

Client update

SECOND CIRCUIT EXTENDS EQUITABLE MOOTNESS DOCTRINE TO CHAPTER 11 LIQUIDATIONS

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In *In re BGI, Inc. f/k/a/ Borders Group, Inc.*,¹ the Second Circuit recently held that the doctrine of equitable mootness — a doctrine that permits appellate courts to refrain from hearing bankruptcy appeals relating to plan confirmation when it would be “inequitable” to do so — applies in liquidations under Chapter 11 of the Bankruptcy Code. This ruling extends the doctrine from Chapter 11 reorganizations, in which it has traditionally been applied in the Second Circuit, to liquidations. The Court further held that the Bankruptcy Court had correctly applied the doctrine to bar the untimely proofs of claim and motion for class certification of certain holders of unredeemed consumer gift cards of former book retailer, Borders Group, Inc.

BACKGROUND

Borders filed a petition for voluntary reorganization in February 2011, and the Bankruptcy Court set June 1, 2011 as the bar date for filing proofs of claim. In June 2011, following Borders’ unsuccessful attempts to reorganize as a going concern, the Bankruptcy Court authorized Borders to liquidate under Chapter 11. Borders filed a Chapter 11 plan of liquidation under section 1125 of the Bankruptcy Code in November 2011. None of the appellants filed claims by the bar date, objected to the plan, or appeared at the confirmation hearing. In December 2011, the Bankruptcy Court issued an order confirming the plan, which was to be effectuated on January 12, 2012. Shortly thereafter, on January 4, 2012, the appellants sought to file untimely proofs of claim, arguing that they had received inadequate notice of the bankruptcy proceedings and the bar date. Appellants further sought to certify a class of all holders of Borders gift cards that had been issued prepetition. The appellants did not seek a stay of the plan pending determination of their claims.

¹ *Beeman v. BGI Creditors’ Liquidating Trust (In re BGI, Inc. f/k/a/ Borders Group, Inc.)*, Case Nos. 13-2226-bk, 13-2288-bk, 13-2300-bk, 2014 WL 5462477 (2d Cir. Oct. 29, 2014).

The Bankruptcy Court denied the creditors' requested relief in August 2012. First, the Bankruptcy Court determined that the appellants were "unknown" creditors at the time the debtor gave notice of the bar date, because Borders had no reasonable method for discerning gift card holders' addresses or identifying information. Thus, Borders' publication of the bar date in a nationwide newspaper was all the notice to which appellants were entitled. The Bankruptcy Court further held that appellants' failure to file timely proofs of claim was not "excusable neglect," in part because, by the time of its ruling in August 2012, the plan had already been substantially consummated. The Bankruptcy Court finally denied appellants' class certification motion as moot. On appeal, the District Court dismissed the appeals as equitably moot.

SECOND CIRCUIT RULING

First addressing the applicability of the equitable mootness doctrine, the Second Circuit held that the doctrine applies in Chapter 11 liquidations as well as reorganizations. The Court saw no principled reason not to extend the doctrine to a Chapter 11 liquidation, where affected parties may have devoted months of time and resources toward negotiating a plan, creditors with urgent needs may have been stayed from accessing assets and funds to which they are entitled, and extensive judicial resources may have been consumed. Thus, as in the reorganization context, parties involved in a liquidation also hold an interest in preventing the belated disruption of a confirmed and substantially consummated plan. "Substantial consummation" under section 1101(2) of the Bankruptcy Code requires "(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).

The Court next examined the application of the equitable mootness doctrine to appellants' claims. The Court found no clear error in the Bankruptcy Court's determination that the plan had been substantially consummated as of August 2012. The Court noted that as of the plan's effective date, Borders had transferred its relevant property to the BGI Creditors' Liquidating Trust, which had begun administering timely filed claims and making distributions to holders of allowed administrative and priority claims.

The Court next noted, however, that, as in reorganizations, the presumption of equitable mootness may be rebutted in a liquidation by demonstrating that the five factors articulated in *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944 (2d Cir. 1993), are satisfied. Specifically, the appellant must establish

that:

- the court can still order some effective relief;
- such relief will not affect the re-emergence of the debtor as a revitalized corporate entity;
- 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;
- the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and
- the appellant pursued 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.

The Court agreed with the District Court that appellants had failed to satisfy the fourth *Chateaugay* factor, because the appellants did not establish that the general unsecured creditors, who could be affected if the proposed class was certified, had received notice of their appeal to the District Court, and had further failed to satisfy the fifth *Chateaugay* factor, because appellants did not appear at the confirmation hearing, file objections to the plan, or appeal or seek to stay the confirmation order.

IMPLICATIONS

BGI expands the reach of the doctrine of equitable mootness to Chapter 11 liquidations, and also serves as a useful reminder that an appeal from a confirmation order is presumed equitably moot once the debtor's plan has been substantially consummated. Consequently, whether in a reorganization or a liquidation, it is important for any affected party to act quickly to preserve its rights in the face of confirmation of the plan by moving for a stay of the confirmation order pending any appeal and prosecuting any appeal with diligence and speed.

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Please do not hesitate to contact us with any questions.