlements were "neither particularly complicated nor irreversible."[12] The court thus held that the scales tipped in favor of considering Ulrich's appeal.

Interestingly, after finding that Ulrich's appeal was not equitably moot, the Eleventh Circuit determined that Welt did not have the authority under Florida law to file a bankruptcy petition on behalf of Nica Holdings. Important to the court was that Nica Holdings, in appointing Welt as its agent, never granted Welt with "freewheeling power" to file a bankruptcy petition and that Florida law permitting ABCs did not provide an assignee such as Welt with such authority either. Ultimately, the Eleventh Circuit's decision had the effect of unwinding the entire bankruptcy case, including the two settlements central to the proceeding.

Conclusion

Nica Holdings is another decision in a line of cases that confirms an increasing reluctance on the part of appellate courts to dismiss appeals of consummated, confirmed plans based on notions of futility or equitable mootness. This is important because the ability of unsuccessful Chapter 11 plan objectors to secure stays pending appeal are typically very limited, particularly creditors who are relative small-fry, and therefore unable to post a bond.[13] Therefore, the availability of post-consummation appeals are often the only way that the objector can exercise its right to test the conclusions of the bankruptcy court in an appellate forum.

The decision is independently noteworthy, for two other reasons. First, the decision is a cautionary tale to parties that would file bankruptcy petitions on behalf of others without ensuring that the agent has been delegated the specific authority to file a bankruptcy petition for the debtor, rather than relying on some perceived general grant of authority. And secondly, the decision highlights the limits of assignments for the benefit of creditors as an effective substitute for federal bankruptcy proceedings. While the lure of the lower professional fee cost and putative control of the process may be enticing, where disputes arise, the state law process generally lacks the tools necessary to keep the debtor and its principals out of hot water.

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of participant concerns in such matters has earned Chapman's Litigation, Bankruptcy and Restructuring Group a distinct presence and reputation for both its strategic advice and creative approach to sophisticated, out-of-court restructurings. If a situation cannot be resolved consensually, we offer skilled representation to creditors, committees (formal and informal), bondholders and others in bankruptcy court and other forums across the nation.

1 Ulrich v. Welt (In re NICA Holdings, Inc.), ___ F.3d ___, 2015 WL 9241140 (11th Cir. Dec. 2015).

2 Id. at *1.

3 Id. at *1.

4 Id. at *2.

5 See, e.g., In re Transwest Resort Props. Inc., 791 F.3d 1140, 1145 (9th Cir. 2015) opinion withdrawn and superseded on reh'g, 801 F.3d 1161 (9th Cir. 2015); In re SCH Corp., 569 F. App'x 119 (3d Cir. 2014); JPMCC 2006-LDP7 Miami Beach Lodging LLC, et al. v. Sagamore Partners Ltd., 620 Fed. Appx. 864 (11th Cir. 2015); but see In re Fiorana Tile Imports Inc., 619 Fed. Appx. 33 (2d Cir. Oct. 19, 2015) (upholding lower court decision finding equitable mootness doctrine applicable).

6 R2 Inv. LDC v. Charter Comm'cn Inc. (In re Charter Comm'cn Inc.), 691 F.3d 476, 481 (2d Cir. 2012) (citations omitted). Of course, in Chapter 7 cases, there can be no plans of reorganization, adding an additional layer of doubt regarding the applicability of the doctrine.

7 Nica Holdings, 2015 WL 9241140, at *4.

8 Id. at *4 (quoting First Union Real Estate Equity & Mortg. Invs. v. Club Assocs. (In re Club Assocs.), 956 F.2d 1065, 1069 (11th Cir. 1992)) (emphasis in original).

9 Id. Other circuits apply a similar analysis.

10 Id.

11 Id. (emphasis in original).

12 Id. at 5.

13 The court passed on determining whether the equitable mootness doctrine even applies in a Chapter 7 bankruptcy proceeding, which has no concept of a "confirmed plan," as opposed to Chapter 11 or 9 proceedings, which do. See, e.g., Franklin High Yield Tax-Free Income Fund v. City of Stockton, Cal. (In re City of Stockton), 2015 WL 8793569 (9th B.A.P. Dec. 11, 2015) (equitable mootness doctrine applies in Chapter 9).

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Originally published January 5, 2016 in Law360.