

Third Circuit Limits Equitable Mootness Doctrine

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Recently, the U.S. Court of Appeals for the Third Circuit reaffirmed its narrow construction of the doctrine of equitable mootness in *In re SemCrude L.P. (Samson Energy Resources v. SemCrude L.P.)*, Case No 12-2736 (3d Cir. Aug. 27, 2013) (Ambro, J.).

FACTS AND PROCEDURAL HISTORY

Prior to commencing their Chapter 11 cases, SemCrude L.P. and certain of its affiliates purchased oil and gas from producers in several states. The appellants were four oil and gas producers from Oklahoma. In the bankruptcy cases, these producers, including the appellants, argued that they were entitled to payment for the oil and gas supplied to the debtors ahead of other creditors, including the secured lenders, pursuant to state statutes granting liens or creating statutory trusts for such oil and gas sales. Because the legal issues in these disputes affected hundreds or thousands of producers in each affected state, the debtors sought to establish procedures for resolution of the common legal issues that would permit all potentially affected parties to participate, streamline the proceedings before the bankruptcy court, and minimize the costs to the estates.

The debtors and appellants disagreed on the procedure for resolution of these "producer claims." The debtors proposed and obtained bankruptcy court approval of global procedures for resolution of the common legal issues whereby a "representative adversary proceeding" would be commenced for each state in which producers supplied oil and gas to the debtors. All producers selling oil from a state were permitted to participate in the representative proceeding for such state, and all parties, regardless of participation, would be bound by the legal rulings from the applicable representative action. The appellants objected to this global procedure, and advocated instead for permission to prosecute their own adversary proceeding seeking class certification to assert claims of similarly-situated Oklahoma producers. The bankruptcy court denied the appellants' proposed approach and stayed the appellants' adversary proceeding pending resolution of the representative actions.

The representative proceedings were commenced, and the bankruptcy court granted summary judgment against the Oklahoma (as well as Kansas and Texas) producers. Acknowledging that it was ruling on novel issues of great significance to the parties, the bankruptcy court certified direct appeals of these decisions to the Third Circuit. Before the appeals were heard by the Third Circuit, the debtors, their secured lenders, an official producers committee and other key parties in interest in the bankruptcy cases participated in a judicial mediation and reached a settlement to resolve the claims of all producers. This settlement was embodied in a plan of reorganization, and votes on such plan were solicited from affected creditors, including the appellants and other producer claimants. The requisite majority of producer claimants accepted the plan. Although the appellants objected to the plan, the bankruptcy court overruled their objection and confirmed the debtors' plan of reorganization.

The appellants appealed the confirmation order to the district court. They did not, however, seek a stay of the effectiveness of the confirmation order pending the appeal, so the debtors' plan became effective. The debtors filed a motion to dismiss the appeal as equitably moot. Thus, the district court granted the debtors' motion, and the appellants appealed the district court's dismissal of the appeal.

THE THIRD CIRCUIT'S RULING

The Third Circuit reversed the district court's dismissal and remanded for the district court to hear the appeal on the merits. The court narrowly construed the doctrine of equitable mootness, holding that dismissal of an appeal as equitably moot should be "rare, occurring only where there is sufficient justification to override the statutory rights of the party seeking review."

Judge Thomas L. Ambro's opinion questioned the validity of the "judge-made" doctrine, noting that "courts have rarely analyzed the source of their authority to refuse to hear an appeal on equitable mootness grounds." However, in an en banc decision in *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996), the Third Circuit had previously adopted the doctrine of equitable mootness, so the court in *SemCrude* did not have the opportunity to consider "whether federal common law can support [the doctrine's] use."

In considering the applicability of the doctrine, the court noted that aggrieved parties have a statutory right to appeal a bankruptcy court's confirmation of a plan of reorganization and that, upon the commencement of an appeal, the federal courts have an obligation to exercise their appellate jurisdiction. The court specifically noted that the Bankruptcy Code limits appellate review of certain unstayed orders, including orders allowing the sale or lease of property or the incurrence of post-petition debt, but does not contain a similar bar for review of orders confirming a plan.

The court of appeals reviewed the district court's equitable mootness determination for abuse of discretion, the standard established by the court in its en banc decision in *Continental Airlines*. Notably, however, the opinion also favorably cited then-Judge Samuel A. Alito Jr.'s dissent in *Continental Airlines*. That dissent criticized the abuse of discretion standard of review as inconsistent with the established standard that the circuit court exercises plenary review when the district court sits as an appellate court, which the dissent stated is essentially the district court's role in deciding a motion to dismiss an appeal. The court in *SemCrude* noted, "We are inclined to agree with this criticism, but nonetheless are bound to review for abuse of discretion."

In a matter of first impression, the court addressed the burden of proof for equitable mootness. The court held that the burden does not shift back to the appellant once the plan has been substantially consummated, joining the Ninth, Tenth and Eleventh circuits in placing that burden on the party seeking dismissal.

In 2012, in *In re Philadelphia Newspapers LLC*, 690 F.3d 161 (3d Cir. 2012), the court remarked on the overlapping and interconnected nature of the five-factor test articulated in *Continental Airlines*. In *SemCrude*, the court condensed the five-factor test into "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." Applying this test, the

court found that, while the plan had been substantially consummated, "the perceived harms [were] at best speculative." Agreeing again with Alito's dissent in *Continental Airlines*, the court indicated that the consequences of a successful appeal could be more appropriately dealt with by fashioning limited relief upon the success of such an appeal than by refusing to hear the appeal outright.

In reviewing the record before it, the court was not persuaded that the debtors' lenders, equity investors, customers and suppliers or creditors would be harmed by a successful appeal. In addition to the record transmitted from the district court, the court also reviewed and cited the reorganized debtors' public securities filings both from the period immediately prior to the district court's decision and subsequent periods, and found that the reorganized debtors' financial future appeared stable and likely to remain so. Thus, according to the court, even if the appellants were successful on remand and obtained a reversal and then ultimately prevailed on their claims, there was no reason that the reorganized debtors could not pay a judgment without upsetting the rest of the plan.

In weighing policy considerations, the court emphasized the "responsibility of federal courts to exercise their jurisdictional mandate" and the "'virtually unflagging obligation' of federal courts to exercise the [appellate] jurisdiction conferred upon them" over the application of a "judge-made" doctrine. The court held that "preserving the finality of plan confirmation to encourage parties to move forward with plan execution justifies forbearing the exercise of jurisdiction only where precluding the appeal will prevent a perverse outcome," such as the near certainty of producing a "'perverse' outcome — 'chaos in the bankruptcy court' from a plan in tatters and/or significant 'injury to third parties.'" Because it did not find that would be the case here, it reversed.

SIGNIFICANCE OF *SEMCRUDE*

The court's opinion in *SemCrude* reaffirms its opinion in *Philadelphia Newspapers* from just one year earlier and emphasizes that the equitable mootness doctrine should be applied judiciously and sparingly. Nonetheless, it should not be read as a complete victory for appellants. In fact, in *SemCrude*, notwithstanding its reversal of the district court's dismissal, the court specifically stated that the "appellants have a long road ahead despite their procedural victory here." Parties can, as a result of the opinion, expect to see more confirmation appeals moving forward on the merits of the appeal. Additionally, debtors' counsel should be prepared, as is suggested by the court in *SemCrude*, to request that appellate courts fashion limited relief in the event of a reversal on appeal.

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