Chapman and Cutler LLP

Chapman Client Alert

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Current Issues Relevant to Our Clients

Plan Opponents' Appeal Goes down the Sewer—the Eleventh Circuit Holds the Ratepayers' Appeal in Jefferson County Is Equitably Moot

The Jefferson County bankruptcy proceeding may have reached its culmination with a recent decision by the U.S. Court of Appeals for the Eleventh Circuit (the *"Eleventh Circuit"* or the *"Circuit Court"*) finding an appeal of the bankruptcy court's approval of the Jefferson County plan of adjustment as equitably moot.[1] The Eleventh Circuit's decision provides comfort to creditors who vote in favor of a bankruptcy plan and municipalities emerging from a bankruptcy proceeding that if upon court approval they implement and substantially consummate a plan of adjustment, courts will not unwind the plan outside of special circumstances.

In a follow-up to an earlier client alert, we write to provide an update based on a recent decision rendered by the Eleventh Circuit in the Jefferson County, Alabama bankruptcy proceeding.[2] Almost five years after the bankruptcy court approved Jefferson County's plan of adjustment to emerge from bankruptcy, the Eleventh Circuit has applied equitable mootness to an appeal by, *inter alia*, certain ratepayers and the tax assessor with respect to certain provisions of the Jefferson County bankruptcy plan to bring finality to the case. By its decision, the Eleventh Circuit joined the U.S. Court of Appeals for the Sixth Circuit and the United States Bankruptcy Appellate Panel for the Ninth Circuit in finding that the doctrine of equitable mootness applies in municipal bankruptcy proceedings. The court focused on factors such as: (i) the failure to seek a stay; (ii) the significant and largely irreversible steps in reliance on the unstayed plan; and (iii) the merits and the public interest.

Background

Pursuant to its plan of adjustment that had been approved by the bankruptcy court, Jefferson County, Alabama (the *"County"*), issued and sold in the public markets new sewer warrants, with the proceeds and other funds being used to redeem and retire prior sewer warrants. The County also agreed to implement a series of single-digit-percent sewer rate increases over a span of forty years (if the County failed to act, the bankruptcy court retained jurisdiction to require it). The County could not reduce rates in a given fiscal year unless it could offset the decrease in some way (such as by increasing its rate base). At the confirmation hearing, a group of ratepayers objected on a variety of grounds including that the plan, by taking the ability to set rates out of the hands of elected Jefferson County commissioners, infringed on their rights to vote and to be free from overly burdensome debt without due process, and that the plan was not feasible because it was imposed over a service area with a declining population and falling income levels. The bankruptcy court approved the plan over the objection of the ratepayers. The decision was appealed initially to the District Court, which rejected the County's mootness arguments but certified its ruling for interlocutory review to the Circuit Court.

The Doctrine of Equitable Mootness

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 the plan. As described in the decision, "the use of the word mootness . . . in the term equitable mootness is a legal fiction"; instead, it is a prudential doctrine. Citing a decision on similar grounds by the Sixth Circuit arising out the City of Detroit, Michigan, bankruptcy proceeding, the Circuit Court noted that "[i]ndeed in an equitably moot appeal, the relief sought is the opposite of moot—the consequences of granting it would be so great that they are deemed inequitable."[3] 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.

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 courts to issue an opinion as to whether equitable mootness is applicable in a Chapter 9 proceeding were the Sixth Circuit[4] and the Ninth Circuit in a non-precedential ruling.[5]

The Eleventh Circuit's Decision

In issuing its decision, the Circuit Court considered a number of factors. It asked a number of questions to arrive at its decision, including: (a) will allowing an appeal to go forward impinge on actions taken to one's detriment in "good faith reliance on a [final and unstayed] judgment,"[6] (b) will permitting an appeal interfere with actions taken without knowledge that any claims are still pending resolution, (c) how substantially has the aggrieved party allowed the "egg of that judgment to be scrambled"—the more that people have acted in ways that render inequitable the relief sought by the aggrieved party, the less likely the court will be willing to consider ordering anyone to countenance "the pains that attend any effort to unscramble the egg,"[7] and (d) the more complex a transaction, and the greater length of time that has passed since confirmation, the harder it will be to undo the past. The Circuit Court noted the following factors that weigh against equitable mootness: (i) the extent to which relief does not undermine actions taken in reliance on the judgment, (ii) interests that underlie the right of a party to seek an appeal of an adverse ruling, (iii) actions taken by the party to obtain or seek a stay or the unjustifiable denial of a stay pending appeal, and (iv) other equitable considerations.

As to whether equitable mootness applies in a Chapter 9 case generally, the Circuit Court determined that the principles and considerations involved in whether to grant equitable mootness are not dependent upon the type of case, noting that the interests of finality may apply with greater force in a Chapter 9 proceeding, which affects thousands of creditors and residents. The Circuit Court noted the sovereignty, constitutionality, and public concerns raised by the ratepayers weigh against applying equitable mootness, but stated that these considerations in some cases may actually favor equitable mootness.

Discussing the merits, the Circuit Court noted that the ratepayers never asked for a stay of the implementation of the plan, nor did they ask for an expedited appeal of the matter. Further, the County and others have taken significant and largely irreversible steps in reliance on the confirmed, unstayed, plan. The new warrants were issued and sold based on an unstayed court order requiring that sewer rates be set to particular amounts over the course of the next 40 years. Altering this commitment by striking provisions of the plan may have a significant adverse effect on the holders of the warrants. Finally, the court looked to the merits of the case to determine whether the decision might result in injustice, particularly where, as in this case, the plan impinged on the sovereignty of the municipality.

The Circuit Court found that the argument that the plan permitted current county commissioners to bind future county commissioners with respect to sewer rates was not very strong. The Circuit Court found that the plan did not fundamentally have an effect on how the municipality is governed and noted that actions by elected officials frequently have effects on the future—*i.e*., running budgetary deficits, entering into long-term contracts, and the like. It did not view the rate limitations as "an illegal end-run around constitutional governance." Of course, other cases may present issues that in fact do impede appropriate governance and dictate a different analysis and decision. In concluding, the Circuit Court noted that no party had asked the bankruptcy court to exercise its jurisdiction to force the County to adjust its sewer rates according to the provisions of the confirmed plan. The Circuit Court thus expressed no view on whether the ratepayers (or anyone else) could enforce the County's compliance with the plan.

Conclusion

The Eleventh Circuit's decision may have brought finality to the County's bankruptcy proceeding and provides comfort to creditors who vote in favor of a plan of adjustment and municipalities emerging from bankruptcy that if they implement a plan of adjustment, outside of special circumstances, the courts will not unwind the transaction. It is important to note, however, that the decision does not prevent well-meaning and vigilant parties in interest from appealing an order confirming a Chapter 9 bankruptcy plan. However, a successful appellant may be required to seek a stay of the confirmation order (which may require the posting of a substantial bond) and will be required to show 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 that its appeal is equitably moot as the plan becomes substantially consummated.

At bottom, the ruling provides additional comfort for creditors and municipalities who have relied on and/or taken action in connection with the entry of an order approving a municipality's bankruptcy plan and the consummation thereof.

For More Information

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1 *Bennett v. Jefferson Cty., Ala. (In re Jefferson Cnty., Ala.)*, 899 F.3d 1240 (11th Cir. 2018) (hereinafter *"Jefferson County Opinion"*). Although the Jefferson County Opinion has brought finality to the Jefferson County bankruptcy proceeding, the appellants have petitioned the Eleventh Circuit for a rehearing *en banc* and could petition the U.S. Supreme Court to hear the matter.

2 *See* "Sixth Circuit Dismisses Appeal of Detroit's Plan of Adjustment as Equitably Moot" (October 12, 2016).

3 *Jefferson Cnty.*, 899 F.3d at 1247 (*citing Ochadleus v. City of Detroit (In re City of Detroit, Mich.)*, 838 F.3d 792 (6th Cir. 2016)).

4 *Ochadleus v. City of Detroit (In re City of Detroit, Mich.)*, 838 F.3d 792 (6th Cir. 2016).

5 *See In re City of Vallejo*, 551 F. App'x 339 (9th Cir. 2013) (affirming dismissal on equitable mootness grounds). Note that in *City of Stockton,* the Bankruptcy Appellate Panel for the Ninth Circuit also applied the doctrine of equitable mootness, but the precedential value of this ruling is unsettled. *In re City of Stockton*, 542 B.R. 261, 273–74 (9th Cir. BAP 2015).

6 *First Union Real Estate Equity & Mortg. Invs. v. Club Assocs. (In re Club Assocs.)*, 956 F.2d 1065, 1069–70 (11th Cir. 1992).

7 *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994).

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