Not intended for print publication.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

CHARLESTON DIVISION

IN RE: SHAWNEE HILLS, INC.

Debtor.

THE HUNTINGTON NATIONAL BANK,

Appellant,

v. CIVIL ACTION NO. 2:02-0872

SHAWNEE HILLS, INC.,

Appellee.

MEMORANDUM OPINION AND ORDER

Pending before the court is a motion by Appellee H. Lynden Graham Jr., trustee of the bankruptcy estate of Shawnee Hills, Inc., to dismiss the appeal filed by Appellant Huntington National Bank. Graham argues that the appeal should be dismissed because it is both legally and equitably moot. After a hearing and full briefing from the parties, the court **GRANTS** Graham's motion to dismiss [Docket 5] and **DISMISSES** the appeal as equitably moot.

I. Background

Shawnee Hills, Inc., was a non-profit corporation that operated mental health, mental retardation, and alcohol counseling and rehabilitation facilities throughout West Virginia. Shawnee Hills employed approximately eight hundred employees to serve between ten to twelve thousand

patients on a regular basis. On May 1, 2002, Shawnee Hills filed for Chapter 7 bankruptcy. H. Lynden Graham was appointed as trustee.

On May 2, 2002, counsel for the debtor, Shawnee Hills, and counsel for the trustee, Graham, filed a motion to compel Huntington National Bank (Huntington) and City National Bank (City) to honor payroll checks drawn before the filing of Shawnee Hill's bankruptcy.[1] After an emergency telephone hearing held that afternoon on the motion, the Bankruptcy Court granted the debtor's and trustee's motion over Huntington's objections. The next day, on May 3, 2002, Huntington filed a motion for reconsideration of that order. The Bankruptcy Court held a hearing on May 15, 2002 and denied the motion for reconsideration. The Bankruptcy Court found that Huntington appeared to be fully secured by other assets, including real estate, and that it appeared that Huntington did not have priority in the cash accounts over the Shawnee Hills payroll check holders.

Huntington now appeals. On appeal, Huntington argues that the Bankruptcy Court deprived it of its property without due process of law and erred in its application of the Uniform Commercial Code and the Bankruptcy Code. Graham, the trustee, filed a motion to dismiss the appeal, arguing that the case is moot both as a matter of constitutional law and as a matter of equity. This court held a hearing on the motion to dismiss on August 19, 2002.

II. Analysis

[1] Specifically, the emergency motion sought to: (1) disgorge monies deposited with Huntington by the debtor that had been set off by Huntington and applied to the debtor's obligations to Huntington; (2) compel Huntington to require City to unfreeze an account in which Huntington claimed a pre-petition security interest; and (3) require both Huntington and City to honor the paychecks delivered to Shawnee Hills employees in the weeks before the filing date, notwithstanding Huntington's claim of a perfected pre-petition security interest.

Graham argues that the case is moot both as a matter of constitutional law and as a matter of equity. First, Graham argues that events during the pendency of the appeal have rendered it impossible for the court to provide relief to the Appellant, and that as such, no Article III case or controversy now exists. *See Cent. States, Southeast and Southwest Areas Pension Fund v. Cent. Transp., Inc.*, 841 F.2d 92, 95-96 (4th Cir. 1988) (*citing Mills v. Green*, 159 U.S. 651, 653 (1895)). Second, Graham invokes the doctrine of equitable mootness, arguing that the rights of the parties as well as parties not before the court have been so modified that effective judicial relief is no longer practically available. *See Mac Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622, 625 (4th Cir. 2002). "Unlike the constitutional doctrine of mootness, which bars consideration of appeals because no Article III case or controversy remains, the doctrine of equitable mootness is a pragmatic principle, grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable." *Id.* Because the court concludes that the appeal is moot as a matter of equity, the court will not address Graham's constitutional argument.

The doctrine of equitable mootness is particularly suited to bankruptcy proceedings, both because of "the equitable nature of bankruptcy judgments," *id.*, and because bankruptcy judgments frequently result in complex business reorganizations or distributions of assets that would be difficult for an appellate court to unravel. The doctrine of equitable mootness is a flexible concept that cannot be captured in a set of rigid rules. Rather, "a court must determine whether judicial relief on appeal can, as a pragmatic matter, be granted." *Id.* In determining whether to apply the doctrine of equitable mootness, the court considers factors such as: "(1) whether the appellant sought and obtained a stay; (2) whether the reorganization plan or other equitable relief ordered has been

substantially consummated; (3) the extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and (4) the extent to which the relief requested on appeal would affect the interests of third parties." *Id.* This court now turns to these factors as well as any others that might affect the balance of equities given the particular facts and circumstances of this case.

The first enumerated factor under *Mac Panel* is "(1) whether the appellant sought and obtained a stay." *Id.* Huntington concedes that it failed to seek a stay either in the bankruptcy court or in the district court. *See Fed. R. Bank. P.* 8005 (West 2002). It argues, however, that an order regarding the use of cash collateral may be reversed or modified on appeal without the need for a stay. Huntington reaches this conclusion by drawing a negative inference from 11 U.S.C. § 363(m), a provision of the Bankruptcy Code providing that appellate reversal of a sale or lease of property does not affect the validity of that sale or lease absent a stay. Huntington argues that because § 363 contains no similar provision with regard to the disposition of cash collateral, a stay is neither needed nor relevant in a case involving cash collateral. Huntington's negative inference is a weak one. Even if the Bankruptcy Code supports the proposition that a district court *could* reverse a prior distribution of cash collateral, the question remains whether such a reversal is practicable or desirable as a matter of equity. Huntington failed to seek a stay of the Bankruptcy Court's order to distribute the cash collateral, and this factor weighs against this court's appellate reconsideration of that order.

The second enumerated factor is "whether the reorganization plan or other equitable relief ordered has been substantially consummated." *Mac Panel*, 283 F.3d at 625. In this case, Huntington makes much of the fact that the Shawnee Hills bankruptcy proceeding is still underway and that the

order on appeal is not a comprehensive reorganization plan, but rather an order issued very early in the bankruptcy proceedings simply requiring Huntington to honor employee paychecks. This fact, Huntington argues, renders factor two irrelevant to this appeal. Many cases discussing the doctrine of equitable mootness do involve reorganization plans; nonetheless, this factor also applies to an order of "other equitable relief" that "has been substantially consummated." *Id.* If there is any distinction between simple orders early in the bankruptcy proceedings and final comprehensive reorganization plans, it is that a simpler, preliminary order may be easier to unravel than a comprehensive reorganization plan. *See In re Continental Airlines*, 91 F.3d 553, 560-61 (3d Cir. 1996) (en banc). Whether that is true in this case remains to be seen and will be discussed below under factors three and four. But regardless of whether this court can unravel the order, factor two simply asks the court to determine whether the order has been substantially consummated. In that regard, Huntington argues that while the employee paychecks have been presented for payment, over $300,000 remains in the City account on which Shawnee Hills payroll checks are drawn. Huntington argues that given the remaining funds, the Bankruptcy Court's order has not been "substantially consummated." But the parties agree that it is very unlikely that any employee paychecks remain outstanding on that account. The trustee's affidavit filed in support of this motion to dismiss states that as of July 8, 2002, approximately $498,136.78 in payroll checks had been honored by City and that approximately $15,000 in payroll checks had been honored by Huntington. Accordingly, the evidence presented indicates that the Bankruptcy Court's order for City and Huntington to honor employee payroll checks has been substantially consummated.

The third enumerated factor is "the extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted." *Mac Panel*, 283 F.3d

at 625. In this case, there is no comprehensive reorganization plan the success of which would be imperilled by the reversal of the Bankruptcy Court's order. Instead, given the facts of this case, the court must determine whether the relief requested on appeal – reversal of the Bankruptcy Court's order – could successfully undo the distribution of the cash collateral, which has already been substantially consummated. Huntington acknowledges that putting into effect a reversal of the Bankrupcty Court's order would involve disgorging funds from the employees who have cashed their payroll checks. Huntington argues that such disgorgement could be accomplished through various statutory mechanisms. The question of whether disgorgement *could* be accomplished would be relevant to the issue of constitutional mootness. But as to the issue of equitable mootness, the question is instead whether disgorgement is practicable. *See id.* In this case, the cash collateral at issue has been distributed to many, probably hundreds, of Shawnee Hills employees. Tracking down these many employees, determining whether they are entitled to keep the funds as innocent transferees, and, if not, determining whether they are able to repay the funds, would be an impracticable, if not literally impossible, venture.

The difficulty of recovering monies already paid out to hundreds of employees also brings the court to the final enumerated factor, "the extent to which the relief requested on appeal would affect the interests of third parties." *Id.* While the Shawnee Hills employees are creditors of Shawnee Hills (or at least were when they held uncashed payroll checks), they did not file the motion in question and were not represented before the Bankruptcy Court or on appeal. Disgorgement of paychecks long since cashed would clearly impose a significant hardship on them. *See Manges v. Seattle-First Nat'l Bank (In re Manges),* 29 F.3d 1034, 1043 (5th Cir. 1994). Most people promptly spend much or all of their regular paychecks on living expenses. Because the Bankruptcy Court's

order involved distributing funds to cover regular employee paychecks, a prompt stay was all the more critical in this case, and Huntington's failure to seek such a stay is all the more damaging to its case on appeal.

Finally, Huntington argues that the Bankruptcy Court's emergency order, issued with only a few hours of notice, deprived it of its property without due process of law. While this argument goes in part to the merits of the order on appeal, it is also potentially relevant to the issue of equitable mootness. In the context of preliminary injunctions, for example, courts consider the likelihood of success on the merits as part of the equitable determination of whether an injunction is warranted. *See aaiPharma Inc. v. Thompson*, 296 F.3d 227, 234 (4th Cir. 2002). While likelihood of success on the merits is not typically mentioned as a factor in evaluating equitable mootness, a court in equity must always consider the possibility of serious injustice. *See Brotherhood of Locomotive Engineers v. Missouri-Kansas-Texas R. Co.*, 363 U.S. 528, 532 (1960) (courts should exercise equitable powers in a manner that "ensure[s] that . . . equitable remedies will not become the engines of injustice."). If it were true that the Bankruptcy Court had acted with such haste as to deprive Huntington of its property without a meaningful opportunity to present evidence and arguments, then the difficulty of fashioning relief from the Bankruptcy Court's order would not stand in the way of this court's ability to correct the resulting injustice. However, Huntington presents an incomplete picture of the procedural history of this case when it focuses entirely on the admittedly hasty emergency hearing and order. After that order, Huntington filed a motion for reconsideration. In response, the Bankruptcy Court held a hearing twelve days later, at which Huntington was able, with adequate time to fully prepare its case, to present evidence and arguments in support of its position. To the extent that adequate process was lacking from the emergency hearing and order, Huntington

received the process it was due in the hearing on its motion to reconsider. *See Houston v. Holder (In re Omni Video, Inc.),* 60 F.3d 230, 233 (5th Cir. 1995). Finally, Huntington had the procedural opportunity to seek a stay, an option it declined to pursue. Huntington disputes the correctness of the Bankruptcy Court's decision after this hearing, but the Due Process Clause is concerned with adequate process, not the merits of the eventual decision. Accordingly, Huntington has failed to show that it was deprived of property without due process of law.

In sum, the equities favor a finding of mootness in this case. Huntington was given an adequate opportunity to present its case to the Bankruptcy Court. The resulting order, which Huntington did not attempt to stay, has been substantially consummated. Attempting to grant Huntington relief at this time would be impractical and would impose significant hardship on hundreds of employees who cashed their regular paychecks months ago and who are not parties to this appeal. Therefore, this court concludes that Huntington's appeal of the Bankruptcy Court's order is equitably moot.

III. Conclusion.

For the foregoing reasons, the court **GRANTS** Appellee Graham's motion to dismiss and **ORDERS** that Huntington's appeal be **DISMISSED** as moot.

The court **DIRECTS** the Clerk to send a copy of this Order to counsel of record and any unrepresented party.

ENTER: November 19, 2002

JOSEPH R. GOODWIN
UNITED STATES DISTRICT JUDGE