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The Future of Prudential Barriers in Bankruptcy Appeals Post-'Kaiser Gypsum'

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For decades, insurers seeking to object in their insured's Chapter 11 reorganizations were blocked by the "insurance neutrality" doctrine, a prudential limitation that stopped courts from considering objections on the merits unless the insurer could show a confirmed plan "impair[ed] the insurer's pre-petition policy rights" or "'alter[ed] the quantum of liability'" it faced. But in *Truck Insurance Exchange v. Kaiser Gypsum*, the U.S. Supreme Court unanimously rejected this judge-made limitation as "conceptually wrong and mak[ing] little practical sense." That ruling also indicates tension between the court's statutory approach and that of lower courts which apply other doctrines to end bankruptcy appeals on prudential grounds with no consideration of the merits.

Truck addressed the scope of the right to participate in bankruptcy proceedings created by Section 1109(b) of the Bankruptcy Code. Truck Insurance Exchange is the liability insurer of the debtor, which faces thousands of asbestos tort claims. Notwithstanding Truck's obligation to pay virtually every dollar of those claims, each lower court had applied the insurance-neutrality doctrine to hold that Truck had no right to be heard. The Supreme Court disagreed. The court recognized that in Section 1109(b), Congress used "capacious" language "to promote greater participation in reorganization proceedings" and conditioned a party's right to be heard only on "whether the reorganization proceedings might affect

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a prospective party, not how a particular reorganization plan actually affects that party." In holding that insurers like Truck "with financial responsibility for a bankruptcy claim" are "'part[ies] in interest' that can raise objections" because the reorganization can affect their interests in "myriad ways," the court refused to allow prudential considerations unmoored from the Code to trump congressionally enacted language.

This holding ensures that insurers who have long been silenced in Chapter 11 proceedings will now be heard. It is also a shot across the bow for two other judge-made, atextual doctrines that bar consideration of the merits in Chapter 11 appeals.

Equitable Mootness

Despite its name, equitable mootness has no relation to an appellate court's jurisdiction. It is a "prudential doctrine" under which courts dismiss bankruptcy appeals when they believe that affording relief would be "impractical" or "imprudent." This requires bankruptcy appellants—and appellate courts—to race through stay motions and requests for expedited review. And even when they do, as soon as the debtor declares its plan "substantially consummated," the court may still dismiss the appeal. In most circuits, equitable mootness can end an appeal with no consideration of the merits by any Article III court.

Equitable mootness is a target of substantial criticism. Judges have condemned the doctrine as "legally ungrounded and practically unadministrable," and "[d]ivorced" from "any statutory basis." The United States has joined the chorus, criticizing it as "particularly troubling given [its] lack of statutory foundation." Adding to the confusion, the doctrine is applied differently, with differing elements, in different circuits. It is little surprise then, that the U.S. Court of Appeals for the Eighth Circuit has predicted that the Supreme Court may "severely curtail" or "perhaps even abolish" it.

Although the Supreme Court has never directly considered equitable mootness, the decision in *Truck* is not the only recent one to cast a shadow over equitable mootness. In *MOAC Mall Holdings LLC v. Transform Holdco LLC* and *Mission Product Holdings v. Tempnology LLC*, the court made clear—without specifically addressing equitable mootness—that its "cases disfavor th[e] kinds of mootness arguments" that challenge a court's power to afford "typical appellate relief" unless it would be "impossible" for the appellate court to do so. The Supreme Court has declined recent invitations to address equitable mootness directly. But, taken together, *Truck*, *Mission Product*, and *MOAC* suggest that equitable mootness may not survive that review, if granted.

Bankruptcy Appellate Standing

The Bankruptcy Act, which governed bankruptcy proceedings prior to 1978, limited appellate rights to a "person aggrieved by an order of a referee." Congress repealed that provision when it enacted the Bankruptcy Code. Now, Section 1109(b) of the Code, the provision considered in *Truck*, broadly authorizes any party in interest to raise any issue. Unlike the parallel subsection stating

the SEC may be heard in bankruptcy court but "may not appeal," the Code imposes no limitation on the appellate rights of other parties in interest.

But despite the repeal of the act's restrictive appellate rule and the textual support in the Code for expansive appellate rights, the act's restriction on appellate rights "has been maintained by the courts as an essentially prudential requirement." The rule "is more restrictive than the 'case or controversy' standing requirement of Article III." Lower courts have attempted to justify the doctrine by invoking "the 'particularly acute' need to limit appeals in bankruptcy proceedings, which often involve a 'myriad of parties,'" or reasoning that it "insures that bankruptcy proceedings are not unreasonably delayed by protracted litigation," or is necessary for "efficient judicial administration." One court even explained that Congress' "omission" of any comparable limitation in the Code "does not mean that the 'person aggrieved' test is no longer valid" because "the need for the rule continues to exist."

Courts have already questioned the doctrine's reliance on prudential considerations. The Supreme Court's emphatical rejection of similar calls to prudence and efficiency in *Truck* places the bankruptcy appellate standing doctrine's vitality in substantial doubt.

The insurance-neutrality doctrine, equitable mootness, and the bankruptcy appellate standing rule each act as barriers to resolving the merits in bankruptcy appeals. Indeed, fewer than one in 1,500 bankruptcy cases reaches the courts of appeals. The resulting dearth of appellate development has stark consequences, impairing "accuracy and uniformity in the law of bankruptcy." In the wake of *Truck*, it appears increasingly likely that the Supreme Court will reject these atextual barriers to appellate review, provided it can be persuaded to take up an appropriate petition.

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