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The Second Circuit Signals in In Re Charter Communications, Inc. that it Favors the Appellee Under the Equitable Mootness Doctrine

The Second

On August 31, 2012, the United States Court of Appeals for the Second Circuit issued its decision, in *In re Charter Communications, Inc.*, 2012 WL 3764706 (2d Cir. Aug. 31, 2012), expressly adopting an abuse of discretion standard for reviewing equitable mootness determinations. The *Charter Communications* decision also reaffirmed the Second Circuit's rebuttable presumption of equitable mootness upon substantial consummation of a debtor's reorganization plan, which places the burden on appellants to overcome equitable mootness. Accordingly, the *Charter Communications* decision is significant because the adoption of the abuse of discretion standard for review coupled with the rebuttable presumption signifies that appellants likely face a difficult task appealing bankruptcy court decisions in the Second Circuit after substantial consummation of a reorganization plan.

Equitable Mootness Doctrine

The doctrine of "equitable mootness" is not based on statute. Rather, the doctrine is unique to bankruptcy proceedings and was judicially created to address situations where redress is possible, but it would be inequitable to overturn a confirmed reorganization plan. In other words, "[i]n the bankruptcy context, 'where the ability to achieve finality is essential to the fashioning of effective remedies,' equitable mootness serves as 'a prudential doctrine . . . that is invoked to avoid disturbing a reorganization plan once implemented.'" *R^2 Investments, LDC v. Charter Communications, Inc. (In re Charter Communications, Inc.)*, 449 B.R. 14, 22 (S.D.N.Y. 2011); *see Bank of New York Trust Co. v. Pacific Lumber Co. (In re ScoPac)*, 624 F.3d 274, 281 (5th Cir. 2010) ("Equitable mootness is not an Article III inquiry into whether a live case or controversy exists, but rather a recognition that there is a point beyond which a court cannot order fundamental changes in reorganization actions.").

Courts widely accept the doctrine of equitable mootness and consider different combinations of prudential factors when determining whether to dismiss an appeal on equitable mootness grounds, including: (i) whether the reorganization plan has been substantially consummated; (ii) whether a stay has been sought and obtained; (iii) whether the relief requested will affect the rights of other parties not before the court; (iv) whether the relief requested will affect the success of the confirmed reorganization plan; (v) the public policy favoring the finality of bankruptcy judgments; (vi) whether the relief requested will affect the reemergence of the debtor as a revitalized corporate entity; and (vii) whether the appellant's challenge is legally meritorious or equitably compelling. *See, e.g., In re Philadelphia Newspapers, LLC*, 2012 WL 3038578 (3d Cir. July 26, 2012); *ScoPac*, 624 F.3d 274; *In re Paige*, 584 F.3d 1327 (10th Cir. 2009); *In re Am. Homepatient Inc.*, 420 F.3d 559 (6th Cir. 2005). As explained below, the Second Circuit employs five similar factors, commonly referred to as the "*Chateaugay* factors."

The Second Circuit, however, is unique among the circuits in that it relies on a rebuttable presumption standard to analyze equitable mootness decisions. Specifically, in the Second Circuit, an appeal is presumed equitably moot where the reorganization plan has been substantially consummated. *Aetna*

Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.), 94 F.3d 772, 776 (2d Cir. 1996); *Frito-Lay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944, 952-53 (2d Cir. 1993) ("Chateaugay II"). "Substantial consummation" is defined in the Bankruptcy Code to require that all or substantially all of the proposed transfers in a plan are consummated, that the successor company has assumed the business or management of the property dealt with by the plan, and that the distributions called for by the plan have commenced. 11 U.S.C. § 1101(2).

The presumption of equitable mootness can be rebutted in the Second Circuit if the appellant meets all five of the following "*Chateaugay* factors": (i) the court still can order some effective relief; (ii) the relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (iii) the 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; (iv) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (v) 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 order subject to the appeal. *Chateaugay II*, 10 F.3d at 952-53.

Unlike the other circuits, the Second Circuit's rebuttable presumption, therefore, squarely places the burden on parties opposing equitable mootness to satisfy the *Chateaugay* factors.

Case Background

In March 2009, Charter Communications, Inc. ("Charter"), the nation's fourth-largest cable television company and a leading provider of broadband service, along with its 130 affiliated debtors, filed prenegotiated Chapter 11 cases in the United States Bankruptcy Court for the Southern District of New York, commencing what the bankruptcy court described as "perhaps the largest and most complex prearranged bankruptcies ever attempted, and in all likelihood . . . among the most ambitious and contentious as well." *Charter Communications,* 2012 WL 3764706, at *1 (citing *JPMorgan Chase Bank, N.A. v. Charter Communications Operating, LLC (In re Charter Communications)*, 419 B.R. 221, 230 (Bankr. S.D.N.Y. 2009)).

The cornerstone of Charter's Chapter 11 plan was the "Allen Settlement." At the time of Charter's bankruptcy cases, Microsoft co-founder, Paul G. Allen, was the chairman of Charter's board and a major investor in Charter whose ownership stake gave him control of the company. Charter's reorganization strategy was driven by the goal of reinstating its senior credit facility with JPMorgan Chase Bank ("JPMorgan"), believing that renegotiating its senior debt during the financial turmoil of 2008 and early 2009 would not be favorable for the company. *Id.* Charter thus needed to structure its reorganization in a way that would avoid triggering a default under the credit agreement with JPMorgan, including satisfying one express condition whereby Charter agreed that Allen would retain thirty-five percent of the ordinary voting power of Charter Communications Operating, LLC ("CCO"), the obligor under the senior credit facility. *Id.*

Therefore, for the reorganization to succeed, Charter negotiated with Allen for Allen to retain a thirty-five percent voting interest in CCO. *Id.* Additionally, to preserve roughly $2.85 billion in net operating losses, a valuable tax attribute, Charter negotiated with Allen for Allen to refrain from exercising his contractual exchange rights and to maintain a one percent ownership interest in Charter Communications Holding Company, LLC. *Id.* at *2. In return, Allen would receive $375 million, of which $180 million was classified as pure settlement consideration, and a third-party release. *Id.* at 2. This agreement became known as the Allen Settlement, and also contemplated Charter's prenegotiated reorganization in bankruptcy.

On November 17, 2009, after a nineteen-day hearing, the bankruptcy court overruled all objections and confirmed the Chapter 11 plan as submitted by Charter. The Law Debenture Trust Company of New York, an indenture trustee for certain notes issued by Charter, and R^2 Investments, LDC, a shareholder (together, the "Appellants"), appealed the confirmation order and filed motions with the bankruptcy court

and district court seeking a stay pending appeal, which were denied. The confirmation order and the Chapter 11 plan became effective on November 30, 2009, and Charter immediately took actions to implement the Chapter 11 plan.

On appeal to the district court, the Appellants disputed the Allen Settlement, the bankruptcy court's valuation of Charter, and the compliance with the Bankruptcy Code's cramdown provisions. The Appellants requested that the district court reverse the confirmation order and remand the matter to the bankruptcy court to (i) conduct a valuation of Charter and direct payment of any excess value to Charter's shareholders, (ii) void the payment to Allen under the Allen Settlement, and (iii) strike the third-party releases to Allen and others. *Charter Communications,* 449 B.R. at 21.

In response, Charter, Allen and the Committee of Unsecured Creditors argued that the such relief could not be granted without disturbing the substantially consummated Chapter 11 plan and, therefore, equitable mootness barred the appeals. *Charter Communications*, 2012 WL 3764706, at *2. The district court agreed: finding that the Chapter 11 plan had been substantially consummated and the Appellants had failed to satisfy the *Chateaugay* factors. *Charter Communications*, 449 B.R. at 23-24. The district court, therefore, dismissed the appeals as equitably moot. The Appellants subsequently appealed to the Second Circuit.

The Second Circuit's Opinion

The Second Circuit affirmed the district court's decision. Initially, the Second Circuit addressed the standard of review for equitable mootness determinations. The Court noted that district courts typically review the bankruptcy court's factual findings for clear error and its conclusions of law de novo; and the circuit court ordinarily reviews the district court's decisions de novo. *Charter Communications*, 2012 WL 3764706, at *4. The Court, however, recognized that equitable mootness appeals arise in a different procedural context: the district court is not reviewing the bankruptcy court, but exercising its own discretion as to whether it is practicable to grant relief. *Id.* The Court also acknowledged that the courts of appeals are split over whether a de novo or abuse of discretion standard should be applied to equitable mootness appeals. *Id.* (citations omitted). In prior equitable mootness cases, the Second Circuit merely has described the general standard of review for bankruptcy cases without further discussion. *Id.*

The Second Circuit decided to expressly join the circuits that apply the abuse-of-discretion standard, holding that "equitable mootness determinations involve 'a discretionary balancing of equitable and prudential factors,' the type of determination we usually review for abuse of discretion." *Id.* at 5 (citation omitted).

With respect to the equitable mootness analysis, the Second Circuit reaffirmed its reliance on the rebuttable presumption: an appeal is presumed equitably moot where the Chapter 11 plan has been substantially consummated, but the presumption of equitable mootness can be overcome if the appellant meets all five of the *Chateaugay* factors. *Id.* at 3.

The parties did not dispute that Charter's Chapter 11 plan had been substantially consummated. Accordingly, the Court focused on whether the Appellants met their burden with respect to the *Chateaugay* factors.

The Court held that the Appellants met their burden with respect to the first, fourth and fifth factors. Specifically, the Court held that the Appellants had shown: (i) it is not impossible to grant the Appellants relief, in the sense that the appeals are not constitutionally moot (first *Chateaugay* factor); (ii) the relief the Appellants sought would not adversely affect parties without an opportunity to participate in the appeal (fourth *Chateaugay* factor); and (iii) the Appellants were diligent in seeking a stay of the confirmation order (fifth *Chateaugay* factor). *Id.* at 5-6.

The Court, however, held that the Appellants have failed to establish that the relief they requested would not affect Charter's emergence as a revitalized entity (second *Chateaugay* factor) and would not require unraveling complex transactions undertaken after the Chapter 11 plan was consummated (third *Chateaugay* factor). *Id.* at 6. The Court recognized that reorganized Charter has been successful, "with substantial assets and cash flow, access to an $800 million revolving line of credit, and long-term debt structured on favorable terms." *Id.* Further, the Court held that modifying the terms of the Allen Settlement, "would be no ministerial task. The Allen Settlement was the product of an intense multi-party negotiation, and removing a critical piece of the Allen Settlement -- such as Allen's compensation and the third-party releases -- could impact other terms of the agreement and throw into doubt the viability of the entire Plan." *Id.* at 7.

The Court also held that "the compensation to Allen and the third-party releases were critical to the bargain that allowed Charter to successfully restructure . . . . and Allen may not be willing to give up the benefit he received from the Allen Settlement without also reneging on at least part of the benefit he bestowed on Charter." *Id.* at 8. As a result, if the Court were to grant the relief sought in the appeal, the parties would have to enter into renewed negotiations, casting uncertainty over Charter's operations until the issue's resolution. *Id.*

Additionally, as with the Allen Settlement, the Court found that the Appellants' challenges regarding Charter's valuation and the cramdown provisions would require significant revision of the confirmation order; and "is not the type of relief that can be undertaken without knocking the props out from under the completed transactions or affecting the re-emergence of the debtor from bankruptcy." *Id.*

The Second Circuit, therefore, held that the district court did not abuse its discretion when dismissing the appeals as equitably moot.

Conclusion

In sum, the *Charter Communications* decision should signal to any party seeking to appeal a bankruptcy decision in the Second Circuit, including an order confirming a plan of reorganization or a sale order, after substantial consummation of the plan, that the Second Circuit favors the appellee when it comes to equitable mootness. First, by adopting the stricter abuse of discretion standard for review, this means that appeals of equitable mootness decisions to the Second Circuit are less likely to be overturned. Second, the Second Circuit's reaffirmation of the rebuttable presumption confirms that, after a Chapter 11 plan has been substantially consummated, appellants have the heavy burden of satisfying each of the *Chateaugay* factors to overcome the equitable mootness presumption.

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