AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
March 2017 • Vol. XXXVI, No. 3
The Essential Resource for Today's Busy Insolvency Professional

Marblegate: Second Circuit Limits TIA Prohibition to Altering Legal Right to Payment page 12

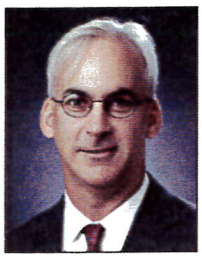
By Jason W. Harbour and Shannon E. Daily

On the Inside

Annual Spring Meeting
Schedule of Events
page 44

By Paul A. Avron

Equitable Mootness: Is It Time for the Supreme Court to Weigh In?



Paul A. Avron
Berger Singerman LLP
Boca Raton, Fla.

Paul Avron is a partner with Berger Singerman LLP in Boca Raton, Fla. His practice includes corporate restructuring and appellate litigation in state and federal courts, both prosecuting and defending appeals.

At least two federal circuit court judges have recently called into question the viability of the judge-made doctrine of equitable mootness through which courts hearing appeals from bankruptcy courts — principally district and circuit courts — decline to exercise their statutory-based appellate jurisdiction under 28 U.S.C. § 158(a) and (d), respectively, and dismiss bankruptcy appeals on equitable grounds. Generally, under the equitable mootness doctrine, an Article III appellate court declines to consider an appeal from an order of an Article I bankruptcy court on the merits given consummation of all (or substantially all) of the transactions authorized by that order. Appellate courts in the bankruptcy context have principally applied the equitable mootness doctrine to dismiss appeals of orders confirming chapter 11 plans and approving settlements. This article examines the reasons recently advanced for questioning the viability of the equitable mootness doctrine, which has prompted calls for its flat-out abandonment, or at least narrowing its application, and posits that intervention by the U.S. Supreme Court is needed in order to address the validity of the doctrine and (if valid) its proper scope.

In re City of Detroit[1]

On Oct. 3, 2016, a divided Sixth Circuit panel affirmed the district court's dismissal, on equitable mootness grounds, of several related, consolidated appeals by pensioners from the bankruptcy court's order confirming the City of Detroit's chapter 9 adjustment plan.[2] The majority opinion, authored by Hon. Alice M. Batchelder, explained that "[i]n resolving its bankruptcy, the City crafted a complex network of settlements and agreements with its thousands of creditors and stakeholders, and memorialized those agreements in a comprehensive Plan," described as "intricate and carefully woven," "with almost all of [the city's] creditors and stakeholders."[3] She detailed significant post-confirmation transactions that had occurred in reliance on the confirmation order, including the issuance of bonds in excess of $1 billion, and $720 million in new notes, the irrevocable transfer of all Detroit Institute of Art assets to a perpetual charitable trust, and the transfer of interests in real property pursuant to certain settlement agreements as the basis of dismissal of the appeal.[4] Quoting from *In re Ormet Corp.*,[5] Judge Batchelder explained:

> Equitable mootness is not technically "mootness" — constitutional or otherwise — but instead a prudential doctrine that protects the need for finality in bankruptcy proceedings and allows third parties to rely on that "finality" by "prevent[ing] a court from unscrambling complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract."[6]

After setting forth the factors applied by Sixth Circuit case law, Judge Batchelder concluded that the issue was "not a close call," and equitable mootness compelled dismissal of the appeals.[7] In addition, she rejected the contention that, given recent pronouncements by the Supreme Court challenging prudential doctrines that abdicate jurisdiction, which federal courts have a duty to exercise,[8] equitable mootness is no longer viable.[9] Judge Batchelder acknowledged the recent Supreme Court cases questioning prudential doctrines cited by the appellants, but stated that those were not bankruptcy cases and that their holdings did not extend to the equitable mootness doctrine previously adopted by Sixth Circuit law and could not be abolished under the prior panel precedent rule.[10]

In dissent, Hon. Karen Nelson Moore took direct aim at the viability of the equitable mootness doctrine, explaining that "[t]he current trend at the Supreme Court is toward a greater recognition of our 'virtually unflagging obligation ... to exercise jurisdiction [that has been] given [to

1 *In re City of Detroit*, 838 F.3d 792 (6th Cir. 2016).
2 Before the district court on intermediate appeal, several individual pensioners challenged, among other things, the reductions in municipal benefits called for in the city's chapter 9 plan. *In re City of Detroit*, 838 F.3d at 797. The Sixth Circuit decided the separate appeals together because equitable mootness was the "determinative issue" in all of them. *Id.* at 797-98.
3 *Id.* at 795.
4 *Id.* at 797.
5 355 B.R. 37 (S.D. Ohio 2006).
6 *In re City of Detroit*, 838 F.3d at 798.
7 *Id.* at 799.
8 *See, e.g., Lexmark Intern. Inc. v. Static Control Components Inc.*, 134 S. Ct. 1377 (2014).
9 *In re City of Detroit*, 838 F.3d at 800.
10 *Id.* Every circuit court has recognized and applied, or decided not to apply, the equitable mootness doctrine. *See, e.g., In re Pub. Serv. Co. of N.H.*, 963 F.2d 469 (1st Cir. 1992); *In re Charter Commc'ns Inc.*, 691 F.3d 476 (2d Cir. 2012); *In re One2One Commc'ns LLC*, 805 F.3d 428 (3d Cir. 2015); *MAC Panel Co. v. Va. Panel Corp.*, 283 F.3d 622 (4th Cir. 2002); *In the Matter of The Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009); *In re City of Detroit*, n.1, *supra*; *In re UNR Indus.*, 20 F.3d 766 (7th Cir. 1994); *Metro Prop. Mgmt. Co. v. Info. Dialogues Inc.*, 662 F.2d 475 (8th Cir. 1981); *In re Transwest Resort Props. Inc.*, 801 F.3d 1161 (9th Cir. 2015); *In re Paige*, 584 F.3d 1327 (10th Cir. 2009); *In re Club Assocs.*, 956 F.2d 1065 (11th Cir. 1992); and *In re AOV Indus. Inc.*, 792 F.2d 1140 (D.C. Cir. 1986), *vacated in part on other grounds*, 797 F.2d 1004 (D.C. Cir. 1986).

us]."'[11] Citing to *Lexmark*,[12] Judge Moore stated that "having one's case decided by an Article III Judge is no mere formality."[13] She concluded that there was no legal basis for the equitable mootness doctrine. Judge Moore also noted that most circuit courts that have adopted it have made little inquiry into a basis for it, and she described the Seventh Circuit's decision in *In re UNR Indus.*,[14] wherein it relied upon 11 U.S.C. §§ 363(m)[15] and 1127(b),[16] as unpersuasive.[17]

Judge Moore further questioned the proposition that equitable mootness can be justified by abstention doctrines, with the former characterized as an "abdication" doctrine because the litigant is thrown out of court, whereas in the latter the litigant is merely directed to a different forum.[18] She also posited that application of the equitable mootness doctrine raises separation-of-powers concerns — that is, a decision by a district or circuit court judge to dismiss (*i.e.*, not hear) a bankruptcy appeal is a rejection of powers granted to the courts by Congress.[19] Judge Moore's discussion of equitable mootness in the context of separation of powers is premised upon appellate review by Article III courts:

> The problem with equitable mootness is not only that it cuts off entirely the right to appeal to an Article III court, but that "it effectively delegates the power to prevent that review to the very non-Article III tribunal whose decision is at issue" because "bankruptcy courts control nearly all of the variables" that are considered in assessing whether an appeal is equitably moot.[20]

In sum, Judge Moore posited that premising continued use of the equitable mootness doctrine based on reliance interests of third parties is insufficient.[21]

In re One2One Commc'ns

The matter before the Third Circuit was a district court order dismissing as equitably moot an appeal of a bankruptcy court order confirming the debtor's chapter 11 reorganization plan.[22] Writing for the panel, Hon. Joseph A. Greenaway, Jr. explained that the appellant asked the court to use the appeal to declare invalid Third Circuit law adopting the equitable mootness doctrine in *In re Continental Airlines*[23] as unconstitutional and contrary to Bankruptcy Code provisions.[24] Judge Greenaway, like Judge Batchelder in *City of Detroit*, concluded that the panel was bound to adhere to the Third Circuit adoption of the equitable mootness doctrine under the prior panel precedent rule, and that did not change given the holding in *Stern v. Marshall*.[25] However, Judge Greenaway explained that since the adoption of the equitable mootness doctrine, the Third Circuit has "emphasized that the doctrine must be construed narrowly and applied in limited circumstances"[26] and ultimately reversed the district court and remanded the matter back to the district court for an adjudication of the appeal on the merits.[27]

Hon. Cheryl A. Krause wrote a concurring opinion because she did not believe that the Third Circuit should continue in what she described as its "failed attempts" to limit the equitable mootness doctrine, a "legally ungrounded and practically unadministrable 'judge-made abstention doctrine.'"[28] She explained that Supreme Court case law handed down since the Third Circuit adopted the equitable mootness doctrine confirmed that the doctrine "cannot survive constitutional scrutiny today."[29] Judge Krause noted

11 *In re City of Detroit*, 838 F.3d at 805 (quoting *Colorado River Water Conserv. Dist. v. United States*, 424 U.S. 800, 821 (1976); *In re Cont'l Airlines*, 91 F.3d 553, 567-73 (3d Cir. 1996) (Alito, J., dissenting) (challenging adoption of equitable mootness doctrine given statutory-based jurisdiction to hear bankruptcy appeals and virtually unflagging obligation to exercise that jurisdiction).
12 *See* n.8, *supra*.
13 *See* n.11, *supra* at 806.
14 *See* n.10, *supra*.
15 Section 363(m) provides that reversal of an order approving a sale or lease shall not affect the validity of the sale or lease to a purchaser who acted in good faith. *See* 11 U.S.C. § 363(m).
16 Section 1127(b) provides the circumstances wherein a confirmed chapter 11 plan can be modified post-confirmation. *See* 11 U.S.C. § 1127(b). The phrase "substantial consummation" is defined as the transfer of all or substantially all of the property to be transferred under the plan, assumption by the debtor or a successor thereto under the plan, and commencement of distributions contemplated by the plan. *See* 11 U.S.C. § 1101(2)(A)-(C).
17 *In re City of Detroit*, 838 F.3d at 809-10. Judge Moore quoted from Judge Krause's concurring opinion in *One2One Commc'ns*, n.10, *supra*, as follows: "[A]s courts and litigants … have struggled to identify a statutory basis for the doctrine, it has become painfully apparent that there is none." *Id.* at 809.
18 *See id.* at 811.
19 *Id.* at 810.
20 *Id.* at 812 (quoting *In re One2One Commc'ns*, 805 F.3d at 445) (Krause, J., concurring).
21 *Id.* at 814.
22 805 F.3d at 431.
23 *Id.*
24 *In re Cont'l Airlines*, 91 F.3d 553 (3d Cir. 1996) (*en banc*).
25 *One2One Commc'ns*, 805 F.3d at 433.
26 *Id.* at 435.
27 *Id.* at 438.
28 *Id.* (quoting *In re Semcrude LP*, 728 F.3d 314, 317 (3d Cir. 2013)).
29 *Id.*

continued on page 70

Claims Chat: Mortgagees and the Non-Reaffirmed Mortgage Note

from page 29

secures,[25] and that the mortgage cannot exist without or independently of a valid obligation. *Aurora Loan Services LLC v. Taylor*[26] stated that the note — not the mortgage — is the dispositive instrument to confer standing and that the transfer of the note automatically transfers the mortgage, unless the parties to the transfer agree otherwise.[27] In *Vitellas*, the debtor paid mortgage note installments for approximately seven years after the discharge. The assignment allegedly followed the debtor's default, although the mortgagee/assignee claimed that the note and mortgage were delivered to it years before the mortgagor's default in installment payments.[28]

The *Vitellas* court rejected the debtor's contentions that his discharge destroyed the mortgage note or rendered the note invalid. *Vitellas* relied on *Johnson*, *supra*, stating:

> Post-bankruptcy, the mortgage still secures an obligation; it is simply no longer personal, but *in rem* ... although a bankruptcy discharge extinguishes one mode of enforcing a note — namely, an action against the debtor *in personam*; it leaves intact another — namely, an action against the debtor *in rem* (*see Johnson v. Home State Bank*, 501 U.S. at 84-86; *Nelson LP v. Jannance*, 87 A.D.3d at 733; *McArdle v. McGregor*, 261 A.D.2d at 592).[29]

Vitellas then quoted *Johnson*[30] at length, including the phrase "a discharge extinguishes *only* 'the personal liability of the debtor.'"[31] In addition, *Vitellas* correctly applied *Johnson* when it determined that a REM note survived the debtor's discharge, except that the discharged debtor was no longer subject to recourse and personal liability. *Vitellas* is consistent with bankruptcy courts following *Johnson* to hold that a bankruptcy discharge extinguishes "only the personal liability of the debtor" and a right to pursue the debtor *in personam*, but leaves viable the creditor's right to proceed against the debtor *in rem*.[32]

In re Zine[33] noted that it is hornbook law that the discharge extinguishes personal liability on a mortgage note while, "from a legal standpoint, the debt remains technically in existence, and may be enforced against the collateral." Whether the mortgage note's survival is real or merely technical, the conclusion is that all note terms survive a debtor's discharge in all respects except for the debtor's personal liability.

Conclusion

A chapter 7 discharge does not destroy or extinguish the note secured by a consumer REM. All note terms, except recourse to the discharged maker, remain in force. The substantive rights of the parties to the mortgage and note are governed by the same legal principles under both the Bankruptcy Code and state law, as explained in *Vitellas*. The *Vitellas* case provides a meaningful starting point for all parties in weighing the effect of non-reaffirmed mortgage notes after a consumer chapter 7 debtor's discharge. abi

25 *Vitellas*, 131 A.D.3d at 61-62.
26 25 N.Y.3d 355, 361 (2015).
27 *Aurora*, 25 N.Y.3d at 361.
28 *Vitellas*, 131 A.D.3d at 61-62.
29 *Id.* at 63.
30 501 U.S. at 82-83.
31 *Id.* (emphasis in original).
32 *Gill*, 521 B.R. at 37.
33 521 B.R. 31, 39 (Bankr. D. Mass. 2014).

Equitable Mootness: Is It Time for the Supreme Court to Weigh In?

from page 37

that equitable mootness is not included among the limited abstention doctrines recognized by the Supreme Court that contemplate postponement — not abdication — of a federal court's exercise of jurisdiction.[30] She rejected as a basis for equitable mootness 28 U.S.C. § 1334(c)(1), which provides that "nothing in this section prevents a district court ... in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under Title 11," and if it did, it would violate the provisions of § 1334(d) that provide that a decision to abstain or not abstain is not reviewable by a court of appeals or the Supreme Court.[31] Judge Krause then rejected the contention that 11 U.S.C. §§ 363(m),[32] 364(e)[33] and 1127(b)[34] provide a basis for equitable mootness; she explained that since Congress "specified certain orders that cannot be disturbed on appeal absent a stay, basic canons of statutory construction compel us to presume that Congress did not intend for other orders [*i.e.*, confirmation orders] to be immune from appeal."[35]

Judge Krause further explained that even if one could read the foregoing statutes as supporting, constitutional concerns would militate against such reading — that is, adjudication by an Article I bankruptcy court without Article III review recently reaffirmed by the Supreme Court in *Wellness Intern. Network Ltd. v. Sharif*,[36] and the doctrine's "effective ... delegat[ion] [of] the power to prevent that review to the very non-Article III tribunal whose decision is at issue."[37] Finally, Judge Moore explained that while equitable mootness "was intended to promote finality ... it has proven far

30 *Id.* at 440.
31 *Id.* at 441-42. Judge Krause explained that the second clause of § 1334(c)(1) regarding the interests of comity with state courts or respect for state law was inapposite, and as to the first clause, it would not be "just" to avoid deciding a case on the merits when a federal court "could use its equitable authority to fashion a limited remedy while still protecting third parties that may be harmed if a plan is undone."
32 *See* n.15, *supra*.
33 Section 364(e) provides that "[t]he reversal or modification on appeal from an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or lien so granted, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal." 11 U.S.C. § 364(e).
34 *See* n.16, *supra*.
35 *One2One Commc'ns*, 805 F.3d at 443-44.
36 135 S. Ct. 1932 (2015).

more likely to promote uncertainty and delay," noting years of litigation over the issue of whether a bankruptcy appeal is equitably moot, and if not, remands back to district courts to adjudicate the merits of appeals years after entry of the orders in question.[38]

37 *One2One Commc'ns*, 805 F.3d at 444-45. Judge Krause explained that "[a]lthough Article III judges decide whether an appeal is equitably moot, bankruptcy courts control nearly all the variables in the equation, including whether a reorganization plan is initially approved, whether a stay of plan implementation is granted, whether settlements or releases crucial to a plan are approved and executed, whether property is transferred, whether new entities (in which third parties may invest) are formed, and whether distributions (including to third parties) under the plan begin — all before plan challengers reach an Article III court." *Id.* at 445.

38 *Id.* at 446-47. Judge Moore noted that a group of bankruptcy law professors also challenged the continuing vitality of the equitable mootness doctrine (*id.* at 448-49), citing to an *amicus* brief filed in support of *certiorari* in *Law Debenture Trust Co. of N.Y.C. Charter Commc'ns Inc.*, which was denied. 133 S. Ct. 2021 (2013). A subsequent *amicus* brief by law professors in support of *certiorari* — also denied by the Supreme Court — was filed in *Aurelius Cap. Mgmt. LP v. Tribune Media Co.*, No. 15-891, 2016 WL 552720 (Feb. 12, 2016).

Conclusion

The equitable mootness doctrine has been used — and continues to be used — offensively to obtain dismissal of bankruptcy appeals of confirmation orders and orders approving settlements without review by Article III courts. Certain circuit court judges, like Judge (now Justice) Samuel Alito before them in his dissenting opinion in *In re Continental Airlines*,[39] have recently called into question the equitable mootness doctrine, concluding that there is no statutory basis for it, and that its use raises constitutional issues that are not easily answered. The continuing vitality of the doctrine of equitable mootness is an issue that is ripe for consideration, and resolution, by the Supreme Court. abi

39 *See* n.11, *supra*.

Consumer Point: Communications Should Be Subject to Standard

from page 22

that any of their communications would be open to "bizarre or idiosyncratic interpretations."[16]

Given the operation of the bankruptcy discharge, any communication that suggests that an individual might be personally liable for a debt that has been discharged is necessarily false, misleading or deceptive, which is why lawsuits endeavoring to collect discharged debts have been found to violate the FDCPA.[17] Currently, to determine if communications after discharge are attempts to collect on discharged debt, the court must consider the text of the communications, determining whether (1) the communication contained a disclaimer, (2) it served a clear purpose other than the collection of the debt, (3) the communication included words of collection like "demand" or "loan" and (4) due dates were listed.[18] Applying the least-sophisticated-consumer standard to analyze the communication would make the court's analysis easy, objective and regular.

Even the typical qualification in the informational notices — *if the debt has been discharged in bankruptcy, this communication is not an attempt to collect a debt* — leaves open a reasonable-but-inaccurate interpretation. A consumer might be concerned. Was the debt in fact discharged? If not, why wouldn't it be? If the debt at issue had been inadvertently unlisted, or transferred to a collection agency, what then? What if the discharged debtor has bad eyes and literally cannot see that qualification in the small print?[19] It would not be burdensome for a creditor to begin a letter, in 24-point font, with, "We understand you have discharged this debt through your bankruptcy...."

The least-sophisticated-consumer standard would be the appropriate standard to apply to both front-line creditors and collection agencies; both are enjoined by the discharge, but discharged consumers currently only enjoy the FDCPA's protections against debt collectors, notwithstanding that the purpose of the discharge is to protect consumers. There is no useful purpose behind allowing an original creditor more freedom to communicate *vis-à-vis* a discharged debt than a collection agency.

Section 524(j) of the Bankruptcy Code does not contravene this principle. This section operates as a safe harbor for secured creditors, specifying that § 524(a)(2) does not operate to enjoin a secured creditor's communications when (1) the creditor retains a security interest in real property that is the debtor's principal residence, (2) the communication is in the ordinary course of business between the debtor and creditor, and (3) the communication is limited to seeking or obtaining periodic payments associated with a valid security interest in lieu of pursuit of *in rem* relief to enforce the lien.

Furthermore, secured creditors in many jurisdictions are required to provide certain notices to debtors before, *e.g.*, instituting a foreclosure proceeding against them.[20] Even in circumstances where such communication is necessary, such mandatory disclosures should be permitted to protect the least-sophisticated debtor by including more information rather than less — something as simple as a plainly written cover page indicating that the debt has been discharged as to the debtor personally, but that the communication is required for the creditor to take back its collateral.

The application of the least-sophisticated-consumer standard would protect the creditor by ensuring that the third prong of that test is satisfied. The § 524(j) exclusion, by specifying that communication needs to be limited to the recovery of payments (as an alternative to *in rem* foreclosure), would again show that discharged debtors should be clearly and unambiguously advised of their rights. The creditor's subjective intent can be proven by its providing objective clarity.

When creditors send informational notices to discharged debtors, it is the least sophisticated discharged debtor whom the discharge injunction must protect. It is only from the least sophisticated consumer that the creditor would net a recovery above and beyond that which the consumer would have voluntarily elected to pay. It is only the least sophisticated

16 *Clomon v. Jackson*, 988 F.2d 1314, 1320 (2d Cir. 1993).

17 *Evans v. Midland Funding LLC*, 574 F. Supp. 2d 808 (S.D. Ohio 2008).

18 *See, e.g., In re Mele*, 486 B.R. 546 (Bankr. N.D. Ga. 2016); *In re Lemieux*, 520 B.R. 261 (Bankr. D. Mass. 2014); and *In re Nassoko*, 405 B.R. 515 (Bankr. S.D.N.Y. 2009).

19 *But cf.* Tom Waits, *Small Change* (1976, Asylum Records): "The large print giveth and the small print taketh away."

20 *See In re Gill*, 529 B.R. 31 (Bankr. W.D.N.Y. 2015), for an example from New York; analogously, *see Melnarowicz v. Pierce & Assocs.*, 2015 WL 4910748 (N.D. Ill. 2016), for a discussion of whether such communication might be a violation of the FDCPA by virtue of being in violation of the automatic stay.

continued on page 72