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Serta's (Un)Surprising Take on Equitable Mootness

By Lauren R. Lifland, Benjamin W. Loveland and George W. Shuster Jr.*

In this article, the authors examine a recent decision by the U.S. Court of Appeals for the Fifth Circuit sharply criticizing the equitable mootness doctrine.

In its decision in *Serta Simmons Bedding*, the U.S. Court of Appeals for the Fifth Circuit underscored the importance of drafting debt documents with clarity and precision and cautioned against borrowers' reliance on ambiguous language to effectuate the popular uptier exchange transaction being utilized by debtors across the country to restructure their debt. Since its issuance, this decision has been the subject of many articles discussing its potential impact on the future of liability management exercises (LMEs).

Receiving somewhat less attention is the Fifth Circuit's refusal to apply the judicially created principle of equitable mootness with respect to the bankruptcy court's order confirming a plan containing broad indemnities for the uptier exchange participants. The Fifth Circuit's criticism of the equitable mootness doctrine is not particularly surprising if one examines Fifth Circuit jurisprudence over the past decade, but the court's sharp criticism of the doctrine nevertheless serves as a useful reminder of the doctrine's limitations in preventing appellate review of certain transactions.

THE *SERTA* DECISION

Plagued with liquidity issues stemming from the COVID-19 pandemic, Serta Simmons Bedding (Serta) entered into an uptier agreement with certain of its lenders holding first-lien and second-lien debt (the Participating Lenders). The Participating Lenders provided new money financing and exchanged existing debt for new super-priority debt. The applicable credit agreement contained a typical pro rata sharing provision prohibiting Serta from paying its obligations to certain, but not all, of its lenders. Serta and the Participating Lenders took the position that the uptier transaction was permitted under the credit agreement's "open market purchase" exception to the pro rata sharing provision. Recognizing the inherent risk of the transaction, Serta agreed to indemnify the Participating Lenders for any and all losses incurred in connection with their participation.

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Serta ultimately filed for bankruptcy in January 2023 and filed (i) an adversary proceeding seeking approval of the uptier exchange, and (ii) a plan that provided for an indemnity covering the Participating Lenders. The bankruptcy court validated the uptier transaction and confirmed the plan, including the indemnity.[1] Thereafter, the lenders excluded from the uptier transaction (the Objecting Lenders) appealed (i) the validity of the uptier transaction, and (ii) the propriety of the indemnities granted to the Participating Lenders under the plan.

The Fifth Circuit reversed the bankruptcy court's decision, finding the uptier transaction was not a permissible "open market purchase" under the credit agreement. In reaching that conclusion, the Fifth Circuit rejected Serta's and the Participating Lenders' argument that the doctrine of equitable mootness barred the court's review of the plan confirmation order, calling the doctrine a "judicial anomaly" that is a "scalpel, rather than an axe" to be applied with "caution" to direct appeals from a bankruptcy court.[2]

The circuit court analyzed the three factors considered when determining whether to apply equitable mootness:

(i) Whether a stay of the confirmation order was obtained by the Objecting Lenders;

(ii) Whether the plan was substantially consummated; and

(iii) Whether the relief requested – excising the indemnity provisions at issue from the plan confirmation order – would affect the rights of parties not before the court or the success of the plan.[3]

The court quickly dispensed with the first two factors, acknowledging that while the Objecting Lenders failed to obtain a stay and the plan was substantially consummated, "this court has still exercised appellate review when only the third factor weighed against equitable mootness."[4] The court found that the third factor did just that: excising the indemnity from the confirmation order would not necessarily harm any third parties not before the court; rather, it would impact only Serta and the Participating Lenders, the former of which

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[1] Serta Simmons Bedding LLC v. AG Ctr. St. P'ship (In re Serta Simmons Bedding, LLC), No. 23-9001 (DRJ) (Bankr. S.D. Tex. June 6, 2023), rev'd in part sub nom. Excluded Lenders v. Serta Simmons Bedding, L.L.C. (In re Serta Simmons Bedding, L.L.C.), 125 F.4th 555 (5th Cir. 2024), as revised (Jan. 21, 2025), as revised (Feb. 14, 2025).

[2] Excluded Lenders v. Serta Simmons Bedding, L.L.C. (In re Serta Simmons Bedding, L.L.C.), 125 F.4th 555, 585 (5th Cir. 2024).

[3] Id.

[4] Id. at 585-86.

would benefit from the excision, while the latter would not. Both Serta and the Participating Lenders were present before the court.[5] Nor would excising the indemnity threaten the success of the plan, the court found; in fact, Serta would benefit from the excision and "face an easier future without a massive liability hanging over its head."[6]

The court was similarly unsympathetic to the Participating Lenders' claim that doing away with their indemnity would require unwinding the plan. Indeed, the court stated that "our precedents do[] not indicate that the remedy of excision requires thus," citing two Fifth Circuit decisions, *Highland Capital* and *Pacific Lumber*, both of which rejected the notion that a court cannot excise certain plan provisions without unraveling the entire plan.[7] Lastly, and most notably, the court offered a "full-throated rebuttal" of Serta's and the Participating Lenders' complaint that excising the indemnity was "unfair" to them because had they known the indemnity would be excised, they would not have agreed to the settlement. This position, the court stated, if endorsed, would:

> [E]ffectively abolish appellate review of even clearly unlawful provisions in bankruptcy plans. Parties supporting such provisions could always argue they would have done things differently if they had known the provisions would later be excised. And if we cannot excise specific provisions but must let the parties go back to square one – which we cannot do without destroying the underlying Plan – then the appellate courts are effectively stripped of their jurisdiction over bankruptcy appeals, despite Congress's clear intent to the contrary.[8]

Not only did the *Serta* court wholly reject appellees' equitable mootness argument – it then went on to question the very existence of the doctrine, remarking that "*to the extent equitable mootness exists at all*, we affirm that it cannot be 'a shield for sharp or unauthorized practices.'"[9]

THE FIFTH CIRCUIT'S WARINESS OF EQUITABLE MOOTNESS

While the robustness of the *Serta* court's criticism of equitable mootness is notable, it does not represent a significant departure from the Fifth Circuit's historical approach to the doctrine. The cases cited by the *Serta* decision – *Highland Capital* and *Pacific Lumber* – are two of several examples where the

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[5] Id. at 586.

[6] Id.

[7] Id. at 587.

[8] Id. at 588.

[9] Id. (emphasis added).

Fifth Circuit has previously refused to dismiss an appeal on equitable mootness grounds and instead fashioned "'fractional relief' to minimize an appellate disturbance's effect on the rights of third parties."[10]

In *Highland*, the Fifth Circuit held equitable mootness did not bar its review of what it viewed as overly broad plan exculpation provisions, notwithstanding that the plan had been substantially consummated. In so ruling, the *Highland* court explained that "the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process," and "the legality of a reorganization plan's non-consensual non-debtor release is consequential to the Chapter 11 process and so should not escape appellate review in the name of equity."[11] The *Highland* court cited the Fifth Circuit's *Pacific Lumber* decision in refusing to apply the doctrine.

The *Pacific Lumber* court similarly declined to apply equitable mootness to a secured creditor's absolute priority rule challenge and challenge to the plan's allegedly overbroad release insulating multiple parties from liability. The release at issue in *Pacific Lumber* was alleged to be "part of [the parties'] bargain . . . without [which] neither [party] would have been willing to provide the plan's financing."[12] Unmoved, the *Pacific Lumber* court reasoned, "[t]hat there might be adverse consequences to [appellants] is not only a natural result of any ordinary appeal – one side goes away disappointed – but adverse appellate consequences were foreseeable to them as sophisticated investors who opted to press the limits of bankruptcy confirmation and valuation rules."[13] Accordingly, the *Pacific Lumber* court evaluated these two claims on their merits, leaving the plan's distribution scheme untouched but striking the offending non-debtor releases except with respect to the creditors committee and its members.[14]

Other decisions from the Fifth Circuit declining to apply equitable mootness include the 2013 decision in *Rodgers v. Colin-G Properties, Ltd.*, where the court determined that granting the relief requested on appeal – requiring the debtors to make additional payments to appellant – would not affect the debtors' other creditors or the success of the plan because, among other reasons, the debtors'

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[10] NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt., L.P.), 48 F.4th 419, 431 (5th Cir. 2022), cert. denied, 144 S. Ct. 2714 (2024) and cert. denied, 144 S. Ct. 2715 (2024); see also Bank of N.Y. Tr. Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.), 584 F.3d 229, 241 (5th Cir. 2009).

[11] Highland Cap. Mgmt., 48 F.4th at 431-32.

[12] Pac. Lumber, 584 F.3d at 251-52.

[13] Id. at 244.

[14] Id. at 253.

other creditors were already paid in full.[15] In so holding, the *Rodgers* court, like the *Serta* court, stressed that the equitable mootness doctrine must be applied "with a scalpel rather than an axe" and that courts "may fashion whatever relief is practicable instead of declining review simply because full relief is not available."[16] And in *Senior Care Centers*, the court found that the unwinding of a sale transaction, as requested by appellant, "would simply involve transferring ownership of the nursing home back to the estate."[17] There, the debtors failed to establish that litigating sale-related issues would negatively impact any third parties that based their support of the plan on the related settlement. Accordingly, the court found the matter was not equitably moot, considered the merits of the appeal, and ultimately affirmed the bankruptcy court.

A decision from the *Bouchard* court was also in keeping with the Fifth Circuit's view that equitable mootness "should not be a shield for sharp or unauthorized practices" that impedes review of substantive provisions, because "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process."[18] There, rather than declare the appeal equitably moot, the court narrowed the plan's non-debtor exculpation provisions because such exculpation violated Fifth Circuit precedent "categorically bar[ring] third-party exculpations absent express authority in another provision of the Bankruptcy Code."[19]

And in *ConvergeOne*, the confirmed plan was premised on a restructuring support agreement under which holders of first-lien debt took back debt and were given the option to purchase equity in the reorganized debtor through an equity rights offering. Certain minority lenders were excluded from the equity rights offering and objected to the plan, and appealed after the plan was confirmed and substantially consummated.

On appeal, the district court acknowledged that the concept of equitable mootness "is looked at with great scrutiny, especially when it involves appeals

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[15] No. 12-CV-4831 (SAL) (N.D. Tex. Aug. 22, 2013).

[16] Id.

[17] Harden Healthcare LLC v. OLP Wyo. Springs LLC (In re Senior Care Ctrs., LLC), No. 19-CV-2722 (JJB) (N.D. Tex. Feb. 18, 2021) ("In the Fifth Circuit, courts should be 'hesitant to invoke equitable mootness' and should 'treat[] it as a scalpel rather than an axe.'") (quotations omitted).

[18] Bouchard v. Bouchard Transp. Co. (In re Bouchard Transp. Co.), No. H-21-2937 (LHR) (S.D. Tex. Feb. 7, 2023).

[19] Id. at *3.

concerning the rights of secured creditors," and that "the very courts that have implemented this concept have cautioned against its widespread use."[20]

Ultimately, the *ConvergeOne* court found that while the plan was substantially consummated and appellants had failed to obtain a stay of the confirmation order, limited relief – a monetary award or redistribution of the equity allocation the minority lenders would have been offered had they been permitted to participate in the equity rights offering – was available and would not require unwinding the plan. Accordingly, the district court refused to dismiss the minority lenders' appeal on equitable mootness grounds.[21]

CONCLUSION AND LOOKING AHEAD

Looking back at the past decade of Fifth Circuit jurisprudence, the *Serta* court's refusal to apply the equitable mootness doctrine is not unprecedented. Practitioners negotiating confirmation orders should be mindful of the fact that even if a plan has been substantially consummated, a Fifth Circuit court will likely make a concerted effort to consider the merits of any appeal rather than declare it equitably moot.

The Fifth Circuit approach is especially important to keep in mind in the context of complex Chapter 11 plans that incorporate multifaceted bargains among many constituents. Where more aggressive plan provisions are challenged, it is possible that beneficiaries of those provisions will remain bound by what they compromised under the plan while losing some of the benefits they obtained through those compromises. Moreover, attempts to solve for this dilemma within a Chapter 11 plan may themselves be subject to challenge under *Serta*.

The *Serta* indemnity, by creating a backstop to the Participating Lenders' potential losses, can be viewed as an attempt to hold the core deal under the Chapter 11 plan together even if part of that plan was challenged – and yet the indemnity itself was excised from the plan. And so, even creative attempts to build a substitute for equitable mootness into a Chapter 11 plan may be difficult to sustain against objection.

IN SUMMARY

- The Fifth Circuit's decision in *Serta Simmons Bedding* invalidated an uptier transaction in which certain lenders provided new money financing and exchanged existing debt for new super-priority debt.
- The Fifth Circuit criticized the doctrine of equitable mootness,

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[20] In re ConvergeOne Holdings, Inc., No. 24-CV-02001 (ASH) (S.D. Tex. Oct. 23, 2024).

[21] Id.

rejecting the argument that the doctrine barred the court's review of the bankruptcy court's plan confirmation order because the plan had already been substantially consummated and relied upon by third parties.

- The Fifth Circuit's refusal to apply the doctrine of equitable mootness is not unprecedented but nevertheless raises important concerns for companies, lenders, and others in Chapter 11 restructurings.