Educational Materials

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# BANKRUPTCY MORNING EDITION FROM BROKEN BENCH RADIO

# Broken Bench Radio
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**Debra Grassgreen, Pachulski, Stang, Ziehl & Jones**
***Husky Int'l Elecs., Inc. v. Ritz*, No. 15-145, 2016 WL 2842452 (U.S. May 16, 2016)**

***INTRODUCTION***

Section 523(a)(2)(A) of the Bankruptcy Code provides that an individual debtor is not discharged from any debt "for money, property [or] services … to the extent obtained by false pretenses, a false representation, or actual fraud[.]" Circuits had split as to whether "actual fraud" under section 523(a)(2)(A) requires an actual affirmative misrepresentation; the Fifth Circuit had held that this was a necessary element to prevent discharge, but the Seventh Circuit had held that "actual fraud" encompassed a broader range of behaviors. In *Husky Int'l Elecs., Inc. v. Ritz*, No. 15-145, 2016 WL 2842452 (U.S. May 16, 2016), the Supreme Court resolved this split, rejecting the Fifth Circuit's narrow interpretation and finding that the term "actual fraud" does not necessitate an affirmative misrepresentation by the debtor.

***PRIOR SPLIT OF AUTHORITY***

As explained herein, the Fifth Circuit Court of Appeals in the *Husky* case held that the term "actual fraud" in § 523(a)(2)(A) required proof of a misrepresentation from the debtor to the creditor. *See In re Ritz*, 787 F.3d 312 (5th Cir. 2015). Primarily relying upon arguably ambiguous language in Supreme Court precedent, the Fifth Circuit disagreed with the Seventh Circuit's holding in *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), in which case the Seventh Circuit ruled that "actual fraud" for purposes of the statute "is not limited to misrepresentations and misleading omissions": "[B]y distinguishing between 'a false representation' and 'actual fraud,' the statute makes clear that actual fraud is broader than misrepresentation." The *McClellan* court concluded that actually fraudulent transfers (transfers through which the debtor intends to hinder the creditor) constitute "actual fraud" (while constructively fraudulent transfers do not constitute "actual fraud"). As noted by the Fifth

Circuit Court of Appeals, some courts (including in the Sixth and Tenth Circuits) have followed *McClellan*, while other courts (including in the First and Fourth Circuits) have rejected the *McClellan* approach. *See also In re Slyman*, 234 F.3d 1081, 1085 (9th Cir. 2000) (generally creditors have to prove, *inter alia*, "misrepresentation, fraudulent omission or deceptive conduct by the debtor" in order to "prevail on any claim arising under § 523(a)(2)(A)" (9th Circuit citations omitted)).

***THE RECENT HUSKY DECISION***

In *Husky*, the Supreme Court addressed whether "actual fraud" under § 523(a)(2)(A) encompasses fraudulent transfer schemes, or whether it requires that the creditor show a fraudulent misrepresentation. Husky International Electronics sold goods to Chrysalis Manufacturing Corporation. Chrysalis never fully paid Husky because one of Chrysalis' owners (Ritz) bankrupted Chrysalis, draining it of its assets and funneling them to other companies that he controlled. Husky sued Ritz, arguing that he was personally liable for Chrysalis' debt to Husky and claiming that his intercompany transfer scheme constituted "actual fraud" under Texas law (which allows creditors to hold shareholders responsible for corporate debt). Ritz then filed his chapter 7 case, and Husky initiated an adverary proceeding to bar discharge of his debt because it was for property that Ritz obtained by actual fraud. The Supreme Court granted certiorari to resolve a split among the courts of appeals as to whether the exception to discharge applies only when the debtor has made a false representation, or whether it also applies when the debtor has knowingly obtained money through a fraudulent transfer scheme that was actually intended to cheat a creditor.

The District Court held that Ritz was personally liable for the debt under state law, but the debt was not "obtained by … actual fraud" and therefore could be discharged. The Fifth

Circuit affirmed on appeal, holding that the term "actual fraud" in § 523(a)(2)(A) required proof of a misrepresentation from the debtor to the creditor. While Ritz may have hindered Husky's ability to recover its debt, the Fifth Circuit concluded, he did not make any false representations to Husky. The Court refused to use its equitable powers to expand the exceptions to discharge available to Husky.

The Supreme Court reversed. Justice Sotomayor delivered the opinion of the Court, in which Chief Justice Roberts and Justices Kennedy, Ginsburg, Breyer, Alito, and Kagan joined. Justice Thomas filed a dissenting opinion. The Supreme Court held that the term "actual fraud" in § 523(a)(2)(A) "encompasses forms of fraud, like fraudulent conveyance schemes, that can be effected without a false representation." The Court began by pointing out that before 1978, the Bankruptcy Code prohibited discharge of debts obtained by "false pretenses or false representations." The Court concluded that when Congress added the term "actual fraud" in 1978, it could not have intended that phrase to require false representations because the term "false representations" was already in the statute. That is, when Congress acts to amend a statute, the amendment is presumably meant to have a real and substantial effect. The Court also explained that the historical meaning of the term "actual fraud" is broader than just false representation, and has included transfers of assets that impair a creditor's ability to collect a debt. The Court concluded that "a false representation has never been a required element of 'actual fraud,' and we decline to adopt it as one today." Further, the Court's construction of "actual fraud" does not render duplicative other discharge exceptions (§ 523(a)(4) and (6)) because while there may be some overlap, "actual fraud" encompasses more conduct not covered by those other provisions.

Moreover, disagreeing with the dissent on this point, the majority opined that its construction is not inconsistent with § 523(a)(2)(A)'s "obtained by" requirement. Although the transferor of a fraudulent transfer does not obtain assets or debts through the fraudulent transfer, the transferee –who, with the requisite intent, also commits fraud– does. "Thus, at least sometimes a debt 'obtained by' a fraudulent transfer scheme could be nondischargeable as actual fraud." The Supreme Court remanded to the Fifth Circuit to determine whether the Husky debt was "obtained by" Ritz's scheme (Husky contended that Ritz was, in effect, both the transferor and transferee). The majority also rejected the dissent's contention that the fraud must arise at the inception of a credit transaction; "[n]othing in the text of § 523(a)(2)(A) supports that additional requirement." Noting that "there is no need to adopt a definition for all times and all circumstances," the Supreme Court left the door open to further broaden the definition of "actual fraud" and make exceptions to granting debtors a discharge.

***<u>POTENTIAL CONSEQUENCES OF HUSKY DECISION</u>***

- *Husky* reaffirms the purpose of the Bankruptcy Code, to give a fresh start only to honest but unfortunate debtors. If not for Husky, a debtor could develop a strategy of avoiding direct communication with creditors so as to not make any kind of misrepresentation and thus avoid a possible exemption to discharge under § 523(a)(2)(A). Such a debtor would receive an undeserved fresh start in bankruptcy. Construing "actual fraud" to include a fraudulent transfer would not weaken the Bankruptcy Code protections available to honest debtors.
- *Husky* reached the appropriate decision as a matter of policy, because requiring a creditor to show a fraudulent misrepresentation in all cases would create a safe harbor for debtors to commit fraud and would reward dishonest debtors at the expense of creditors.

- Creditors who have been subjected to fraudulent conduct (aside from fraudulent misrepresentations) by their debtors will be able to continue to pursue them and try to realize some recovery.
- *Husky* expanded the exception to bankruptcy discharge in an ambiguous manner, and effectively undermined federal bankruptcy law's fresh start policy.
- Allowing creditors to exempt debtors' debts from discharge without requiring proof of a fraudulent misrepresentation will unjustly favor creditors. Many creditors will especially target small businesses which often receive pre-bankruptcy transfers by their very nature on a daily basis, even if the transfers took place years after the debtor first received the credit from the subject creditor.
- The Court's holding will be particularly harmful to entrepreneurs, who often find the need to file for bankruptcy and whose personal assets are typically exposed to creditors.
- Relatedly, the Court's holding will have an indirect negative effect on limited liability and the corporate veil between a corporation and its owners.
- The Court's holding will result in increased litigation with potentially unfair results in many cases.
- The broader effect of Husky will be that creditors will pursue nondischargeability actions involving fraud through concealment or myriad other means, and not just fraud through misrepresentations.
- The *Husky* ruling increases the potential avenues for attack in nondischargeability actions and may enhance the probability of settlements.
- Under *Husky*, a fraudulent transfer judgment based on actual fraudulent intent on the part of the transferor will be exempted from discharge if the debtor is the transferee and it

acted with actual intent to hinder, delay or defraud. The debtor-transferee will be able to discharge a constructive fraud judgment if the debtor-transferee did not act with actual intent to hinder, delay or defraud. That is, although courts in fraudulent transfer actions generally look at the transferor's intent, bankruptcy courts will now have to rule on the transferee's intent as well, to determine whether the actual fraud exemption applies.

- While *Husky* specifically dealt with an individual debtor chapter 7 bankruptcy, § 523 applies expressly to the discharge under § 1141 (d) (2) for individual chapter 11 debtors.
- The Court's decision will adversely impact corporate debtors because § 1141(d)(6)(A) makes the § 523(a) discharge exceptions applicable to debts owed to a governmental unit or to a person as the result of enforcement actions under subchapter III of Chapter 37 of title 11 or any similar state statute. Governmental units (like taxing authorities and the SEC) may be able to cast a cloud over a reorganized debtor's affairs for extended periods, as governmental investigations and the claims administration process continues after plan confirmation. Authorities like the SEC have more commonly obtained stipulations extending the time to bring a nondischargeability action to the extent there is a deadline.
- Creditors will likely argue that courts should take into consideration conduct by the debtor that occurs after a debt is incurred in making a decision as to whether a particular debt is dischargeable. Up to now, the inquiry was largely limited to what was done or said at the time the debt was incurred.
- *Husky* could be applied to schemes that did not exist at the time the debt was incurred. The ruling opens the door to creative lawyering by creditors that want to recover against parties that were not in privity with the creditor when the debt first arose. In the context of a fraudulent transfer, the ruling opens the way for the transferor's creditors to recover

the proceeds of a fraudulent transfer from an initial or subsequent transferee that later files for bankruptcy. In the transferee's bankruptcy case, the ruling will put the transferee's creditors in competition with the transferor's creditors and possibly put the indirect creditors whose claims originated with the transferor on a better footing than the transferee's direct creditors.

- *Husky* is not of broad application. The Supreme Court remanded to the Fifth Circuit, to decide whether Ritz's particular obligation was actually nondischargeable. The Supreme Court did not decide whether the particular debt in *Husky* was "obtained by" fraud. Thus, boiling down *Husky* to its essence, all that the Supreme Court did was hold that an actual fraudulent transfer is a possible example of a nondischargeable debt. In many cases, the relevant debt would not have been "obtained by" fraud, and so in such event, § 523(a)(2) would not be satisfied.
- From a practical standpoint, arguably, it is unlikely that *Husky* will have a substantial effect on nondischargeability actions generally. Such actions will be difficult to pursue in many cases, even under the *Husky* court's broad interpretation, and may be difficult to justify on a cost-benefit basis in numerous cases.
- The *Husky* court failed to fully identify the required connection between the debt and the fraudulent transfer. Conceivably, there may be a finding of nondischargeability even if there were no direct dealings between the transferee and the creditor. It remains to be seen whether lower courts broadly apply *Husky* or apply it only to closely similar cases.

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**James Sprayregen**
**Major Issues in the Caesars Entertainment Operating Company, et al. Chapter 11 Cases[1]**

## I. *Executive Summary*

### A. **Background Facts**

1. Caesars Entertainment Operating Company, Inc. ("CEOC") and 172 of its direct and indirect subsidiaries (the "Debtors") are currently debtors in possession in pending chapter 11 cases in the United States Bankruptcy Court for the Northern District of Illinois.

2. The Debtors represent the largest, majority-owned operating subsidiary of Caesars Entertainment Corporation ("CEC"), a publicly traded company that is the world's most diversified casino-entertainment provider (collectively, "Caesars").

3. Caesars owns and operates or manages 50 casinos in five countries on three continents, with properties in the United States, Canada, the United Kingdom, South Africa, and Egypt. The Debtors, for their part, own and operate or manage 38 gaming and resort properties in fourteen states and five countries, operating primarily under the Caesars®, Harrahs®, and Horseshoe® brand names.

[1] This overview is based on publicly available information. These materials should not be construed as legal advice or be relied on for any party's legal position. Parties should rely on the documents and positions taken in the bankruptcy cases for the exact positions of the parties and for the facts of, and legal outcomes from, the cases.

## B. **Chapter 11 Filing**

1. The Debtors' capital structure is the legacy of one of the largest leveraged buyouts in history. On January 28, 2008, affiliates of Apollo and TPG, along with certain co-investors, acquired Caesars (then known as Harrah's Entertainment, Inc.) for approximately $30.7 billion. The sponsors contributed approximately $6.1 billion in cash to fund the LBO, with the remainder funded through the issuance of approximately $24 billion in debt, approximately $19.7 billion of which was secured by liens on substantially all of CEOC's and its subsidiaries' assets.

2. Before the Debtors' chapter 11 filing in January 2015, CEC and its affiliates undertook numerous initiatives that they contend were designed to right size CEOC's balance sheet, including several "challenged" transactions at the heart of litigation between CEC, CEOC, and CEOC's creditors.

3. The Debtors have sought to settle their claims and causes of action on account of these "challenged transactions" during their chapter 11 cases through a settlement with CEC, which settlement is encompassed in the Debtors' plan of reorganization. The settlement requires CEC to contribute cash and securities to the Debtors as well as provide other support for the Debtors' reorganization (which is proposed to occur through the separation of the Debtors' business into a real estate investment trust and an operating company) in exchange for a settlement

of claims between the Debtors, their creditors, and CEC, its non-debtor affiliates, and its sponsors, including a third party release. The challenged transactions and the settlement have been at the center of the Debtors' chapter 11 cases.

4. The Debtors' bankruptcy and the related non-bankruptcy court litigation have the potential to establish important precedent for the restructuring world, including precedent related to litigation regarding an involuntary proceeding and use of a grace period as well as the out-of-court restructurings in light of potential rulings regarding the Trust Indenture Act ("TIA") and the creation of original issue discount in out-of- court exchange offers. Several of the important bankruptcy and non-bankruptcy court litigation is summarized in these materials based on publicly available information.

## II. *Involuntary Proceeding*

### A. **Background Facts**

1. On December 15, 2014, CEOC announced that it would forego making an interest payment due under certain of its second lien indentures to take advantage of a 30-day grace period under such indentures to continue to negotiate with its creditors on the terms of a restructuring plan.

2. On December 19, 2014, CEOC and CEC announced that they had reached agreement on a restructuring support agreement with holders of their first lien notes.

   a. Under the RSA, CEOC would not pay the interest due on the second lien notes and would file voluntary petitions for chapter 11 on or after January 15, 2015.

3. On January 7, 2015, Debtwire reported that CEOC was contemplating filing its voluntary chapter 11 petition in Chicago.

4. On January 12, 2015, three second lien creditors filed an involuntary bankruptcy petition against CEOC (but not its subsidiaries) in the United States Bankruptcy Court for the District of Delaware.

5. On January 15, 2015, CEOC and 172 of its subsidiaries commenced voluntary chapter 11 cases in the United States Bankruptcy Court for the Northern District of Illinois.

B. **Venue Fight**

1. On January 15, 2015, the Delaware court stayed the voluntary CEOC proceeding in Chicago to determine proper venue. At issue was whether petitioning creditors in an involuntary case could "win the race to the courthouse" and choose the venue for a company's chapter 11 case, or whether the debtor's choice of venue was entitled to deference.

2. At a two-day trial, CEOC argued that its venue choice was entitled to deference and was based on sound reasons, including favorable case law.

3. On January 28, the Delaware court issued a ruling establishing venue in Chicago.

   a. The Delaware court found that "rewarding the Petitioning Creditors' preemptive filing in another forum would set bad precedent for future bankruptcy cases and limit the ability of future debtors to openly negotiate with creditors prior to filing a voluntary bankruptcy petition."

   b. The Delaware court also reinforced that a debtor was entitled to deference in choosing a venue based on, among other things, case law that the debtor found could be beneficial to a restructuring.

C. **Propriety of Involuntary Petition**

1. In October 2015, a seven-day evidentiary trial was held to determine the propriety of the involuntary petition. At issue was whether the petitioning creditors could meet their burden of showing that CEOC was "generally not paying its debts as they came due."

   a. This question addresses more than just the missed interest payment under the second lien notes indenture; it also implicates custom, practice, or expectation in the industry with respect to the so-called "grace periods" under indentures. Namely, the trial focused on

whether bondholders can file an involuntary petition against a company on the basis of a missed interest payment during the grace period before that missed payment becomes an Event of Default under the indenture (without necessarily knowing of other unpaid debts).

b. The Bankruptcy Court permitted substantial discovery into whether CEOC was otherwise paying its debts as they came due to allow the bondholders to meet their burden on the propriety of the involuntary petition.

c. If the Bankruptcy Court finds that CEOC was paying other debts as they came due but, nonetheless, allows the Involuntary Petition to stand based on the missed indenture payment during the grace period, this could have ramifications for out-of-court restructuring negotiations more generally. This is so because companies regularly have used the "grace period" to negotiate with creditors and/or prepare for a chapter 11 filing, but such a finding may enable creditors to file companies for chapter 11 during the customary "grace period" without any knowledge regarding the company's other debts. Such a result may further caution against the use of grace periods for these purposes.

2. The Bankruptcy Court has not yet issued a ruling on the propriety of the involuntary petition. The Bankruptcy Court is currently set to rule on the involuntary petition dispute on July 20, 2016.

## *III. Examiner's Investigation*

### A. **Background**

1. Before the Petition Date, CEC and its affiliates engaged in multiple capital market transactions that CEC contends were designed to reduce CEOC's debt, increase CEOC's liquidity, and facilitate overall enterprise growth. These transactions included, among other things, intellectual property transfers to Caesars Interactive Entertainment ("CIE"), the formation of, and transfers of property to, Caesars Acquisition Company ("CAC"), Caesars Entertainment Resort Properties, LLC ("CERP") and Caesars Growth Partners, LLC ("CGP"), and the refinancing of CEOC's term loan and an August 2014 transaction that CEC asserts released CEC's guaranty of CEOC's debt (the "Challenged Transactions"). Creditor dissatisfaction with these Challenged Transactions prompted multiple prepetition lawsuits against CEOC, CEC, various affiliates, and certain directors and officers to compensate the creditors for these transactions.

2. After the commencement of CEOC's chapter 11 cases, following requests from CEOC and other stakeholders, the Bankruptcy Court appointed an examiner, Richard Davis (the "Examiner"), to provide an independent and neutral analysis of the Challenged Transactions and other estate claims.

B. **Examiner's Investigation**

1. Pursuant to the Bankruptcy Court's order, the Examiner investigated more than 15 prepetition transactions among CEOC and other entities controlled by CEC. These transactions occurred from 2008 through 2014.

2. During his investigation, the Examiner served 55 subpoenas seeking documents from 46 parties, including the Debtors, CEC, the sponsors, and other affiliates, and ultimately reviewed more than 1.2 million documents consisting of 8.8 million pages.

3. The Examiner also conducted interviews of 92 individuals from September 15, 2015, through February 25, 2016.

C. **Examiner's Report**

1. The Examiner's initial, partially redacted final report was released on March 15, 2016, and a substantially unredacted final report was filed on May 16, 2016.

2. The Examiner concluded that many of the transactions he investigated were structured and implemented in a manner that removed assets from CEOC to the detriment of CEOC and its creditors.

3. As a result of these transactions, the Examiner found the Debtors have claims for constructive fraudulent transfer, actual fraudulent transfer, breach of fiduciary duty, and aiding abetting breach of fiduciary duty

against CEC, CGP, CIE, other Caesars affiliates, CEOC directors, the sponsors, and certain of CEC's directors.

4. The Examiner concluded that the potential damages arising from claims on which the Debtors would more likely than not be successful range from $3.6 billion to $5.1 billion.

## *IV. <u>Parent Guarantee Litigation</u>*

1. Originally, CEC guaranteed substantially all of CEOC's funded debt, which CEC has asserted was for ease of financial reporting, not to provide credit support.

2. Before the Petition Date in the Debtors' bankruptcy, CEC and its affiliates entered into a series of transactions that CEC contends resulted in the release of guarantees under various first, second, and unsecured indentures.

3. Creditors have brought actions to reinstate and collect on the guarantees. Certain of these actions also brought claims on account of the prepetition Challenged Transactions that have been the subject of the Examiner's investigation in the Debtors' chapter 11 cases, though such actions as to the Challenged Transactions were stayed due to the pendency of the Debtors' chapter 11 cases.

4. The following are the facts that led to the release of CEC's guaranty of the Debtors' debt and the litigation related to each transaction.

   a. Language in the indenture of CEOC's bonds provided certain avenues to potentially remove the guarantees because it requires that subsidiary to be a "Wholly Owned Subsidiary." Under most of CEOC's indentures (the ones issued on or after a leveraged buyout of Caesars in 2008), "Wholly Owned Subsidiary" required 100% ownership.

   b. In May 2014, CEC sold 5% of its stake in CEOC to certain third-parties as part of a credit agreement refinancing, and asserted the guarantee was no longer in effect because CEOC was no longer a "Wholly Owned Subsidiary." Subsequently, CEOC established a management equity pool with an additional 6% of its equity. CEC now owns 89% of CEOC.

      i. On August 4, 2014, Wilmington Savings Fund Society ("WSFS") filed suit in the Delaware Chancery Court asserting liability for fraudulent transactions and violations of fiduciary duties, among other things. The focus of this litigation has shifted to breach of contract and claims under the Trust Indenture Act (the "TIA") on account of guarantee claims under one of CEOC's second lien indentures.

ii. On March 3, 2015, BOKF commenced an action in the Southern District of New York seeking to enforce CEC's guarantee obligations under one of CEOC's second lien indentures.

iii. On June 15, 2015, UMB Bank ("UMB") commenced an action in the Southern District of New York seeking to reinstate CEC's guarantee of payment on CEOC's first lien indentures.

iv. On October 21, 2015, the indenture trustee for CEOC's subsidiary-guaranteed unsecured notes, Wilmington Trust, National Association, filed an action against CEC in the Southern District of New York seeking to void the removal of CEC's guarantee of the subsidiary-guaranteed notes.

c. Certain series of CEOC's pre-LBO legacy unsecured notes were issued under an indenture with a different provision for "Wholly Owned Subsidiary." Certain holders under of those notes asserted that their guarantees were still in place despite the sale of CEOC's equity to third parties and the establishment of the management equity plan. In August 2014, CEOC and CEC purchased approximately $155 million of CEOC's unsecured notes from four holders and amended the relevant unsecured notes indentures with the holders of such notes to trigger a release of CEC's guarantee.

i. On September 3, 2014 MeehanCombs filed suit in the Southern District of New York asserting violations of the TIA in connection with termination of CEC's guarantee, among other things.

ii. On October 2, 2014, Frederick Barton Danner commenced an action against CEC in the Southern District of New York for alleged violations of TIA in connection with termination of CEC's guarantee.

5. TIA § 316(b) states "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security . . . or to institute suit for the enforcement of any such payment . . . shall not be impaired or affected without the consent of such holder."

a. Creditor plaintiffs argue that the release of the guarantees effected a non-consensual change to plaintiffs' payment rights and affected plaintiffs' practical ability to recover payment.

b. CEC has taken the position that the TIA only protects a noteholder's *legal* right to receive payment when due. In other words, the focus is on changes to terms of an indenture that affect payment of principal and interest to the holders of bonds, not whether such payments will actually occur.

c. Recent case law, however, such as *Marblegate Asset Management v. Education Management Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014), has found that the TIA covers not the *legal* right to receive payment when due, but also the practical right of bondholders to receive payment of principal and interest.

d. If the TIA is interpreted broadly to protect the practical right of bondholders to receive payment, it is possible that more debt restructurings will be forced to occur in bankruptcy where 100% consensus is not required. Such a result will also likely result in increased leverage for minority holders of indenture debt during out-of-court restructuring negotiations.

B. **Section 105 Injunction**

1. On March 11, 2015, the Debtors commenced an adversary proceeding in the Bankruptcy Court for the Northern District of Illinois seeking to stay the litigation against CEC in Delaware and New York pursuant to section 105 of the Bankruptcy Code.

2. Section 105 allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code.

3. The Seventh Circuit has found that a bankruptcy court may enjoin any action that is "related to" a chapter 11 proceeding. <u>Zerand-Bernal Grp.,</u>

Inc. v. Cox, 23 F.3d 159, 162 (7th Cir. 1994). A matter is at least "related to" a chapter 11 case where "its resolution also affects the bankrupt's estate or the allocation of its assets among creditors." Home Ins. Co. v. Cooper & Cooper, Ltd., 889 F.2d 746, 749 (7th Cir. 1989) (Easterbrook, J.).

4. The Debtors argued that an injunction was appropriate because the Bankruptcy Court needed to protect the Debtors' claims and causes of action on account of the Challenged Transactions, and if the Debtors' creditors were to be successful on the parent guarantee litigation, those creditors would recover ahead of the Debtors to the detriment of the Debtors' estates. In particular, CEC would be unable to settle or pay a judgment to the Debtors if they were also liable for the parent guarantees of up to $18 billion.

5. After a two-day trial and post-trial briefing, the Bankruptcy Court denied an imposition of a stay of the parent guarantee litigation in July 2015, finding that a bankruptcy court could only enjoin third party litigation where that third party litigation was based on the same acts as the debtors' own litigation claims.

6. The Debtors subsequently appealed the decision to the Seventh Circuit Court of Appeals. On December 23, 2015, the Seventh Circuit issued an opinion vacating the lower court opinions.

a. In the opinion, Judge Richard Posner wrote that section 105(a) of the Bankruptcy Code grants "extensive equitable powers" to a bankruptcy court, and the appropriate analysis is "whether the injunction sought by [a debtor] is likely to enhance the prospects for a successful resolution of the disputes attending its bankruptcy. If it is, and its denial will thus endanger the success of the bankruptcy proceedings, the grant of the injunction would, in the language of § 105(a), be 'appropriate to carry out the provisions' of the Bankruptcy Code, since successful resolution of disputes arising in bankruptcy proceedings is one of the Code's central objectives." In re Caesars Entertainment Operating Co., Inc., 808 F.3d 1186, 1188–89 (7th Cir. 2015).

7. On February 26, 2016, the Bankruptcy Court granted the Debtors' motion to stay the BOKF parent guarantee litigation in the Southern District of New York, which was otherwise scheduled for trial in March 2016, for a period of 74 days, up to May 9, 2016 (when certain other trials were set to commence). This stay expired on May 9, 2016. The Bankruptcy Court found that the stay would help parties reach settlement following the release of the Examiner's report.

8. On June 6, 2016, on the eve of summary judgment briefing in each of the parent guarantee actions, the Debtors renewed their request to stay the parent guarantee actions until the Bankruptcy Court issues a decision on plan confirmation. In part, this injunction was sought to protect the

Debtors' agreements on a settlement and contribution from CEC (and certain of its affiliates) to the Debtors' reorganization plan and recently agreed-to restructuring support agreements with several creditor groups (including several that were close to being finalized). On June 15, 2016, the Bankruptcy Court granted the additional 105 injunction through August 29, 2016 (an additional 74 days) to provide the parties additional time to consensually resolve the contentious CEOC bankruptcy cases. The Bankruptcy Court encouraged the parties to come to a consensual deal during that time and noted that the likelihood of an additional extension of the § 105 injunction is small.

9. Despite the fact that the Bankruptcy Court has noted that it may not grant further extensions of the § 105 injunction, the Seventh Circuit's ruling in the Caesars case has clarified the extensive power of bankruptcy courts to grant relief under § 105, including through enjoining litigation in other courts that has the ability to harm a debtor and its estate, and is also related to that debtor's chapter 11 case.

## *V. Standing Motions*

### A. Statutory Unsecured Claimholders' Committee's Lien Standing Motion & Subsidiary Guaranteed Notes Standing Motion (the "Lien Standing Motion")

1. On August 7, 2015, the Debtors' Statutory Committee of Unsecured Claimholders (the "UCC") filed a motion for derivative standing to challenge certain prepetition security interests, mortgages, liens and claims

the Debtors granted to collateral agents to secure the Debtors' first and second lien debt. As part of this request, the UCC sought the exclusive right to settle these various lien challenges.

2. Given the Challenged Transactions and certain litigation regarding security interests (including in the Debtors' substantial post-petition cash related to their gaming enterprise), the Lien Standing Motion was seen as an important bellwether for whether the Bankruptcy Court would grant standing on other issues driving the Debtors' chapter 11 cases.

3. In briefing on the Lien Standing Motion, the Debtors argued, among other things, that the Debtors' plan of reorganization was a global settlement of all issues arising in the Debtors' bankruptcy cases, including with regards to potential lien challenges. In particular, the Debtors asserted that the value available to junior creditors was made available to those creditors by senior lenders as part of overall negotiations related to the Debtors' plan.

4. On March 16, 2016, the Bankruptcy Court issued an opinion and order noting that the Debtors' justification for not pursuing the lien challenges, namely that the pursuit of a global settlement as part of a comprehensive chapter 11 plan is superior to litigation, is a reasonable exercise of business judgment and sufficient grounds for denying the Lien Standing Motion.

    a. The Bankruptcy Court did not deny the Lien Standing Motion outright, but instead continued it to a later hearing so as not to

prejudice the UCC if the comprehensive settlement encompassed in the plan of reorganization is not approved.

b. Notably, the Bankruptcy Court has clarified, in the context of a standing motion related to the Challenged Transactions, that its use of the word "settlement" in its continuance of the Lien Standing Motion was made in the context of a consensual plan. "It was the consensualness of the plan that constituted the settlement." June 7, 2016, Hr'g Tr. 13:10–12. This is not the same as thinking of the "proposed plan as a settlement of these claims." Id. 12:23–24. The Bankruptcy Court clarified that this is precisely the reason the Lien Standing Motion was moved to a later hearing as opposed to after confirmation, "because it seemed to me that if you didn't have a consensual plan by then, that settlement would no longer, in the sense I was using it, be a justification for refusing to bring the claims." Hr'g Tr. 14:2–6.

## B. Official Committee of Second Priority Noteholders' Standing Motion

1. On May 13, 2016, the Official Committee of Second Priority Noteholders filed a motion seeking derivative standing to pursue claims for fraudulent transfers, breach of fiduciary duty, aiding and abetting fiduciary duty, and other claims against CEC, certain of CEC's and CEOC's directors and officers, and CEC's sponsors on account of the Challenged Transactions.

As part of this request, the Noteholders' Committee has sought the exclusive right to settle the Challenged Transactions.

a. The motion alleges that CEOC's Special Governance Committee lacks sufficient independence to bring or compromise such claims.

2. The Bankruptcy Court has set a discovery and briefing schedule, with a hearing set on September 21, 2016, to consider the standing motion.

## *VI. Original Issue Discount ("OID") Objections*

A. Arguments, generally

1. On June 2, 2016, CEOC filed an objection to the proofs of claim filed by the indenture trustees and collateral agent for CEOC's second lien notes. The objections seek to disallow unamortized 'original issue discount' as 'unmatured interest' under § 502(b)(2)."

2. For tax purposes, when the actual issue price of a note is less than its face value at issuance, that note has an "original issue discount." Applicable non-bankruptcy law requires both the issuer and the noteholder to reflect this difference as interest for tax and accounting purposes. The difference (the OID) is amortized over the life of the note.

3. The Second Lien Notes were issued at a discount to face value and therefore include varying degrees of OID.

4. CEOC believes that approximately $1.9 billion of OID remained unamortized for the various Second Lien Notes, in the aggregate, at the Petition Date.

5. CEOC argues that the OID is “unmatured interest” as defined by § 502(b)(2) and the Bankruptcy Code therefore requires disallowance of these amounts.

B. If successful, the OID Objection would reduce the aggregate allowed amount of the Second Lien Notes Claims from approximately $5.5 billion to approximately $3.7 billion.

C. The OID Objection, if successful, may also have ramifications for out-of-court debt-for-debt exchanges, at least where such debt-for-debt exchanges could result in OID, as it is possible that it will be more difficult to execute on such exchanges if debt holders are concerned about the potential later disallowance of a portion of their claims in a bankruptcy case.

## *VII. __Confirmation__*

A. On June 22, 2016, the Bankruptcy Court approved the Debtors’ disclosure statement for solicitation and established a schedule for confirmation of the Debtors’ proposed plan, which includes the following key dates:

1. **Deadline to Complete Solicitation**: July 11, 2016

2. **Voting and Plan Objection Deadline**: October 31, 2016

3. **Deadline to File Pretrial Briefs**: December 29, 2016

4. **Confirmation Hearing Begins**: January 17, 2017

B. The confirmation hearing (if not resolved consensually before confirmation) is expected to last several weeks and, although it will feature testimony on a range of issues in dispute throughout the Debtors' chapter 11 cases, will likely focus on the following key issues:

1. The settlement of the Challenged Transactions;

2. The propriety of the non-consensual third-party releases necessary to implement the settlement and make available the recoveries available under the plan; and

3. Whether the plan satisfies the "new value" rule of section 1129(b) of the Bankruptcy Code.

C. **Settlement of Challenged Transactions**

1. As described above, a key element of the Debtors' chapter 11 cases has been the potential value of litigation claims against CEC, its non-debtor affiliates, and certain other parties related to the Challenged Transactions.

2. The Debtors' plan of reorganization reflects the settlement of these claims in exchange for various forms of cash and non-cash consideration needed to implement the transactions contemplated by the Plan, which at a high-level include:

a. The separation of CEOC into a real estate investment trust ("PropCo") and an operating company ("OpCo");

b. A commitment by CEC to purchase the OpCo equity to provide cash to CEOC to be distributed to creditors under the Plan; and

c. The release of Debtor claims and third-party claims against CEC, its sponsors, and its non-debtor affiliates.

3. The Bankruptcy Court has acknowledged that a standard similar to the Bankruptcy Rule 9019 standard will apply to the settlement of the Challenged Transactions as part of confirmation. This means that, at a high level, the Debtors will need to demonstrate that the settlement is in the best interests of the Debtors' estates, is fair and equitable, and falls within the reasonable range of possible litigation outcomes. See, e.g., In re Doctors Hosp. of Hyde Park, Inc., 474 F.3d 421, 426 (7th Cir. 2007).

4. Much of this will depend on the valuation of the cash and non-cash consideration provided by non-debtors (including CEC) under the plan. Based on a valuation analysis performed by the Debtors' financial advisor, the Debtors believe these contributions are worth between $1.9 billion and $6.3 billion, with a midpoint of $4.3 billion. The Official Committee of Second Priority Noteholders, by contrast, has asserted that the settlement is inadequate because, among other things, the contributions do not consist entirely of cash and the value of the non-cash consideration is much less than the Debtors' have ascribed to such consideration. Moreover, the

Official Committee of Second Priority Noteholders believe the value of the potential litigation claims is much higher—ranging from $8.1 billion to $12.6 billion—and, therefore, the value of the contribution itself (regardless of the form of consideration) is inadequate.

D. **Third-Party Releases**

1. An essential component of the settlement of the Challenged Transactions is the release of claims held by third parties against CEC and various other non-debtor parties (the "Third-Party Releases").

2. Such Third-Party Releases are generally available when they are "consensual." In In re Specialty Equip. Cos., for example, the court approved a third-party release where "each creditor could choose to grant, or not to grant, the release irrespective of the vote of the class of creditors or interest holders of which he or she is a member." 3 F.3d 1043, 1046 (7th Cir. 1993).

3. Under applicable Seventh Circuit law, nonconsensual third-party releases may also be approved under certain circumstances. These cases generally require that the release be essential to the reorganization, narrowly-tailored, and supported by valuable consideration. See, e.g., In re Airadigm Commc'ns, Inc., 519 F.3d 640 (7th Cir. 2008).

   a. In Airadigm, the court approved a nonconsensual third-party release that was required by the debtors' proposed financing source

where the financing “was itself essential to the reorganization,” release was of claims in connection with restructuring, and the release is “appropriate and not inconsistent with any provision of the bankruptcy code.” 519 F.3d at 657.

b. In In re Ingersoll, Inc., 562 F.3d 856 (7th Cir. 2009), the court similarly approved the nonconsensual release of third party litigation by a non-creditor against a non-debtor where “it was central to the negotiation and ultimate success of the plan” and supported by “good and valuable consideration [that] will enable unsecured creditors to realize distribution in this case.” 562 F.3d at 863–65.

4. The issue of the consideration provided by the various parties benefiting from the release will be heavily litigated. Certain parties, including the Official Committee of Second Priority Noteholders, have challenged the Debtors’ ability to meet the standard in the Seventh Circuit. In particular, the Official Committee of Second Priority Noteholders intends to argue, among other things, that the aggregate consideration provided by CEC and its affiliates under the Debtors’ plan cannot meet the applicable standard because it is insufficient to support the release of the Debtors’ estate’s claims related to the Challenged Transactions and the release of the third-party guarantee claims.

E. **“New Value” Plan**

1. Under the Debtors’ plan, CEC will own all of the OpCo equity distributed under the Plan. Thus, because the Debtors’ plan will not provide full recoveries to all creditors, CEC’s retention of equity in the reorganized entity will likely implicate the “new value” rule.

2. Under section 1129 of the Bankruptcy Code, a debtor cannot confirm a plan of reorganization over the objections of an impaired class of creditors, if that plan does not comply with the “absolute priority rule.” The absolute priority rule, which is codified in 11 U.S.C. § 1129(b)(2)(B)(ii), requires that, with respect to a class of unsecured claims that has not received payment in full, “the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.” This provision therefore prohibits a debtor’s prepetition equity holders from receiving any property pursuant to a plan of reorganization “*on account of*” their prior ownership unless all senior creditor classes are paid in full or vote in favor of the plan.

3. Applicable case law, however, has created an exception—called the “new value” exception—where old equity owners may receive new equity in the reorganized debtors notwithstanding the absolute priority rule in exchange for injecting “new value” into the reorganized company. These courts generally require proof that the new value contributed by old equity is

(i) new, (ii) substantial, (iii) in the form of money or money's worth, (iv) necessary for a successful rehabilitation, and (v) reasonably equivalent to the value or interest retained. See Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'Ship, 526 U.S. 434 (1999).

4. Courts in the Seventh Circuit in particular have required that some form of "market test" or other competitive process is required to satisfy this standard. See In re Castleton Plaza, LP, 707 F.3d 821 (7th Cir. 2013).

5. To meet this standard, the Debtors conducted a marketing process to solicit proposals for alternative transactions involving the purchase of the Debtors and/or their subsidiaries that would create more value than the plan supported by CEC.

6. Certain parties, including the Official Committee of Second Priority Noteholders, have asserted that the process conducted by the Debtors fails to satisfy the appropriate legal standard. Among other things, the Official Committee of Second Priority Noteholders argues that the process did not produce a useable market test because the indications of interest received by the Debtors do not provide a sufficient basis for measuring the market value of the property CEC will receive under the Plan. The Official Committee of Second Priority Noteholders further argues that the process itself was flawed because the Debtors did not invite enough parties to participate and even those they did invite likely viewed the process as a sham and so did not submit legitimate bids.

7. The legitimacy of the marketing process for purposes of meeting the standard under 11 U.S.C. § 1129(b) therefore will likely be subject to extensive litigation at the confirmation hearing.

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**Michael St. Patrick Baxter ***
**Debt Recharacterization in Bankruptcy**

## Introduction to Debt Recharacterization

Bankruptcy courts are often called upon by debtors, creditors' committees, or trustees to recharacterize loans or other debts as equity. Recharacterization looks at the true "substance" of the loan to determine whether the loan should be treated as debt or equity.[2] The effect of recharacterization is to subordinate the loan or debt, and, as a result, the priority that would ordinarily be accorded the creditor.

Debt recharacterization is similar to, but distinct from, equitable subordination. The latter is a remedy against debt holders whose misconduct led to injury to other creditors or shareholders. In equitable subordination, debt is subordinated to the extent necessary to redress the injury. While the result of debt recharacterization and equitable subordination may be similar, there are significant differences between the two. First, equitable subordination is a remedy in response to misconduct. Debt recharacterization requires no misconduct. Second, equitable subordination is expressly authorized by § 510(c) of the Bankruptcy Code (*"Code"*), while a bankruptcy court's authority to recharacterize is usually based on the implied authority of either § 105(a) or § 502(b) of the Code.

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[2] *See* Pepper v. Litton, 308 U.S. 295, 304-05 (1939) ("[equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form….")

Courts have been divided on two primary issues regarding debt recharacterization: (i) the source of authority to recharacterize, and (ii) the test applied to recharacterize debt. This lack of uniformity exists across circuits, and even within some circuits.

According to some courts, the authority to recharacterize debt comes from § 105(a) of the Code. Section 105(a) grants courts the power to issue any order that is "necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." According to other courts, the authority to recharacterize is found in § 502(b), which implies a duty for bankruptcy courts to defer debt recharacterization to state law. In recharacterizing debt, courts have mostly used varying multifactor tests, adopted primarily from federal tax law.

## *I.* ***Variances in Debt Recharacterization Between Circuits***

Some circuits disagree on the bankruptcy court's power to recharacterize, and, if empowered, the source of that power. Six circuit courts[3] have stated that bankruptcy courts have the authority to recharacterize debts; however, these courts have not agreed on the source of this authority. The remaining circuits have not addressed the issue, leaving lower courts to make their own determinations. This section will discuss (i) the § 105(a) approach by circuit, (ii) the § 502(b) approach by circuit, and (iii) the approaches taken by the remaining circuit courts.

### A. **Section 105(a) Approach**

The Third, Fourth, Sixth, and Tenth Circuits attribute to § 105(a) the bankruptcy court's authority to recharacterize debt. These circuit courts have either (i) created their own tests to determine whether a claim is debt or equity, or (ii) adopted tests of other circuits.

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[3] The Eleventh Circuit has analyzed debt recharacterization, but has not identified an authorizing Code section. In re N&D Properties, Inc., 799 F.2d 726, 733 (11th Cir. 1986).

### 1. Recharacterization in the Sixth Circuit

The Sixth Circuit was the first circuit to declare that bankruptcy courts had the authority to recharacterize debt under § 105(a). In 2001, the Sixth Circuit in *In re AutoStyle Plastics, Inc.* affirmed that bankruptcy courts have the authority to recharacterize debt as equity,[4] stating that § 105(a) gives bankruptcy judges equitable powers to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Code.[5] The Sixth Circuit refused to follow the Ninth Circuit Bankruptcy Appellate Panel (*"BAP"*), which, at the time, had held that courts did not have the power to recharacterize debt as equity.[6]

After establishing the authority to recharacterize debt, the Sixth Circuit applied a multifactor test from *Roth Steel Tube Co. v. Commissioner of Internal Revenue*.[7] The "*Roth Steel* factors" were eleven factors used in a federal tax case to distinguish a capital contribution from a loan. The Sixth Circuit in *AutoStyle Plastics* established a framework for analyzing these factors. First, the Sixth Circuit stated that none of the *Roth Steel* factors would be controlling.[8] Second, each factor is to be considered within the circumstances of each unique case.[9] Lastly,

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[4] 269 F.3d 726 (6th Cir. 2001).

[5] *Id.* at 748.

[6] *See* In re Pac. Exp., Inc., 69 B.R. 112, 115 (B.A.P. 9th Cir. 1986).

[7] 800 F.2d 625, 630 (6th Cir.1986).

[8] *AutoStyle Plastics*, 269 F.3d at 750.

[9] *Id.*

the court added that the more a transaction resembles an arm's-length negotiation, the more likely it will be treated as debt.[10]

The *Roth Steel* factors include (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments."[11] In *AutoStyle Plastics,* the Sixth Circuit examined each factor in its analysis. However, subsequent circuits have focused their analysis on several pertinent factors.[12] After evaluating the facts in light of each factor, the Sixth Circuit decided not to recharacterize the debt as equity.[13]

In *AutoStyle Plastics*, the Sixth Circuit became the first circuit to declare that bankruptcy courts had the authority to recharacterize debt under § 105(a). Following *AutoStyle Plastics*, other circuit courts and lower courts have adopted the 11-factor *Roth Steel* test.

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[10] *Id.*

[11] *Id.*

[12] *See, e.g.*, In re: Dornier Aviation, 453 F.3d 225 (4th Cir. 2006), *infra* Section I.A.2.; In re Submicron Systems Corp., 432 F.3d 448 (3d Cir. 2006), *infra* Section I.A.3.

[13] *AutoStyle Plastics*, 269 F.3d at 753.

### 2. Recharacterization in the Fourth Circuit

In 2006, the Fourth Circuit in *In re Dornier Aviation* affirmed that bankruptcy courts have the authority to recharacterize debt as equity.[14] The Fourth Circuit rejected the argument that debt could not be recharacterized due to the disallowance provision in § 502(b) and the availability of equitable subordination under § 510(c).[15] The Fourth Circuit declared that bankruptcy courts have the authority to recharacterize debt, aligning itself with the Sixth Circuit.[16]

After establishing this authority, the *Dornier Aviation* court adopted the *Roth Steel* factors used in *AutoStyle Plastics*.[17] Like the Sixth Circuit, the Fourth Circuit stated that, in applying these factors, none is to be controlling and their significance will vary, depending on case-specific circumstances.[18] Unlike the Sixth Circuit, however, the Fourth Circuit did not review every factor. Instead, the Fourth Circuit cited the five "particularly significant" factors, and found that the facts adequately supported the lower court's decision.[19]

In its discussion, the Fourth Circuit compared several multifactor tests that it could have used to recharacterize the debt.[20] The court concluded that the substances of the *Roth Steel* test

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[14] 453 F.3d 225 (4th Cir. 2006).

[15] *Id.* at 232.

[16] *Id.* at 233.

[17] *Id.*

[18] *Id.* at 234.

[19] *Id.* at 235.

[20] *Id.* (addressed in footnote 6).

and the 13-factor *Hedged-Investments* test *infra* Section I.A.4., were "identical."[21] Indeed, the substantive equivalence of the tests is supported by the fact that other circuit courts have used the multifactor tests, more as general guidelines than as exhaustive checklists.[22]

### 3. Recharacterization in the Third Circuit

In 2006, the Third Circuit in *In re Submicron Systems Corp.* affirmed that bankruptcy courts have the authority to recharacterize debt as equity.[23] However, unlike the Sixth Circuit, the Third Circuit did not endorse one test over another. Instead, the Third Circuit stated that all tests "devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt to discern whether the parties called an instrument one thing when in fact they intended it as something else."[24] The court then proceeded to review the lower court's findings.

The lower court had denied recharacterization, using a 7-factor test from *In re Color Tile, Inc.*, which considered (1) the name given to the instrument; (2) the intent of the parties; (3) the presence or absence of a fixed maturity date; (4) the right to enforce payment of principal and interest; (5) the presence or absence of voting rights; (6) the status of the contribution in relation to regular corporate contributors; and (7) certainty of payment in the event of the corporation's insolvency or liquidation.[25] The lower court's decision had been based on three prevailing factors: the name of the instrument, fixed maturity and interest rate, and evidence of intent to

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[21] *Id.*

[22] *See, e.g.*, In re Alternate Fuels, Inc., 789 F.3d 1139, 1153 (10th Cir. 2015) (stating that recharacterization tests are performed "on balance").

[23] 432 F.3d 448 (3d Cir. 2006).

[24] *Id.* at 456.

[25] 2000 WL 152129, *4 (D. Del. Feb. 9, 2000).

create a debt instrument.[26] The Third Circuit affirmed the lower court's factual findings and its decision not to recharacterize.

The Third Circuit's failure to endorse a specific multifactor test and its focus on the parties' intent appear to distinguish the court from the Sixth and Fourth circuits. But the Third Circuit's approach is functionally equivalent with other circuits' and does not lead to a different result. First, the 7-factor test that the lower court applied had many of the same elements as the *Roth Steel* and *Hedged-Investments*[27] tests. Second, the Third Circuit made its determination on balance, after considering all factors, none of which was dispositive. If the substance of every multifactor test is "identical,"[28] different tests with more or less factors should not yield substantively different results. Behind the Third Circuit's seemingly divergent approach was the same substantive process used in other circuits.

#### 4. Recharacterization in the Tenth Circuit

In 2015, the Tenth Circuit in *In re Alternate Fuels, Inc.* held that bankruptcy courts have the authority to recharacterize debt as equity through the powers granted by § 105(a).[29] This decision built on an earlier case, *In re Hedged-Investments Assocs., Inc.*, where the court applied a 13-factor test to determine whether a claim was debt or equity (but failed to discuss the source of such authority).[30] The *Alternate Fuels* court established in the Tenth Circuit that § 105(a)

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[26] *Submicron*, 432 F.3d at 457.

[27] *Infra* Section I.A.4.

[28] In re Dornier Aviation, 453 F.3d 225, 235 (4th Cir. 2006) (footnote 6).

[29] 789 F.3d 1139 (10th Cir. 2015).

[30] 380 F.3d 1292, 1295 (10th Cir. 2004).

empowers bankruptcy courts to recharacterize debt, and the 13-factor test from *Hedged-Investments* is to be used.

By adopting the 13-factor *Hedged-Investments* test, the Tenth Circuit appeared to diverge from other § 105(a) circuits. However, many of the factors in the *Hedged-Investments* test are the same as those in *Roth Steel*, and their substance is "identical."[31] The 13-factor *Hedged-Investments* test includes (1) the names given to the certificates evidencing the indebtedness; (2) the presence or absence of a fixed maturity date; (3) the source of payments; (4) the right to enforce payment of principal and interest; (5) participation in management flowing as a result; (6) the status of the contribution in relation to other corporate creditors; (7) the intent of the parties; (8) "thin" or adequate capitalization; (9) the identity of interest between the creditor and stockholder; (10) the source of interest payments; (11) the ability of the corporation to obtain loans from outside lenders; (12) the extent to which funds were used to acquire capital assets; and (13) the failure of the debtor to repay on the due date or to seek a postponement.[32]

In its analysis, the Tenth Circuit addressed two Supreme Court decisions used to challenge debt recharacterization. The Tenth Circuit considered the case of *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, where the Supreme Court, citing § 502(b), stated: "claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed."[33] Challenging the power to recharacterize, it was argued that, applying *Travelers*, "a court may not fashion a test 'solely for its own creation' in

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[31] *In re Dornier Aviation*, 453 F.3d at 235 (footnote 6).

[32] *Alternate Fuels*, 789 F.3d at 1149.

[33] 549 U.S. 443, 452 (2007).

determining what constitutes a 'claim' for purposes of bankruptcy."[34] The Tenth Circuit also considered *Law v. Siegel*, where the Supreme Court stated that § 105(a) may not override other provisions of the Code.[35] It was argued that § 105(a) recharacterization was not permissible when in conflict with § 502(b).[36]

The Tenth Circuit rejected both challenges. First, the court found that both *Travelers* and *Law* were not decided in a recharacterization context, nor did they expressly overrule *Hedged-Investments*.[37] Second, the Tenth Circuit determined that disallowance under § 502(b) and recharacterization under § 105(a) are two distinct courses of action: disallowance is used in cases when "the claimant has no rights vis-à-vis the bankrupt," while recharacterization is used to understand the true nature of a claim.[38] As such, recharacterization does not eliminate the claim, but relegates the claim to the level of "equity to be paid upon satisfaction of the debtor's other outstanding obligations."[39]

### B. **Section 502(b) Approach**

The Fifth and Ninth Circuits attribute a bankruptcy court's power to recharacterize debt to § 502(b) of the Code.

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[34] *Alternate Fuels*, 789 F.3d at 1148.

[35] 134 S. Ct. 1188, 1194 (2014).

[36] *Alternate Fuels*, 789 F.3d at 1148.

[37] *Id.*

[38] *Id.*

[39] *Id.*

### 1. Recharacterization in the Fifth Circuit

In 2011, the Fifth Circuit in *In re Lothian Oil Inc.* held that (i) recharacterization is part of a bankruptcy court's authority to allow and disallow claims under § 502(b), and (ii) state law should be applied to determine if a claim should be recharacterized.[40] The Fifth Circuit looked to § 502(b) of the Code, that "the court … shall determine the amount of such claim … and shall allow such claim in such amount, except to the extent that—(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or *applicable law*…."[41] The Fifth Circuit found that the "applicable law" in this case was state law.[42] The Fifth Circuit was guided by the Supreme Court's decision in *Butner v. U.S.*, that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to *state law*."[43]

The Fifth Circuit observed that Texas courts have used multifactor tests from federal tax law to determine whether a loan is debt or equity,[44] noting that, when applying these tests, all factors are considered, factors may have varying significance, and no one factor is controlling.[45] The Fifth Circuit acknowledged a 16-factor test applied by one Texas court, but did not actually apply this test in *Lothian*. Instead, the Fifth Circuit affirmed the lower court's ruling -- which had been based on a different 11-factor test, similar to the one in *Roth Steel* -- that the underlying

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[40] 650 F.3d 539, 543 (5th Cir. 2011).

[41] *Id.* (emphasis added).

[42] *Id.*

[43] 440 U.S. 48, 54 (1979) (emphasis added).

[44] *Lothian*, 650 F.3d at 544.

[45] *Id.*

loan should be recharacterized.[46] The Fifth Circuit highlighted key elements of the test, such as a lack of a specified interest rate, term of repayment, and maturity date, and concluded that, because Texas law would not have recognized the claims as debt, they were properly recharacterized as equity.[47]

The Fifth Circuit's decision in *Lothian* is notable for several reasons. First, the Fifth Circuit based the bankruptcy court's power to recharacterize on § 502(b), unlike the Third, Fourth, Sixth, and Tenth Circuits, which based the power to recharacterize on § 105(a). Second, notwithstanding disagreement as to the basis of the recharacterization power, the Fifth Circuit ultimately used a multifactor test, much like § 105(a) circuits, demonstrating that, regardless of the source of the recharacterization power, the substantive analysis may be the same.

### 2. Recharacterization in the Ninth Circuit

In 2013, the Ninth Circuit in *In re Fitness Holdings International* held that courts may recharacterize debt, reversing a longstanding precedent.[48] Previously, lower courts in the Ninth Circuit had followed the decision of the Ninth Circuit Bankruptcy Appellate Panel in *In re Pacific Express, Inc.,*[49] which had held that characterization of claims was exclusively

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[46] *Id*.

[47] *Id.*

[48] 714 F.3d 1141 (9th Cir. 2013).

[49] 69 B.R. 112 (B.A.P. 9th Cir 1986). Prior to *Fitness Holdings*, lower courts in the Ninth Circuit followed *Pacific Express* in subordination proceedings. *See, e.g.*, In re Murgillo, 176 B.R. 524, 533 (B.A.P. 9th Cir. 1994) (the "proper exercise of equitable powers regarding allowed claims is through the equitable subordination provisions of § 510(c)"); In re Audre, Inc., 210 B.R. 360, 367 (Bankr. S.D. Cal. 1997) (citing the test found in *Pacific Express* as controlling authority); In re C.P.C. Dev. Co. No. 5, 113 B.R. 637, 641-42 (Bankr. C.D. Cal. 1990) (applying the equitable subordination test from *Pacific Express*).

authorized by, and limited to, equitable subordination principles found in § 510(c) of the Code. By overruling *Pacific Express*, the Ninth Circuit joined the five other circuits that had authorized bankruptcy courts to recharacterize debt, where appropriate.

The Ninth Circuit in *Fitness Holdings* held that courts have the authority to recharacterize debt in accordance with state law. The court disagreed with the holding in *Pacific Express*, which stated that the authority to characterize claims was exclusively drawn from § 510(c).[50] Instead, the court aligned itself with the Fifth Circuit's approach in *Lothian*, which had looked at the lender's claim under § 502(b) and applied a multifactor test pursuant to Texas law.[51] The Ninth Circuit rejected § 105(a) as the source of recharacterization authority, stating "it was inconsistent with Supreme Court precedent".[52]

## C. Recharacterization in Other Circuits

### 1. Recharacterization in the Eleventh Circuit

The Eleventh Circuit has indicated that bankruptcy courts have the authority to recharacterize debt, although it has not identified the source of the authority. In 1986, the Eleventh Circuit in *In re N&D Properties, Inc.* held that insider loans "may be deemed capital contributions in one of two circumstances: where trustee proves initial undercapitalization or where trustee proves that loans were made when no other disinterested lender would have

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[50] *Fitness Holdings*, 714 F.3d at 1147.

[51] *Id.* at 1148.

[52] *Id.*

extended credit."[53] Unlike other circuits that point to either § 105(a) or § 502(b) as enabling authority, the Eleventh Circuit has been silent on the matter.

Some lower courts in the Eleventh Circuit have followed this standard in debt recharacterization. [54] But others have not, choosing instead to adopt the 13-factor *Hedged-Investments* test. [55]

**2. Recharacterization in Bankruptcy Courts of Other Circuits**

The U.S. Courts of Appeals in the First, Second, Seventh, Eighth, and D.C. Circuit have yet to address the issue of debt recharacterization, but some lower courts in these circuits have.

In the First Circuit, many lower courts have applied the "*Hyperion* test," not used by any other circuit.[56] The *Hyperion* test has four factors and five "relevant questions": (1) the adequacy of capital contributions; (2) the ratio of shareholder loans to capital; (3) the amount or degree of shareholder control; (4) the availability of similar loans from outside lenders; and (5) certain relevant questions, such as (a) whether the ultimate financial failure was caused by under-capitalization; (b) whether the note included payment provisions and a fixed maturity date;

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[53] 799 F.2d 726, 733 (11th Cir. 1986).

[54] *See, e.g.*, Diasonics Inc. v. Ingalls, 121 B.R. 626, 630 (Bankr. N.D. Fla. 1990).

[55] *See, e.g.*, In re Biscayne Inv. Group, Ltd., 264 B.R. 765 (Bankr. S.D. Fla. 2001); In re Blevins Concession Supply Co., 213 B.R. 185 (Bankr. M.D. Fla. 1997); Celotex Corp. v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.), 176 B.R. 223, 248 (M.D. Fla. 1994). One reason for the popularity of this test over the 11-factor *Roth Steel* test may be because the former was derived from an earlier Eleventh Circuit case, *Stinnett's Pontiac Service, Inc. v. Commissioner of Internal Revenue,* 730 F.2d 634, 638 (11th Cir.1984).

[56] *See, e.g.*, In re Tempnology, LLC, 542 B.R. 50, 70 (Bankr. D.N.H. 2015); Blasbalg v. Tarro (In Hyperion Enters., Inc.), 158 B.R. 555, 561 (D.R.I. 1993); In re Felt Mfg. Co., Inc., 371 B.R. 589, 629 (Bankr. D.N.H. 2007); In re Micro–Precision Techs., Inc., 303 B.R. 238, 246 (Bankr. D.N.H. 2003).

(c) whether a note or other debt document was executed; (d) whether advances were used to acquire capital assets; and (e) how the debt was treated in the business records.[57] Many of these factors overlap with the *Hedged-Investments* test and the *Roth Steel* test, and all three tests seem functionally equivalent.

In the Second Circuit, lower courts have largely adopted the Sixth Circuit's approach.[58] For example, the bankruptcy court in the Southern District of New York in *In re BH S & B Holdings LLC* stated that § 105(a) is the relevant authority for debt recharacterization and applied the Sixth Circuit's *Roth Steel* 11-factor test to determine the true nature of the underlying claim.[59]

Similarly, in the Seventh Circuit, lower courts have largely adopted the Sixth Circuit's approach.[60] For example, the Northern District of Illinois in *In re Outboard Marine Corp.* determined that bankruptcy courts have authority to recharacterize debt as equity, and applied the Sixth Circuit's *Roth Steel* 11-factor test to analyze the debt.[61]

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[57] In re Hyperion Enterprises, Inc., 158 B.R. 555, 561 (D.R.I. 1993).

[58] *See, e.g.*, In re BH S & B Holdings LLC, 807 F. Supp.2d 199 (S.D.N.Y. 2011); In re Gene. Motors Corp., 407 B.R. 463, 498-99 (Bankr. S.D.N.Y. 2009); In re Adelphia Commc'n Corp., 365 B.R. 24, 73-74 (Bankr. S.D.N.Y. 2009).

[59] 420 B.R. 112, 157 (Bankr. S.D.N.Y. 2009), *aff'd as modified*, 807 F. Supp. 2d 199 (S.D.N.Y. 2011).

[60] *See, e.g.*, In re Repository Techs., Inc., 381 B.R. 852, 865 (N.D. Ill. 2008), vacated, 601 F.3d 710 (7th Cir. 2010); In re Gluth Bros. Const., Inc., 424 B.R. 379, 395 (Bankr. N.D. Ill. 2009).

[61] *In re Outboard Marine Corp.,* No. 00 B 37405, 2003 WL 21697357, at *5 (N.D. Ill. July 22, 2003).

In the Eighth Circuit, lower courts have often invoked § 105(a) and have used the 11-factor *Roth Steel* test.[62] However, a recent case suggests that lower courts in the Eighth Circuit might question whether they have authority to recharacterize debt as equity under § 105(a). In *In re MSP Aviation, LLC,* the bankruptcy court avoided a decision on whether the court had authority under § 105(a) to recharacterize debt as equity, stating that the Eighth Circuit had not ruled on the matter,[63] and that the Supreme Court precedents in *Travelers* and *Law*[64] suggested otherwise. The court concluded that, if it had the power to equitably recharacterize debt to equity, it would not do so in this case because the facts did not support recharacterization.[65]

In the District of Columbia Circuit, the bankruptcy court in *In re Georgetown Bldg. Associates, Ltd. Partnership,*[66] found that it had the authority to recharacterize debt to equity because the issue was a matter of *characterizing* the claim's "true character."[67] The court did not articulate a specific test, and declined to "recite all of the various factors courts examine."[68] Instead, the court took a more targeted look at the factors that might reveal the true substance of the claim, focusing on the lack of a fixed date of repayment, the conditional nature of repayment, and the status of the lenders as insiders.[69] Nonetheless, the analysis resembled the common

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[62] *See, e.g.*, In re Hoffinger Indus., Inc., 327 B.R. 389, 408 (Bankr. E.D. Ark. 2005); In re Vanguard Airlines, Inc., 302 B.R. 292, 300 (Bankr. W.D. Mo. 2003).

[63] 531 B.R. 795, 805 (Bankr. D. Minn. 2015).

[64] *Id. See also supra* Section I.A.4.

[65] 531 B.R. 795, 806.

[66] *See* 240 B.R. 124 (Bankr. D.D.C. 1999).

[67] *Id.* at 137.

[68] *Id.*

[69] *Id.*

approach taken by other courts, which focus on a few relevant factors that closely relate to the facts of the case.[70]

## *II.* ***Section 105(a) vs. Section 502(b): Different Results?***

Courts often diverge on whether the authority to recharacterize debt comes from § 105(a) or § 502(b). While the two sources of authority are legally distinct, it is not clear that the two approaches actually lead to different analyses, or even results. Courts that apply either § 105(a) or § 502(b) may end up using the same or similar multifactor tests in their analyses.

Since debt recharacterization aims to discern the true substance of the loan, it is not surprising that courts consider many of the same factors. Therefore, even if controlling circuit precedent requires a different basis of recharacterization authority, and even if the courts use different multifactor tests, the substantive analysis often considers similar factors, and may lead to the same result. The Fifth Circuit's analysis in *Lothian* is illustrative of this.[71] Therefore, whether courts use § 502(b) or § 105(a) appears to have limited impact on the factors courts will consider in determining recharacterization, or the ultimate result.

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[70] *See, e.g.*, *supra* Section I.A.3. (discussing the approach of the Third Circuit).

[71] *See* 650 F.3d 539 (5th Cir. 2011). The Fifth Circuit was the first to adopt the § 502(b) approach, yet, the 16-factor test used by the Fifth Circuit in *Lothian* had many similarities with tests used in other circuits.

**Summary of Debt Recharacterization Tests**

| **Factors** | ***Roth Steel* Test** (6th, 4th, 2d, 7th, 8th) | ***Hedged-Inv.* Test** (10th, 11th) | ***Color Tile* Test** (3d) | ***Hyperion* Test** (1st) |
|---|---|---|---|---|
| The names given to the certificates evidencing the indebtedness | ■ | ■ | ■ | |
| The presence or absence of a fixed maturity date | ■ | ■ | ■ | ■ |
| The source of payments | ■ | ■ | | |
| The right to enforce payment of principal and interest | | ■ | ■ | |
| Participation in management flowing as a result | | ■ | | |
| The status of the contribution in relation to other corporate creditors | ■ | ■ | ■ | |
| The intent of the parties | | ■ | ■ | |
| "Thin" or adequate capitalization | ■ | ■ | | ■ |
| The identity of interest between the creditor and stockholder | ■ | ■ | | |
| The source of interest payments | | ■ | | |
| The ability of the corporation to obtain loans from outside lenders | ■ | ■ | | ■ |
| The extent to which funds were used to acquire capital assets | ■ | ■ | | ■ |
| The failure of the debtor to repay on the due date or to seek a postponement | | ■ | | |

| The presence or absence of a fixed rate of interest and interest payments | | | | |
|---|---|---|---|---|
| The security, if any, for the advances | | | | |
| The presence or absence of a sinking fund to provide repayments | | | | |
| The presence or absence of voting rights | | | | “amount or degree of shareholder control” |
| Certainty of payment in the event of corp’s insolvency or liquidation | | | | |
| The ratio of shareholder loans to capital | | | | |
| Whether the ultimate financial failure was caused by under-capitalization | | | | |
| Whether a note or other debt document was executed | | | | |
| How the debt was treated in business records | | | | |

**Eric Brunstand, Dechert LLP,**
***Motion for Leave to File and Brief of Bankruptcy Law Professors as Amici Curiae in Support of Granting the Petition*, Aurelius Cap. Mgmt, L.P. v. Tribune Media Co.,**
**Supreme Court, No. 15-891**

No. 15-891

IN THE

# Supreme Court of the United States

AURELIUS CAPITAL MANAGEMENT, LP,

*Petitioner*,

v.

TRIBUNE MEDIA COMPANY, F/K/A TRIBUNE COMPANY, F/K/A TIMES MIRROR CORPORATION; OFFICIAL COMMITTEE OF UNSECURED CREDITORS; OAKTREE CAPITAL MANAGEMENT, LP; ANGELO GORDON & COMPANY; AND JPMORGAN CHASE BANK, NA, ET AL.,

*Respondents*.

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

## MOTION FOR LEAVE TO FILE AND BRIEF OF BANKRUPTCY LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF GRANTING THE PETITION


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## MOTION OF *AMICI CURIAE* FOR LEAVE TO FILE BRIEF IN SUPPORT OF PETITIONER

Pursuant to Supreme Court Rule 37.2(b), the undersigned group of bankruptcy law professors respectfully moves for leave of Court to file the accompanying brief *amici curiae*. In accordance with Rule 37.2(a), *amici* have provided timely notice to all parties of their intent to file a brief. Petitioner Aurelius Capital Management, L.P. and Respondents Tribune Media Company, JPMorgan Chase, NA, and Deutsche Bank Trust Company Americas have consented to *amici* filing a brief, and letters of consent have been filed with the Court. The Petition for Writ of Certiorari names five additional Respondents. Upon information and belief, three of these named Respondents[1] have informed the Court that they do not intend to participate in this proceeding as parties. The remaining two named Respondents, Oaktree Capital Management, L.P. and Angelo, Gordon & Co. have neither consented nor advised the Court that they no longer intend to participate in this case.

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[1] The Official Committee of Unsecured Creditors has been dissolved. Wilmington Trust Company and EGI-TRB LLC have stated that they are not involved in this matter.

*Amici* are bankruptcy law professors at major American law schools and collectively represent a broad range of perspectives on bankruptcy law. Each has a deep interest in the development of bankruptcy law and the application of equitable principles in bankruptcy proceedings. This case presents a recurring question of vital importance in bankruptcy law: whether and to what extent an appellate court may decline to hear and determine an appeal of a decision of a bankruptcy court on grounds of "equitable mootness." While every federal court of appeals has adopted and applied some form of the equitable mootness doctrine, they differ substantially regarding its proper scope, generating great controversy that this Court has yet to resolve.

*Amici* differ on whether there should be an equitable mootness doctrine and, if so, what its contours should be, but agree that the Court should grant the Petition for Writ of Certiorari to lend some guidance in this important area of bankruptcy law and federal appellate jurisdiction. The attached brief offers a unique and detailed account of the discrepancies in the courts of appeals with regard to the contours of the equitable mootness doctrine and the constitutional issues arising therefrom that this Court should address.

For these reasons, *amici curiae* respectfully request that the Court grant leave to file this brief.

Respectfully submitted,

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## INTEREST OF THE *AMICI CURIAE*[1]

*Amici* are all bankruptcy law professors at major American law schools and collectively represent a broad range of perspectives on bankruptcy law.

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Ralph Brubaker is the Carl L. Vacketta Professor of Law at the University of Illinois College of Law.

Jessica Gabel Cino is an Associate Professor at Georgia State University College of Law.

Robert M. Lawless is the Associate Dean for Research, Max L. Rowe Professor of Law, and Co-director of the Illinois Program on Law, Behavior and Social Science at the University of Illinois College of Law.

Ronald Mann is the Albert E. Cinelli Enterprise Professor of Law and Co-Director of the

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. All parties have been timely notified of the undersigned's intent to file this brief.

Charles Evans Gerber Transactional Studies Center at Columbia Law School.

Bruce A. Markell is a Professor of Bankruptcy Law and Practice at Northwestern Pritzker School of Law.

Robert K. Rasmussen is the J. Thomas McCarthy Trustee Chair in Law and Political Science at the USC Gould School of Law.

Charles J. Tabb is the Mildred Van Voorhis Jones Chair in Law at the University of Illinois College of Law.

This brief addresses whether the Court should grant certiorari on a vitally important and recurring question of bankruptcy law: whether and to what extent an appellate court may decline to hear and determine an appeal of a decision of a bankruptcy court on grounds of "equitable mootness." The issue is significant because, although every federal court of appeals has adopted and applied some form of the equitable mootness doctrine, they differ substantially regarding its proper scope and content, and the doctrine has generated great controversy. The issue is also important because the doctrine is routinely used to deny appellants their statutory rights of appeal and excuse appellate courts from exercising jurisdiction they otherwise possess. Finally, the issue is of significance because

bankruptcy judges are not Article III judges and the ability of Article III appellate courts to review the decisions of bankruptcy judges is critical to maintaining the constitutionality of the current bankruptcy jurisdictional scheme. For these and other reasons, the petition for a writ of certiorari should be granted.

## SUMMARY OF THE ARGUMENT

As the Third Circuit explained below, equitable mootness is an ostensibly "narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization." Pet. App. 11a. As such, the doctrine is an equitable exception to the federal courts' "virtually unflagging obligation" to exercise the jurisdiction Congress has granted to them. *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976). The central tension that animates controversy over the equitable mootness doctrine is thus easy to identify: it arises from the fact that courts are using an equitable concept to override a litigant's legal appellate rights in circumstances Congress has not expressly authorized.

Although each of the federal courts of appeals has recognized and applied some version of the doctrine of equitable mootness (save the Federal

Circuit, which does not hear bankruptcy appeals), this Court has never determined either the doctrine's validity or its proper metes and bounds. In addition, the courts of appeals have developed markedly different standards for its application. Several courts have identified various factors to be considered in analyzing whether an appeal should be deemed to be equitably moot, but there is disagreement as to what those factors are, how much weight they should be given, and otherwise how they should be applied. For example, the Second Circuit generally presumes that an appeal requesting relief in conflict with a confirmed bankruptcy plan is equitably moot if the plan has been substantially implemented. In contrast, other courts of appeals have not adopted this presumption.

In general, an equitable mootness determination requires a court to balance two interests—"the equitable considerations of finality and good faith reliance on a judgment and the competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him." *First Union Real Estate Equity and Mortg. Inv. v. Club Assocs. (In re Club Assocs.)*, 956 F.2d 1065, 1069 (11th Cir. 1992). As a result of the inconsistent approaches courts of appeals have taken in making this determination, different courts balance these interests in different ways and the parameters of the doctrine stand in remarkable disarray. This Court

should grant certiorari to lend some much needed guidance in this important area of bankruptcy law and federal appellate jurisdiction.

## ARGUMENT

### The Court Should Grant Certiorari To Determine The Validity And Scope Of The Doctrine Of Equitable Mootness.

It is axiomatic that the federal courts have a "virtually unflagging obligation" to exercise the jurisdiction that Congress has bestowed upon them. *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976). In bankruptcy, Congress has vested the federal district and circuit courts with broad appellate jurisdiction to review the decisions of bankruptcy judges. 28 U.S.C. § 158. Notably, section 158 makes no mention of the doctrine of equitable mootness. Nor is the doctrine premised on constitutional considerations. Rather, it is essentially grounded in practical finality concerns, prescribing generally that, following substantial implementation of a confirmed bankruptcy plan, any appeal seeking relief in conflict with the plan may be dismissed as "equitably moot" if granting appellate relief would effectively undo the plan in some material way. *See, e.g., Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.),* 652 F.2d 793, 797 (9th Cir. 1981). Although the denial of the right of appeal "places a

heavy burden on aggrieved party-appellants in bankruptcy cases," a finding of equitable mootness has been held to be "justified to prevent frustration of orderly administration of estates under various provisions of the Bankruptcy Act." *Id.* at 798. In essence, the doctrine of equitable mootness is a super-finality rule: it ensures that, after a bankruptcy court has confirmed a plan of reorganization and the plan has gone effective, the plan's terms cannot be undone or materially undermined. In effect, it extends to the appellate context the generally binding nature of confirmed plans set forth in section 1141(a) of the Bankruptcy Code, which provides in relevant part that "the provisions of a confirmed plan bind the debtor, [various third parties], any creditor, equity security holder, or general partner in the debtor . . . ." 11 U.S.C. § 1141(a). But it is one thing for a plan to be binding on the parties, and something else for it to bind an appellate court tasked with reviewing its validity.

Although every court of appeals has applied the doctrine of equitable mootness, this Court has not yet determined its validity and scope.[2] It

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[2] In *Bank of America Nat'l Trust & Sav. Ass'n. v. 203 N. LaSalle St. P'ship*, No. 97-1418 (1998), respondent opposed certiorari, and later moved to dismiss the matter, on the ground that, because its chapter 11 plan had long gone effective, principles of equitable mootness barred further appellate review. This Court, however, disregard-

is important that the Court do so because the circuits vary significantly in their formulations of the doctrine, including the proper tests to be applied and the factors to be considered in conducting any equitable mootness inquiry. These differences have resulted in profound inconsistency and disarray in the determination of bankruptcy appellate rights. Moreover, the issue is particularly ripe, given its exceptionally long percolation in the lower courts without this Court's intervention or guidance. Finally, the issue is critically important because bankruptcy judges are not Article III judges and the constitutionality of the current bankruptcy jurisdictional scheme turns on robust review of the decisions of bankruptcy judges by the Article III district and circuit courts. Quite clearly, any denial on "equitable" grounds of a statutory right of appeal effectively erodes that essential review. Certiorari is warranted.

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ed that argument without comment and instead reached the merits of an important issue of bankruptcy law. Although the Court did not address the doctrine of equitable mootness directly, it is worth noting that respondent's invocation of the doctrine, if successful, would have prevented the Court from deciding the merits of the case.

### A. The Doctrine of Equitable Mootness Attempts To Balance A Number Of Interests And Favors Finality At The Expense Of Appellate Review.

Courts apply the doctrine of equitable mootness most often in chapter 11 proceedings, as it typically "responds 'to the particular problems presented by the consummation of [chapter 11] plans of reorganization . . . .'" *Tech. Lending Partners, LLC v. San Patricio Cnty. Cmty. Action Agency (In re San Patricio Cnty. Cmty. Action Agency)*, 575 F.3d 553, 558 (5th Cir. 2009) (quoting *In re Grimland, Inc.*, 243 F.3d 228, 231 n.4 (5th Cir. 2001)). Before a chapter 11 debtor may emerge from bankruptcy as a reorganized entity, the bankruptcy court must approve a plan of reorganization. 11 U.S.C. § 1129. Once a bankruptcy court confirms a plan, the confirmation order is automatically stayed for fourteen days. Fed. R. Bankr. P. 3020(e). This delay permits parties wishing to pursue a variety of appellate rights the opportunity to seek a stay of implementation of the confirmation order and, accordingly, the effectiveness of the plan, thus preventing the doctrine of equitable mootness from even arising. Obtaining such a stay, how-

ever, is typically a daunting task, and most efforts to do so are not successful.[3]

If a stay of the confirmation order is not sought, or is sought but not obtained, the plan may go effective regardless of the pendency of appeals that seek relief inconsistent with the plan's terms. Among other things, the debtor's assets may be sold, claims may be paid, and third parties may transact business with the reorganized debtor in reliance on the plan. Appellate courts faced with appeals seeking relief that conflicts with the terms and effect of a plan thus often find themselves in the position of having to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and the competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him." *First Union Real Estate Equity and Mortg. Inv. v. Club Assoc. (In re Club Assoc.)*, 956 F.2d 1065, 1069 (11th Cir. 1992). The conceptual vehicle for striking this balance is the doctrine of equitable mootness, whereby an appeal may be dismissed "when, even though effective relief could conceivably be fashioned, implementation of that re-

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[3] Among other things, obtaining a stay requires a demonstration of likelihood of success on the merits and irreparable injury in the absence of a stay. Notably, some courts have held that the prospect of mootness is not irreparable injury.

lief would" in the view of the appellate court "be inequitable." *Official Comm. of Unsecured Creditors of LTV Aerospace and Defense Co. Inc. v. Official Comm. of Unsecured Creditors of LTV Steel Co., Inc. (In re Chateaugay Corp.)*, 988 F.2d 322, 325 (2d Cir. 1993).

Unlike constitutional mootness, equitable mootness "is not an Article III inquiry as to whether a live controversy is presented; rather, it is a recognition by the appellate courts that there is a point beyond which they cannot order fundamental changes in reorganization actions." *Manges v. Seattle First Nat'l Bank (In re Manges)*, 29 F.3d 1034, 1039 (5th Cir. 1994); *see also Mac Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622, 625 (4th Cir. 2002) (doctrine of equitable mootness is "grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable"). The doctrine reflects the belief that "the ability to achieve finality [in bankruptcy proceedings] is essential to the fashioning of effective remedies" because "completed acts in accordance with an unstayed order of the bankruptcy court must not thereafter be routinely vulnerable to nullification if a plan of reorganization is to succeed." *In re Chateaugay Corp.*, 988 F.2d at 325-26. The doctrine thus rests clearly on practical considerations and favors finality over appellate review.

### B. The Courts Of Appeals Apply Inconsistent Tests For Determining Equitable Mootness.

Although the federal courts of appeals universally recognize equitable mootness as a legitimate basis for dismissing bankruptcy appeals, they have developed inconsistent methods for analyzing whether an appeal should be dismissed under the doctrine. To begin with, the circuits generally agree that the first step in the analysis is to determine whether a confirmed plan has been materially implemented—in the vernacular, whether there has been "substantial consummation" of the plan's terms. The concept of "substantial consummation" is defined in the Bankruptcy Code as:

> (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
>
> (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
>
> (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2). Notably, courts generally agree that it is the substantial consummation of a plan that triggers application of the equitable mootness doctrine, but thereafter part company on the significance of substantial consummation in the analysis. The most common approach endorsed by several courts of appeals is that, once substantial consummation occurs, a court is to apply a balancing test to determine whether dismissal is warranted. Even among the courts that take this general approach, however, there is disagreement over the relevant factors (ranging from three to six) and the weight to be given to each. For example, the Third Circuit has recently streamlined its equitable mootness analysis, and considers first whether substantial consummation of the reorganization plan has occurred and then, if so, moves on to review the other factors it applies. Pet. App. 12a-13a. Notably, however, the court does not presume equitable mootness to exist upon substantial consummation and requires the party seeking dismissal to demonstrate that the appeal should be denied. In contrast, the Second Circuit follows the rule that substantial consummation triggers a presumption of equitable mootness, and places the burden on the appellant to overcome that presumption. *Frito-Lay, Inc. v. LTV Steel Co., Inc. (In re Chateaugay Corp.)*, 10 F.3d 944, 952-53 (2d Cir. 1993).

Courts likewise differ regarding the importance of an appellant's effort to obtain a stay of the confirmation order. The Ninth Circuit considers this a dispositive factor, moving on to other considerations only after determining that the appellant at least attempted to obtain a stay. *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.),* 677 F.3d 869, 881 (9th Cir. 2012). Other circuits follow a different path. In addition, some iterations of the relevant factors remain fairly vague. As a result of these and other inconsistencies and concerns, the doctrine of equitable mootness stands in profound disarray. This Court's intervention is warranted.

### 1. The "Majority" Approach: A Balancing Of Competing Considerations

Several courts have identified a number of distinct factors to be considered in determining whether to dismiss an appeal as equitably moot (as the Third Circuit did below) and place the burden of proof on the party seeking dismissal of the appeal. *See* Pet. App. 11a.[4] While this is in a general sense the "majority" approach, the

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[4] *See also In re Thorpe,* 677 F.3d at 8780; *Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704, 713-14 (4th Cir. 2011); *In re Lett*, 632 F.3d 1216, 1226 (11th Cir. 2011); *Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327, 1339-1340 (10th Cir. 2009).

number of factors and the weight they are given typically vary from court to court.

The Third Circuit originally identified five factors relevant to its equitable mootness analysis:

> (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of the parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.

Pet. App. 12a (quoting *In re Continental Airlines*, 91 F.3d 553, 560 (3d Cir. 1996) (*en banc*)). More recently, the court has "refined the doctrine to its current, more determinate state," whereby "equitable mootness . . . proceed[s] in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) *if so*, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation." Pet. App. 13a (quoting *Samson Energy Res. Co. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 728 F.3d 314, 321 (3d Cir. 2013)) (emphasis added). Thus, the

Third Circuit will first look to whether the relevant plan is "substantially consummated" as that term is defined in the Bankruptcy Code and only "[i]f this threshold is satisfied . . . continue to the next step in the analysis." *In re SemCrude*, 728 F.3d at 321. Despite a finding of substantial consummation, dismissal on grounds of equitable mootness is inappropriate if "relief would *neither* fatally scramble the plan *nor* significantly harm the interests of third parties who have justifiably relied on plan confirmation." Pet. App. 13a (emphasis in original).

Similar to the Third Circuit, the Eleventh Circuit's approach starts with a determination as to "whether the 'reorganization plan has been so substantially consummated that effective relief is no longer available,'" but recognizes that "[e]ven if substantial consummation has occurred, a court must still consider all the circumstances of the case to decide whether it can grant effective relief." *In re Club Assocs.*, 956 F.2d at 1069 (quoting *Miami Ctr. Ltd. P'ship v. Bank of New York*, 820 F.2d 376, 379 (11th Cir. 1987)). The court has framed the additional circumstances to be considered rhetorically as:

> 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 on appeal? What effect would granting relief have on the interests of third parties not before the court? And, would relief affect the re-emergence of the debtor as a revitalized entity?

*Id.* at 1069 & n.11. Thus, although the Eleventh Circuit considers substantial consummation "the most significant consideration," it "is not the sole consideration." *In re Strickland and Davis Int'l, Inc.*, 612 F. App'x 971, 978 (11th Cir. 2015). Rather, the questions listed in *Club Associates* "provide the reviewing court with the backdrop to evaluate the ultimate issue of whether a confirmation plan has progressed to the point where effective judicial relief is no longer a viable option." *In re Club Assocs.,* 956 F.2d at 1069 n.11.

The Ninth Circuit is the most recent court of appeals to adopt specific factors to evaluate equitable mootness, having previously applied a test for mootness in bankruptcy proceedings that combined both constitutional and equitable mootness concepts. *See In re Thorpe*, 677 F.3d at 880. Prior to its 2012 decision in *Thorpe*, the Ninth Circuit first looked to whether events had occurred "that make it impossible for the appellate court to fashion effective relief," and then to whether "appellants have failed and neglected diligently to pursue their available remedies to obtain a stay of the objectionable orders of the

Bankruptcy Court, thus permitting such a comprehensive change of circumstances to occur as to render it inequitable . . . to consider the merits of the appeal." *Focus Media, Inc. v. Nat'l Broadcasting Co. Inc. (In re Focus Media, Inc.)*, 378 F.3d 916, 922-23 (9th Cir. 2004) (citation and internal quotation marks omitted). The court referred to the second piece of the mootness inquiry as "equitable mootness," but had "not yet expressly articulated a comprehensive test" for how to conduct its analysis. *In re Thorpe*, 677 F.3d at 880-81.

In *Thorpe*, however, the Ninth Circuit embraced a test similar to those of other circuits within the majority, though before applying the various factors the court "will look first at whether a stay was sought, for absent that a party has not fully pursued its rights," and only "[i]f a stay was sought and not gained," will it then consider: (1) "whether substantial consummation of the plan has occurred," (2) "the effect a remedy may have on third parties not before the court," and (3) "whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court." *Id.* at 881. Because "it is obligatory upon [the] appellant . . . to pursue with diligence all available remedies to obtain a stay of the objectionable order," *Rev Op Grp. v. ML Manager LLC (In re*

*Mortgs. Ltd.)*, 771 F.3d 1211, 1215-16 (9th Cir. 2014) (internal quotation marks omitted), under the Ninth Circuit's test, although "an appeal should not be automatically dismissed for failure to *obtain* a stay . . . an appellant must *seek* a stay," *id.* at 1216 (emphasis in original). An appellant who fails to seek a stay, or at least give an adequate reason for failing to do so, "has by definition 'not fully pursued its rights,' and thus the appeal is subject to dismissal." *Id.* (quoting *In re Roberts Farms, Inc.*, 652 F.2d at 798); *but see id.* at 1215-16 (noting that on at least two occasions the Ninth Circuit denied dismissal for equitable mootness where the appellant failed to seek a stay based on the specific facts of the case).

The Fourth, Fifth, and Sixth Circuits apply essentially identical tests with largely cosmetic differences. The Fourth Circuit's four-part test incorporates most of the factors the Third Circuit traditionally considered. *See Retired Pilots Assoc. of US Airways v. US Airways Grp., Inc. (In re US Airways Grp., Inc.)*, 369 F.3d 806, 809 (4th Cir. 2004) (factors to be considered are: "(1) whether the appellant sought and obtained a stay; (2) whether the reorganization plan or other equitable relief ordered has been substantially consummated; (3) the extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and (4) the extent to which the relief

requested on appeal would affect the interests of third parties" (quoting *Mac Panel*, 283 F.3d at 625)). The Fifth and Sixth Circuits apply a three-part test that incorporates the four factors used in the Fourth Circuit, only combining the last two into one. *Scotia Pac. Co., LLC v. Official Unsecured Creditors Comm. (In re Pacific Lumber, Co.)*, 584 F.3d 229, 240 (5th Cir. 2009) (stating that the "court accordingly considers '(1) whether a stay was obtained, (2) whether the plan has been substantially consummated, and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.'" (quoting *In re Manges*, 29 F.3d at 1039)); *see also Bank of Montreal v. Official Comm. of Unsecured Creditors (In re American HomePatient, Inc.)*, 420 F.3d 559, 563-64 (6th Cir. 2005) (expressly adopting Fifth Circuit test). The Fifth Circuit has expressly declined to recognize as a legitimate factor the public policy consideration that the Third Circuit traditionally included in its list. *In re United Producers, Inc.*, 526 F.3d 942, 947 n.2 (5th Cir. 2008).

Adopting a posture that is somewhat more flexible and fluid than some of its peers, the Fourth Circuit has stated that application of the equitable mootness doctrine "does not employ rigid rules," and the factors merely serve to guide the court in determining "whether judicial relief on appeal can, as a pragmatic matter, be

granted." *Mac Panel*, 283 F.3d at 625; *see also Behrmann,* 663 F.3d at 713 (declining to dismiss appeal as equitably moot in spite of plan being substantially consummated where appellants sought a stay and where debtor "failed to demonstrate how the relief requested . . . would jeopardize the success of the [plan]"). Likewise, the Fifth Circuit has stated that "[t]here is no set weight given to the respective prongs," and that "[i]n some cases, a single prong may be determinative." *Alberta Energy Partners v. Blast Energy Svcs., Inc. (In re Blast Energy Svc., Inc.)*, 593 F.3d 418, 424 (5th Cir. 2010). However, "more often the first two are relevant only insofar as they affect the answer to the third question; if no stay has been obtained and the plan has been substantially consummated, the more likely the third prong indicates equitable mootness." *Id.* Substantial consummation "is not necessarily fatal to the appeal of a confirmed reorganization plan," as "[o]nly when the relief that a party requests will likely unravel the plan does it become impracticable and inappropriate for a court to grant such relief." *Id.* at 425; *accord In re American HomePatient*, 420 F.3d at 565 (declining to dismiss appeal as equitably moot despite appellants' failure to seek a stay and the substantial consummation of the plan where appellants had "presented a plausible argument that [relief could be granted] without affecting the success of the confirmed plan").

Finally, the Tenth Circuit, which only expressly recognized the doctrine of equitable mootness in 2009, also falls within the category of courts that weigh a variety of factors to determine equitable mootness. After attempting to synthesize the various tests applied in other circuits, the Tenth Circuit concluded that:

> [A] court should decline to hear an appeal of a bankruptcy court's decision where the answers to the following six questions indicate that reaching the merits would be unfair or impracticable: (1) Has the appellant sought and/or obtained a stay pending appeal? (2) Has the appealed plan been substantially consummated? (3) Will the rights of innocent third parties be adversely affected by reversal of the confirmed plan? (4) Will the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy court decisions—be undermined by reversal of the plan? (5) If appellant's challenge were upheld, what would be the likely impact upon a successful reorganization of the debtor? And (6) based upon a quick look at the merits of appellant's challenge to the plan, is appellant's chal-

> lenge legally meritorious or equitably compelling?

*In re Paige*, 584 F.3d at 1339. Although the Tenth Circuit recites six separate factors, it cautions that these factors "are not necessarily conclusive, nor will each factor always merit equal weight," but merely "seem to reflect the factors often weighed in other cases where equitable mootness is at issue." *Id.* The court observed further that "[m]ost courts seem to place the greatest focus on whether the confirmed plan that is being challenged has been substantially consummated and, if so, what effects reversal of the plan would likely have on third parties," while "focus[ing] slightly less on the issue of whether the parties sought a stay pending appeal," and giving the other factors "much less weight." *Id.* It concluded that "[t]he effects that reversal will have on non-party creditors is probably the foremost concern in our analysis of equitable mootness." *Id.* at 1343; *see also In re Stephens*, 704 F.3d 1279, 1283 (10th Cir. 2013) (declining to dismiss appeal for equitable mootness despite substantial consummation and failure to seek a stay where it was "unlikely that non-party creditors will be adversely affected in any significant way").

### 2. The Second Circuit's Approach: A Presumption of Mootness

The Second Circuit has adopted an approach distinctly different from those of the courts addressed above. Rather than require the party seeking dismissal of an appeal to demonstrate equitable mootness (as the Third Circuit plainly does), the Second Circuit *presumes* equitable mootness upon substantial consummation of a plan and places the burden on the appellant to demonstrate otherwise. Significantly, the appellant may overcome the presumption by demonstrating the existence of each of the following factors:

> (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 "pursue[d] 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."

*In re Chateaugay Corp.*, 10 F.3d at 952-53 (citations omitted); *see also R*[2] *Invs., LDC v. Charter Commc'ns, Inc (In re Charter Commc'ns, Inc.)*, 691 F.3d 476, 482 (2d Cir. 2012) ("The presumption of equitable mootness can be overcome, however, if *all five* of the '*Chateaugay* factors' are met.") (emphasis added).

Whether an appellant sought a stay of the confirmation order is a "chief consideration" under the Second Circuit's approach, though where a stay was not sought, the court will still "consider additionally whether that failure renders relief inequitable." *Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 144 (2d Cir. 2005). As yet, the Second Circuit is the only circuit to adopt a presumption of equitable mootness upon substantial consummation, and some courts have expressly rejected this approach.

*See, e.g., JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 801 F.3d 1161, 1169 (9th Cir. 2015) ("Our circuit's articulation of the equitable mootness test, however, has never included such a presumption."); *In re Paige*, 584 F.3d at 1340 (rejecting "the conclusion that some courts have reached that a finding of substantial consummation will shift the burden to the party seeking to have the court reach the merits of its challenge to the plan").

### 3. The Undifferentiated Approach: Equitable Mootness Without Specific Standards

Still other courts of appeals have recognized and applied the doctrine of equitable mootness without specifically articulating a test or set of specific factors to be considered. The District of Columbia Circuit, for example, has acknowledged that "common sense or equitable considerations may justify a decision not to decide a case on the merits," while also stating that such decisions "cannot be cabined by inflexible, formalistic rules, but instead require a case-by-case judgment regarding the feasibility or futility of effective relief should a litigant prevail." *In re AOV Indus., Inc.*, 792 F.2d 1140, 1147-48 (D.C. Cir. 1986).

The First Circuit likewise has not set forth a list of specific factors that guide its analysis, but

has held that it involves both an "equitable" inquiry as to "whether an unwarranted or repeated failure to request a stay enabled developments to evolve in reliance on the bankruptcy court order to the degree that their remediation has become impracticable or impossible," and a "pragmatic" inquiry "which contemplates proof that the challenged bankruptcy court order has been implemented to the degree that meaningful appellate relief is no longer practicable even though the appellant may have sought a stay with all due diligence." *Hicks, Muse & Co., Inc. v. Brandt* (*In re Healthco Int'l, Inc.*), 136 F.3d 45, 48 (1st Cir. 1998). Similarly, the Eighth Circuit has recognized that "mootness in the bankruptcy setting involve[s] equitable considerations," *In re McGregory*, 223 F. App'x 530, 531 (8th Cir. 2007) (internal citations and quotation marks omitted), and, without formally identifying factors to be considered, has affirmed a finding of equitable mootness where "the plan has been substantially consummated; [appellant] did not seek a stay; the relief requested would negatively affect the rights of parties not before the court and the success of the plan; and public policy weighs in favor of mootness," *In re President Casinos, Inc.*, 409 F. App'x 31, 31-32 (8th Cir. 2010).

The Seventh Circuit recognizes "equitable mootness" in theory, but has for several years declined to use that terminology. As Judge Easterbrook explained, "[t]here is a big differ-

ence between *inability* to alter the outcome (real mootness) and *unwillingness* to alter the outcome ('equitable mootness')." *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (emphasis in original). Because "[u]sing one word for two different concepts breeds confusion," the Seventh Circuit has "banish[ed] 'equitable mootness' from the (local) lexicon" and will "ask not whether this case is moot, 'equitably' or otherwise, but whether it is prudent to upset the plan of reorganization" on appeal. *Id.* While not identifying specific factors to be weighed in determining whether to hear an appeal, the Seventh Circuit has stated that the "now nameless doctrine is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties." *In re Envirodyne Indus., Inc.*, 29 F.3d 301, 304 (7th Cir. 1994).

While the courts of appeals may agree that the doctrine of equitable mootness exists, it is evident that they are far from agreement as to what it entails and how it should be applied. Certiorari is warranted to help de-clutter the legal landscape.

### C. Defining The Availability Of Appellate Review In Bankruptcy Cases Is Particularly Important.

Finally, as this Court has observed, bankruptcy judges are not Article III judges. *See, e.g.*

*Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1938 (2015); *Stern v. Marshall*, 131 S. Ct. 2594, 2600-01 (2011). Moreover, in considering the constitutionality of the current jurisdictional scheme governing the administration of bankruptcy cases, the Court has remarked on the importance of review of the decisions of bankruptcy judges in the Article III courts and how this review may resolve constitutional concerns. *See Exec. Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165, 2172, 2175 (2014). Although subject to waiver, *Wellness*, 135 S. Ct. at 1939, access to an Article III judge remains a constitutional right. Obviously, application of the doctrine of equitable mootness to effectively deny that access erodes the right. Given the important interests at stake, certiorari is warranted.

## CONCLUSION

For the foregoing reasons, as well as those offered by Petitioner, this Court should grant certiorari.

Respectfully submitted,

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