ALERT MEMORANDUM

Eleventh Circuit Holds That Equitable Mootness Is Alive and Well in Chapter 9

August 21, 2018

On August 16, 2018, the United States Court of Appeals for the Eleventh Circuit dismissed an appeal relating to Jefferson County, Alabama's Chapter 9 proceeding on equitable mootness grounds. *Bennett v. Jefferson Cty., Ala.*, Case No. 15-11690, 2018 WL 3892979 (11th Cir. Aug. 16, 2018) (the "Opinion"). In doing so, the Eleventh Circuit reversed the Northern District of Alabama District Court, which had previously held that the doctrine of equitable mootness had no applicability in the Chapter 9 context. The Opinion brings the Eleventh Circuit in line with other courts to have considered the issue, including the Sixth Circuit in connection with Detroit and the Ninth Circuit in connection with Stockton's Chapter 9 proceeding. Looking ahead, the Opinion should provide more assurances to municipal debtors that they will have access to the full range of arguments in potential appeals following confirmation of a plan of adjustment, and will put the onus on plan opponents to seek and obtain stays pending appeal. This opinion could also have important implications for Puerto Rico in the coming months and years as it considers the best path forward in its comprehensive restructuring efforts under the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA").

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Background

In 2011, with more than $4 billion in liabilities, Jefferson County, Alabama commenced what was at the time the largest Chapter 9 bankruptcy. In November of 2013, a plan of adjustment was approved by creditors and confirmed by the bankruptcy court. Among other things, the plan called for the restructuring of Jefferson County's $3.2 billion in outstanding sewer warrants on the following terms:

- New sewer warrants would be issued in the approximate amount of $1.785 billion, and the proceeds would be used (together with other funds) to retire the prepetition sewer warrants at the reduced and compromised amount of approximately $1.8 billion; and
- Jefferson County would make significant cuts to general fund expenditures, creditors would make substantial write-offs and the County would implement a series of sewer rate increases, while the Bankruptcy Court retained the ability to implement the rate increases if the County failed to do so.[1]

At the confirmation hearing, Jefferson County residents concerned about rate increases (the "Ratepayers") objected, arguing that the plan of adjustment (i) "validated the corrupt government activity (e.g., bribery)" that led to the issuance of the prepetition sewer warrants, (ii) was constitutionally impermissible because it infringed on the ability of Jefferson County's elected officials to set rates, and (iii) was not feasible given population projections.[2]

The Ratepayers' objections were overruled at the confirmation hearing, and although the Ratepayers filed a notice of appeal two days prior to the plan's effective date, they never sought a stay of the confirmation order pending appeal. The plan went effective and the new sewer warrants were issued in December of 2013.

The Lower Court Decision

Jefferson County sought to dismiss the Ratepayers' appeal on three grounds: (i) constitutional mootness (*i.e.*, that a "case or controversy" as required under Article III of the Constitution no longer existed); (ii) statutory mootness (*i.e.*, Section 364(e) of the Bankruptcy Code, which protects the validity of post-petition financing, mooted the appeal); and (iii) equitable mootness (*i.e.*, that although relief was theoretically available, equitable considerations counseled against the granting of such relief).

Although the lower court refused to dismiss the appeal on all three grounds, the most relevant portion of its analysis concerns the

[1] *Id.*

[2] *Id.*

applicability of the doctrine of equitable mootness.

First, citing the "public and political interests at stake in any Chapter 9 proceedings"[3] and concerns over making unreviewable decisions with constitutional implications, the District Court categorically rejected the applicability of the doctrine of equitable mootness in Chapter 9 where constitutional issues are at stake.

Second, the District Court held that even if it "considered equitable mootness as appropriate in Chapter 9 proceedings, [it] would, nevertheless, deny the County's motion to dismiss."[4] Specifically, the District Court excused the Ratepayers' failure to seek a stay of the confirmation order as prohibitively expensive, and reasoned that "[t]he equitable considerations for mooting an appeal in a Chapter 11 case are not the same [as] in a Chapter 9 case. Here, the equities lie with the Ratepayers, and the questions they raise about the legality and constitutionality of the Confirmation Order['s] affect [on] public and political interests—not merely private interests—and, thus, counsel for Article III review of the Confirmation Order."[5] Jefferson County appealed to the Eleventh Circuit.

The Eleventh Circuit Opinion

In deciding an issue of first impression in the Circuit, the Eleventh Circuit first held that equitable mootness is applicable in Chapter 9 proceedings, and dismissed the Ratepayers' appeal on those grounds.[6]

The Eleventh Circuit began its analysis with a comprehensive history of the doctrine of equitable mootness, explaining that equitable "mootness" is a misnomer and that the doctrine is in fact meant to be applied where the consequences of reversing a lower court decision would not be moot at all, but rather would be so disruptive that the equities foreclose granting effective relief.[7]

Although recognizing the fundamental difference in a Chapter 9 context, the Eleventh Circuit noted that principles underlying equitable mootness "will sometimes weigh more heavily in the Chapter 9 context precisely because of how many people will be affected by municipal bankruptcies."[8] The unanimous panel held that the interests of finality developed in the Chapter 11 context apply with even greater force to the County's Chapter 9 Plan.[9]

Having established general applicability of equitable mootness in Chapter 9, the Eleventh Circuit turned to apply it to the facts before it.

First, the Eleventh Circuit disagreed with the District Court's analysis regarding the Ratepayers' failure to seek a stay. While the District Court had excused such failure largely on cost grounds, the Eleventh Circuit found

[3] *Bennett v. Jefferson Cty, Ala.*, 518 B.R. 613, 638 (N.D. Ala. 2014), *rev'd and remanded sub nom, Bennett v. Jefferson Cty, Ala.*, Case No. 15-11690, 2018 WL 389279 (11th Cir. Aug. 16, 2018).
[4] *Id.*
[5] *Id.* at 640.
[6] The Eleventh Circuit agreed with the District Court that the case was not constitutionally moot, and did not separately address statutory mootness.
[7] Opinion at *4.
[8] *Id.* at *7
[9] *Id.*

that the Ratepayers' failure to seek a stay, together with their failure to consider other methods of avoiding plan consummation (*e.g.*, a temporary restraining order or a preliminary injunction), strongly favored equitable mootness.[10]

Second, the Eleventh Circuit reasoned that "the County and others have taken significant and largely irreversible steps in reliance on the unstayed plan confirmed by the bankruptcy court."[11] This includes the issuance of the new sewer warrants, the retirement of the old ones, and the rate covenants that were relied on by recipients of the new warrants.[12]

Finally, the Eleventh Circuit considered the merits of the Ratepayers' objections and the public interest implications of applying equitable mootness. Here, the Eleventh Circuit took the view that there had been no substantial departure from the typical legislative process, noting that "[e]lected officials can bind their successors—and consequently also their constituents, the people—to all kinds of unavoidably long-lasting financial effects, sometimes irreversibly."[13]

Conclusion

The Opinion provides meaningful guidance in future municipal bankruptcies, as it brings the Eleventh Circuit in line with other courts that have found that the equitable mootness doctrine should apply in Chapter 9 as it does in Chapter 11 (albeit with slightly different equities to balance given Chapter 9's inherent impact on the public interest). This should provide comfort to Chapter 9 debtors and plan supporters that plan consummation can proceed even where confirmation is heavily contested, and conversely places the onus on plan objectors to obtain a stay. This will, in turn, significantly reduce the leverage that plan opponents may have in the plan process, given the challenges they will face in obtaining a stay, including posting security and demonstrating a likelihood of success on the merits.

These issues and the Opinion may be particularly relevant in Puerto Rico's PROMESA proceedings, where (i) the interdependence of the debtors and inter-debtor conflicts (*e.g.*, between COFINA and the Commonwealth) may make it practically impossible to separate one plan from another and impose a particularly high burden on any party that seeks a stay on implementation and (ii) many of the plans for the PROMESA debtors will involve the issuance of new securities, and once such securities are issued and distributed, courts will be particularly hesitant to attempt to reverse the process. Additionally, as no court in the First Circuit has considered the issue, the Opinion increases the likelihood that courts within the First Circuit will not hesitate to apply equitable mootness in PROMESA proceedings.

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[10] *Id.*
[11] *Id. at *9.*
[12] *Id.*
[13] *Id.*