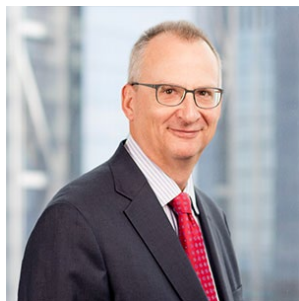




We are asking our Contributors how the Purdue decision will affect bankruptcies going forward? How will bankruptcy deal with the complexity of tort cases? Will bankruptcy still provide a friendly forum for debtors looking to manage mass torts? How hard will it be for private equity sponsors to secure consensual releases against direct claims, and will it change sponsor behavior? Is forum shopping less likely? Does the decision affect directors and officers, to the extent that there may be direct claims or mixed derivative and direct claims? Read on to learn what to expect.



Phil Anker
Wilmer Hale

My guess is that *Purdue* will have less of an impact in Chapter 11 cases not involving alleged mass tort liability than some might suspect. There are several reasons for my “prediction.”

First, *Purdue*, of course, does not limit the ability of the debtor itself to obtain a discharge of its own liability or, perhaps more importantly, for third parties to settle with the bankruptcy estate and obtain a full release of estate causes of action against them. In my experience, sponsors and other controlling shareholders, as well as directors and officers, typically face more exposure to estate causes of action than to claims that truly belong to individual creditors. I have represented majority shareholders, former parents, and directors and officers of the debtor in cases where my clients faced substantial claims – sometimes in the hundreds of millions, if not billions, of dollars – but only by the bankruptcy estate, not by individual creditors. For example, a failed spinoff or leveraged buyout or recapitalization may lead to fraudulent transfer claims against the former parent or shareholders. Outside bankruptcy, creditors (indeed, only creditors) can typically bring such claims. But it is well established that, if the debtor company files for bankruptcy protection, the automatic stay bars creditors from pursuing such claims during the course of the bankruptcy case (absent relief from the stay which is not, in my experience, often granted for these purposes); instead, the bankruptcy estate has standing to do so, and it can (with court approval) settle the fraudulent transfer claims, precluding individual creditors from ever bringing their own claims seeking to “avoid” and recover the same transfers. Similarly, claims for breach of fiduciary duty against directors and officers, or controlling shareholders, are typically viewed as estate causes of action, at least where the underlying allegations concern supposed pre-petition stripping of assets from, or mismanagement of, the debtor. Same with lender liability claims (at least those that assert that the lender exercised undue control of the debtor/borrower, failed to honor a loan commitment, or took other improper actions that directly harmed the debtor/borrower) and, though the case law is not uniform, claims for alter ego liability.

None of this is to say that there are never cases where individual creditors assert claims against non-debtor third parties. Claims of securities or related fraud—that the directors and officers, or controlling shareholders, made misrepresentations to shareholders or creditors to cause them to invest in, or lend, to the now bankrupt debtor—may provide one example. Tortious interference or related claims asserting that one group of lenders or noteholders engaged in “creditor-on-creditor violence” that improperly advantaged them over other, similarly situated creditors may present another. But, at least in my career, those claims have not been as common or as big an economic driver as estate causes of action have been.

Second, even in cases where there are significant claims of individual creditors against non-debtors, Justice Gorsuch was very clear in his opinion for the majority in *Purdue* that the Court was not holding that *consensual* third-party releases were impermissible (or addressing whether a failure to opt out of a third-party release on a ballot for a plan could be deemed consent to grant the release). One of the principal strategies that I expect sponsors, directors and officers, and others facing potential claims by third parties to adopt after *Purdue* is to insist that the proceeds of any settlement they will fund can be made available under a plan only to those creditors that agree to release the potential defendants from any direct claims. In short, the sponsors, directors and officers and other potential “targets” will tell individual creditors in a class that they have a

choice: either “opt in” to the settlement, and receive their ratable share of the settlement proceeds, but grant a full release, or “opt out,” and retain their individual claims, but forgo any right to share in the settlement proceeds. Depending on the amount of the settlement and the strengths and weaknesses of any individual creditor claims, such a structure may incentive most, if not all, creditors to opt into the settlement and grant the target a complete release.

Moreover, the potential defendants can adopt various mechanisms to “price” the risk that some creditors will decline to opt in to the settlement. For example, they can insist as a condition to their settlement that no more than a relatively small percentage of creditors opt out, and they can negotiate to reduce the dollar amount of the settlement for the exposure they retain to opt outs—just has been common in securities fraud and other class actions for decades.

Finally, unlike in mass tort cases where (as the name suggests) the number of creditors can be “massive,” in my experience, there are often only a relatively modest number of holdouts in commercial cases with potential individual claims. By definition, it is easier to negotiate with a small, finite number of claimants than with a massive group, and business cases don’t tend to present some of the negotiating difficulties that mass tort cases can (for example, claimants who, perhaps understandably, are less economically motivated and more angered by what they experienced, as well as potential future claims from individuals who have not even manifested any injury and whose claims may, therefore, have not yet accrued).

All this said, I don’t mean to suggest that *Purdue* will present no challenges to the resolution of commercial cases involving potential creditor claims against third parties. But Chapter 11 has enabled lots of companies in lots of different businesses to reorganize, as lawyers, financial advisors, other professionals and judges have innovated, and I don’t expect that basic paradigm to change.



Martin Bienenstock
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Now that the Supreme Court decided the Bankruptcy Code does not authorize nonconsensual non-debtor releases (coerced releases) in non-asbestos chapter 11 cases, what’s next? To be sure, clever bankruptcy attorneys and jurists will experiment with workarounds, such as imposing requirements that holders of claims against non-debtor third parties engage in mediation before litigation if the claim may impact, directly or indirectly, the reorganized debtor.

The balance of this discussion, however, is about the constitutional issues the Supreme Court did not mention, let alone decide. The constitutional issues impact the currently statutorily authorized coerced releases in asbestos chapter 11 cases in Bankruptcy Code section 524(g)(4)(A)(ii), and any future coerced releases Congress authorizes. The constitutional issues bar coerced releases on multiple grounds.

One might wonder how there can be constitutional blockers to coerced releases issued in some circuits for several decades. I submit there are two main reasons. First, bankruptcy experts are as desensitized to discharges of claims as surgeons are desensitized to blood and internal organs. Second, most of us do not use our full powers of observation. My tenth grade lab teacher asked us to make lists of all the factual observations we could make about a simple wax candle. Most of us listed ten to twenty observations. But, there were over thirty possible observations. So, let's identify the rights lost when a coerced release is imposed.

Most obviously, a coerced release deprives the creditor of the right to sue and obtain a judgment consistent with the common law. The Supreme Court has recognized that the right to sue is a fundamental right, without which all our liberty and property rights are unenforceable. Much jurisprudence suggests the people never granted the federal government the power to permanently deprive any person of the right to sue unless the beneficiary of the release exposes all its assets to satisfying claims.

Assuming the federal government can take a creditor's claim against a non-debtor for the public purpose of promoting reorganization, shouldn't the Fifth Amendment's just compensation requirement apply? When the government takes your house by eminent domain, you get a trial on the value of your house, and are entitled to be paid its full value. How can coerced releases legitimize the taking of a creditor's claim, without valuing the claim and without paying its full value.

Likewise, shouldn't the Fifth Amendment's due process requirement apply? The Supreme Court has long held due process requires that all a debtor's nonexempt assets be fairly distributed to its creditors. In *Purdue Pharma*, the non-debtor parties to be released appear to have been allowed to retain billions of dollars and to pay their personal creditors in full while their creditors who were also creditors of the chapter 11 debtor were fractionally paid.

Coerced releases deprive the Article III judicial branch from determining the claims eliminated by coerced releases and deprive the judicial branch from determining damages under the rules of the common law with a jury trial. That violates the separation of powers principle under which the judicial branch, and only the judicial branch can adjudicate claims. It also violates the Seventh Amendment right to jury trial. The Supreme Court has many times ruled that violations of the separation of powers principle are not cured by the consent of the branch losing its powers.

But, hold the presses. The foregoing list of constitutional violations, by itself, does not mean coerced releases are illegal. The Supreme Court has long held legislation authorized by the

United States Constitution can transgress the constitution. There are examples in the Bankruptcy Code. For instance, its preference provisions take away from a creditor money validly paid to the creditor in satisfaction of a valid debt, if the money was paid within ninety days before bankruptcy. That taking is to carry out the public purpose of equitably distributing the debtor's asset value. The Supreme Court has acknowledged the Fifth Amendment does not bar that taking.

So, the question becomes whether the bankruptcy power in Article I, Section 4, clause 8 of the Constitution authorizes coerced releases. If it does, the constitutional violations do not matter. But, it does not. The Supreme Court has ruled the bankruptcy power cannot deprive litigants of fundamental rights. And, when the Supreme Court was confronted with a district court enjoining nondebtor shareholders from objecting to their corporation's sale of railroad tracks to a reorganized debtor, the Supreme Court ruled the court lacked the power to do so. Some argue bankruptcy jurisdiction was narrower at the time, but suffice it to say it incorporated the power to decide rights of third parties.



Brad Sandler
Pachulski Stang

Recently, the U.S. Supreme Court issued its momentous ruling in the Purdue Pharma Chapter 11 case on the permissibility of nonconsensual third party releases.¹ The Supreme Court, in a 5-4 ruling, categorically held that “the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants.” This is perhaps the most important and consequential bankruptcy decision issued in this millennium, if not longer, which will have ripple effects beyond mass tort cases and potentially impact many other larger Chapter 11 cases.

Plan / Settlement Background

Owned and controlled by the Sackler family, Purdue began marketing OxyContin, an opioid prescription pain reliever, in the mid-1990s. After Purdue earned billions of dollars, in 2007, one of its affiliates pleaded guilty to a federal felony for misbranding OxyContin as “less addictive” and “less subject to abuse.” Thousands of lawsuits followed. The Sacklers proceeded to withdraw approximately \$11 billion from Purdue - roughly 75% of the company's total assets - over the next decade and more, leaving the company in “a significantly weakened financial” state.

¹ *Harrington v. Pharma L.P.*, No. 23-124, 2024 U.S. LEXIS 2848 (U.S. June 27, 2024). Note that this opinion addressed non-consensual releases to non-debtors, and did not address consensual releases or releases of claims held by a debtors' bankruptcy estate.

In 2019, Purdue filed for Chapter 11 bankruptcy protection, and the Sacklers initially proposed to return approximately \$4.3 billion (spread out over a decade) to Purdue's bankruptcy estate; this proposed amount was later increased by the Sacklers to \$5.5 - 6.0 billion.² In exchange, the Sacklers sought a judicial order releasing the family from all opioid-related claims and enjoining victims from bringing such claims against them in the future:

The release sought to void not just current opioid-related claims against the family, but future ones as well. It sought to ban not just claims by creditors participating in the bankruptcy proceeding, but claims by anyone who might otherwise sue Purdue. It sought to extinguish not only claims for negligence, but also claims for fraud and willful misconduct.... And it proposed to end all these lawsuits without the consent of the opioid victims who brought them. To enforce this release, the Sacklers sought an injunction 'forever stay[ing], restrain[ing], and enjoin[ing]' claims against them.... That injunction would not just prevent suits against the company's officers and directors but would run in favor of hundreds, if not thousands, of Sackler family members and entities under their control.³

While thousands of opioid claimants approved of the proposed exchange, together with the support of all 50 state Attorneys General, some parties, including the U.S. Trustee and certain U.S. states, opposed the relief, arguing that nonconsensual third-party releases are not permitted.⁴ The bankruptcy court approved Purdue's proposed reorganization plan, including the broad, nonconsensual third party releases in favor of the Sacklers. The district court vacated that decision, holding that nothing in the law authorizes bankruptcy courts to extinguish claims against third parties like the Sacklers, absent the claimants' consent. A divided panel of the Second Circuit reversed the district court and revived the bankruptcy court's order approving a modified plan. After years of back-and-forth rulings in appeals, the Supreme Court finally decided in favor of the U.S. Trustee and the states.

The Majority Opinion

Justice Neil Gorsuch delivered the majority opinion of the Supreme Court, in which Justices Clarence Thomas, Samuel Alito, Amy Coney Barrett, and Ketanji Brown Jackson joined, making the following main points:

(i) The Bankruptcy Code does not authorize a release and related injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of the affected claimants. Here, the Sacklers have not filed for bankruptcy or placed all their assets on the table for distribution to creditors, but they seek

² *Id.*, at *12-*13 ("As for individual victims harmed by the company's products, Purdue offered, with help from the Sacklers' anticipated contribution, to provide payments from a base amount of \$3,500 up to a ceiling of \$48,000 (for the most dire cases, and all before deductions for attorney's fees and other expenses).... For those receiving more than the base amount, payments would come in installments spread over as many as 10 years.").

³ *Id.* at *12.

⁴ Notably, the majority addressed the fact that only a minority of opioid creditors actually voted on the plan, and it was that smaller group that largely affirmatively supported the plan. *Id.* at *13 ("Creditors were polled on the proposed plan. Though most who returned ballots supported it, fewer than 20% of eligible creditors participated.... Thousands of opioid victims voted against the plan too, and many pleaded with the bankruptcy court not to wipe out their claims against the Sacklers without their consent.").

what essentially amounts to a discharge. No provision of the Bankruptcy Code authorizes that kind of relief.

(ii) The plan proponents' section 1123(b)(6) argument is baseless. Section 1123(b)(6) permits any term in a plan not expressly forbidden by the Bankruptcy Code so long as a judge deems it "appropriate." According to the plan proponents, because plan provisions like the Sackler discharge are not expressly prohibited under the Code, paragraph (6) necessarily permits them. To the contrary, according to the majority, "[w]hen faced with a catchall phrase like paragraph (6), courts do not necessarily afford it the broadest possible construction it can bear.... Instead, we generally appreciate that the catchall must be interpreted in light of its surrounding context and read to 'embrace only objects similar in nature' to the specific examples preceding it." In this case, each of the preceding paragraphs in section 1123(b) concerns the rights and responsibilities of the debtor; and they authorize a bankruptcy court to adjust claims without consent only to the extent such claims concern the debtor. Paragraph (6) cannot be read under the canon of *ejusdem generis* to endow a bankruptcy court with the "radically different" power to discharge the debts of a nondebtor without the consent of affected claimants.

(iii) Additionally, the Bankruptcy Code reserves discharges only for the debtor; the Code requires the debtor to submit all of the debtor's assets to the court; even a discharge is not "unbounded" because some claims are exempted from discharge; and section 524(g)(4)(A)(ii) is the only Code provision expressly authorizing nondebtor releases "but does so in only one context" (namely, plans dealing with asbestos claims). According to the majority, the Purdue plan "transgresses all these limits too."

(iv) Further, "every bankruptcy law cited by the parties and their amici - from 1800 until the enactment of the present bankruptcy code in 1978 - generally reserved the benefits of discharge to the debtor who offered a 'fair and full surrender of [its] property.' ... Had Congress meant to reshape traditional practice so profoundly in the present bankruptcy code, extending to courts the capacious new power the plan proponents claim, one might have expected it to say so expressly 'somewhere in the [c]ode itself.'"

(v) With respect to policy issues and implications, while both sides may have their points, "this Court is the wrong audience for such policy disputes. Our only proper task is to interpret and apply the law; and nothing in present law authorizes the Sackler discharge."

(vi) The majority painted its ruling as a narrow one, leaving for another day other important related issues including some continued grey areas:

Nothing in what we have said should be construed to call into question consensual third-party releases offered in connection with a bankruptcy reorganization plan; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here.... Nor do we have occasion today to express a view on what qualifies as a consensual release or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor. Additionally, because this case involves only a stayed reorganization plan, we do not address whether our reading of the bankruptcy code would justify unwinding

reorganization plans that have already become effective and been substantially consummated.⁵

The Dissent

Joined by Chief Justice John G. Roberts, Jr., Sonia Sotomayor, and Elena Kagan, Justice Brett Kavanaugh “respectfully” dissented in a 54-page opinion (compared to the less than 20 pages for the Opinion of the Court), making a number of arguments including relying on section 1123(b)(6)’s catchall. Ultimately, however, Justice Kavanaugh focused more on the practical, equitable implications involving mass tort cases.

According to the dissent, the majority’s decision was “wrong on the law and devastating for more than 100,000 opioid victims and their families.” “Bankruptcy seeks to solve a collective-action problem and prevent a race to the courthouse by individual creditors who, if successful, could obtain all of a company’s assets, leaving nothing for all the other creditors. The bankruptcy system works to preserve a bankrupt company’s limited assets and to then fairly and equitably distribute those assets among the creditors—and in mass-tort bankruptcies, among the victims. To do so, the Bankruptcy Code vests bankruptcy courts with broad discretion to approve ‘appropriate’ plan provisions. 11 U. S. C. §1123(b)(6).”⁶

Justice Kavanaugh found that “the Bankruptcy Court exercised that discretion appropriately - indeed, admirably.” It was, in his view, a “shining example of the bankruptcy system at work.”⁷ In making a categorical preclusion of nondebtor releases for “no good reason,” he said that the majority “now throws out . . . a critical tool for bankruptcy courts to manage mass-tort bankruptcies like this one.”⁸

Concluding his dissent, Justice Kavanaugh criticized the majority’s opinion as “mak[ing] little sense legally, practically, or economically.” Pointing to the Boy Scouts, the Catholic Church, the breast implants, and other mass tort cases, he stated that nondebtor releases “have been indispensable to solving that problem and ensuring fair and equitable victim recovery.” Justice Kavanaugh suggested that the “Court’s decision will lead to too much harm for too many people for Congress to sit by idly without at least carefully studying the issue.” If the majority believed that \$5.5 billion to \$6 billion from the Sacklers was not enough, he argued that the Court “at most” should have remanded for the lower courts to decide “whether the releases were ‘appropriate’ under 11 U.S.C. § 1123(b)(6) (if anyone had raised that argument here, which they have not).”

Takeaways

⁵ *Id.* at *31-*32.

⁶ *Id.* at *33.

⁷ As stated in the dissent, absent the Sackler releases and settlement payment under the chapter 11 plan, the bankruptcy court found the “most likely result” would be liquidation of a much smaller \$1.8 billion estate, and in such a liquidation, the United States would recover first with its \$2 billion superpriority claim, likely leaving the victims and other creditors with nothing.

⁸ According to the dissent, “The Bankruptcy Code gives bankruptcy courts authority to approve non-debtor releases to solve the complex collective action problems that such cases present. As noted above, a Chapter 11 reorganization plan may release creditor claims against debtors. §1123(b)(1). And a plan may settle and release debtor claims against non-debtors. §1123(b)(3). In addition, the plan may also include ‘any other appropriate provision not inconsistent with the applicable provisions of’ the Code. §1123(b)(6). Section 1123(b)(6) provides ample flexibility for the reorganization plan to settle and release creditor claims against non-debtors who are closely related to the debtor.” *Id.* at *50-*51.

The dissent, making statutory interpretation and other arguments, was trying to put a square peg into a round hole, primarily driven by practical and equitable concerns. Indeed, the Purdue Pharma ruling may severely hinder or at least delay, at more significant costs, acceptable settlements or other fair resolutions in mass tort and other bankruptcies. In short, mass tort bankruptcy cases and other complex bankruptcy cases will likely be considerably more expensive and protracted to get to a resolution, as any party not on board with providing a required release to a third party will have greater leverage. The ripple effect of the Purdue Pharma decision may extend beyond non-consensual third-party releases as the Supreme Court's Opinion, unlike the dissent, read 1123(b)(6) narrowly, and thus, how creative and far-reaching plan terms can be is now unknown and certainly will be tested in the lower courts.

Moreover, likely in the very near term, the next fight in chapter 11 bankruptcies will be over the form of consent required (by affected claimants), potentially leading to more bankruptcy litigation and further delays.⁹ While various jurisdictions like the Second and Third Circuits have allowed for opt-in or opt-out "consensual" third party releases under chapter 11 plans, the U.S. Trustee, creditors' committees, and other affected creditors and parties in interest may raise more objections as to whether such plan release provisions are truly consensual. To the extent that all victims of mass tort have to be solicited, the already expensive cost of solicitation will skyrocket. Beyond the added cost of solicitation, there are practical challenges of soliciting all class members, including identifying and locating them and protecting their often desired confidentiality (in terms of service, proof of service, *etc.*). Many class members may not be easily located, and even if located, they may not want their identity to be known, at least not in the bankruptcy court; however, under the Purdue Pharma ruling, the Supreme Court has put their identity at issue due to the requirement of obtaining their affirmative consent to any proposed third party release.

While much of the focus has been on mass tort, all significant bankruptcy cases will be impacted. Prepackaged bankruptcy cases will be much more challenging if the plan sponsors want releases from all parties in interest, including employees, unions, vendors, and shareholders. Obtaining consent from these creditors, who generally ride through a prepack, could materially risk business operations. In addition, aggressive shareholders could seek to organize a class action seeking to disrupt the prepack by refusing to grant a desired, if not required, release to the plan sponsors, as they likely would be slated to get no recovery in a prepack. The shareholders could then use the threat of a failed prepack as leverage to generate value, making the success of the prepack not only more tenuous but also more expensive. Unions that may not like the intended treatment of their collective bargaining agreements under a proposed plan may also attempt to disrupt operations as well as the prepack itself, leading to riskier and more expensive restructuring plans. Even employees who potentially have employee-related claims, such as those arising under the WARN Act, will have more leverage. Suffice it to say, the more parties in interest, the more challenging it will be to efficiently and successfully confirm a speedy prepackaged bankruptcy plan in which the plan sponsors want or desire a release from third parties, which means that the planning for any prepack will not only be more expensive, but the planning process will need to start earlier for maximizing the likelihood of success.

⁹ The form of consent required was not addressed by the Supreme Court. In addition, the Supreme Court left open the issue of what may happen if parties in interest attempt to question the propriety of nonconsensual third party releases in some previously-confirmed plans. Presumably, in such cases, the plan proponents will attempt to argue that the applicable plan has been consummated and any new attempt to undo the release should be equitably mooted. The success of this potential argument, no doubt, will be determined by the lower courts.

In order to incentivize voting creditors to consent to the non-debtor releases, it is likely Plan Sponsors will more frequently use a carrot-and-stick approach to procure consensual releases, such as increasing the use of death traps¹⁰ and other negative consequences for not providing consent, leading to two practical options: one, non-debtor parties will offer to pay more consideration to obtain consent by all parties in interest, or two, because money is fungible and obtaining consent from all parties may be impractical, if not impossible, pay less consideration (be it upfront or via a death trap if there is a failure to obtain full consent) and use the “savings” as a defense fund for potential future litigation. In the first situation, the “hold out” creditors win; in the second situation, the “hold out” creditors lose, and may lose substantially as the consideration that may desperately be needed, such as in many mass tort cases for victims, would not be forthcoming, if at all, for likely many, many years down the road.

Any non-debtor party that pays additional consideration for consent likely will (and should) want assurances that the consent and the attendant “settlement” is approved, not only by the bankruptcy court, but also, in the case of class action settlements, by the court in which the class action is asserted. This additional procedural step, which likely will become a standard condition precedent to the effective date of any mass tort plan with consensual non-debtor releases, will further delay and complicate bankruptcy cases, causing them to be more expensive and uncertain.

Bankruptcy courts and case participants may be able to work out some clearer guidelines or principles relating to consensual third party releases in particular, but such matters will take time to be fleshed out in chapter 11 bankruptcies. As these issues get resolved in the lower courts, such as what form of consent is required (*e.g.*, opt-in, opt-out, *etc.*), restructuring advisors will need to be keenly focused on plan treatment, solicitation strategy, and forum selection (as different jurisdictions will determine the boundaries of consent) to maximize the likelihood of successful chapter 11s seeking third party releases. Regardless of the merits of the majority opinion in Purdue Pharma, it seems likely, and is unfortunate, that a substantial price will have to be paid by innocent mass-tort victims as the implications of the Purdue Pharma ruling develop over time through the judicial system.



¹⁰ Deathtrap plan provisions commonly provide the impaired voting class receives a distribution, or an increased distribution, in exchange for the class’s acceptance of the plan, but receives no distribution, or only the distribution to which the class is minimally entitled, if the class votes to reject the plan. A number of courts have found deathtrap provisions are permissible where the incentive is consideration beyond a creditor’s existing rights and all creditors in the affected class are offered the same opportunity, but impermissible where the incentive is the threat of stripping existing rights. Post-Purdue Pharma, debtors may more commonly propose similar plan provisions varying the treatment of the claim based on whether the creditor provides the relevant third party release.

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As widely reported, on June 27th the Supreme Court majority in Harrington v. Purdue Pharma L.P. (“Purdue”), in a concise opinion, held that no authority exists in the text of the Bankruptcy Code, in the non-asbestos context, for non-consensual release of non-debtors.

Before providing a high level discussion of some of the likely implications of the Supreme Court’s Purdue decision, a few general observations. The Second Circuit’s approval of non-consensual third party releases under Purdue’s Chapter 11 plan was based on the satisfaction of several enumerated factors, one of the most important of which was the requirement that such releases be overwhelmingly supported by opioid claimants. Such overwhelming support by claimants was found by both the Bankruptcy Court and the Second Circuit: “The claimants voted overwhelmingly to approve” the Plan with “[o]ver 95% of the personal injury claims voting to accept”. “[T]he main challenge is not by creditors, but by the [United States] Trustee – a government entity without a financial stake in the litigation.” The Supreme Court majority, however, was swayed by a contrary view:

“Though most who returned [Plan] ballots supported it, fewer than 20% of eligible creditors participated . . . Thousands of opioid victims voted against the plan too, and many pleaded with the bankruptcy court not to wipe out their claims against the Sacklers without their consent . . .” (Emphasis added.)

Consistent with the Second Circuit, the Supreme Court’s minority, which viewed the majority opinion as “devastating” to opioid claimants, described Purdue’s Chapter 11 plan as, in fact, overwhelmingly supported by opioid claimants:

“The Plan . . . guaranteed substantial and equitable compensation to Purdue’s many victims and creditors . . . and provided significant funding for thousands of state and local governments to prevent and treat opioid addiction. . . . Not surprisingly, therefore, virtually all of the opioid victims and creditors in this case fervently support approval of Purdue’s bankruptcy reorganization plan. And all 50 State Attorney Generals have signed on to the plan — a rare consensus. The only relevant exceptions to the near universal desire for plan approval are a small group of Canadian creditors and one individual [the United States Trustee]. (Emphasis added.)

It appears clear that the Supreme Court’s majority and minority were each swayed by their perceived views of Purdue’s plan’s treatment of opioid claimants. The minority opinion saw the majority’s result as providing nothing good for opioid claimants anytime soon. The Supreme Court’s majority agreed with the United States Trustee that the Sacklers’ legal exposure absent a release “may induce the Sackler’s to negotiate consensual releases on terms more favorable to opioid victims. . . . and there may be a better deal on the horizon.” Interestingly, the Supreme Court’s minority refers to the United States Trustee as “one lone individual” whose actions “remain mystifying” and said, “that the U.S. Trustee does not speak for the victims of the opioid crisis and is indeed thwarting the opioid victim’s efforts at a fair and equitable recovery. . . .”

What The Majority Opinion Did Not Address

The final Section IV of the majority's opinion, which reads like a supplemental after-thought, was particularly careful to emphasize the limits of its decision. Specifically, the majority declined to offer any view regarding the effect of its opinion on: (a) already effective and substantially consummated Chapter 11 plans in other cases, (b) plans that provide for consensual, as opposed to non-consensual, releases and (c) plans that purport to pay claimants in full. The Supreme Court's Purdue decision also affects neither derivative claims (i.e., claims that are held or owned by the debtor but asserted by third parties) nor cases involving asbestos claims, which are governed by Section 524(g) of the Bankruptcy Code.

Rather than debating myriad interesting matters including the merits of the statutory construction principles construing Section 1123(a)(6) of the Bankruptcy Code (or even whether, as speculated by some that the Supreme Court's minority opinion was to be the majority until one Justice flipped at the last moment), below is a high level discussion of some of the practical implications of Purdue on future mass tort cases.

Effect of Remand On Purdue Chapter 11

Ultimately, Purdue will resolve its opioid claims and the Sacklers will pay billions over time to move on. There may be trailing litigation given that not all claims will be released. But such litigation, if pursued, would be protracted and expensive to prosecute. Purdue has already moved for a further stay of all litigation to enable the parties to mediate a resolution consistent with the Supreme Court's ruling. It remains to be seen whether the Sacklers will pay more or less than offered in exchange for full releases. It likewise remains to be seen whether opioid claimants and the states will receive a better or worse recovery, particularly given the delays in payments. To the extent some plaintiffs wish to pursue actions against the Sacklers, at the end of the day the results or fruits of such actions will likely not be material.

Effect of the Supreme Court's Ruling on Other Mass Tort Cases

As the tail of the majority opinion indicated, "because [Purdue] involves only a stayed reorganization plan we do not address whether our reading of the bankruptcy code would justify unwinding reorganization plans that have already become effective and been substantially consummated." It should be clear that substantially consummated plans will not be disturbed.

It appears that the Third Circuit deferred ruling on the Boy Scouts' plan confirmation appeal pending the Supreme Court's ruling in Purdue. The Boy Scouts Chapter 11 plan went effective, was partially consummated, but was not stayed notwithstanding the appeal of the plan confirmation order. There will no doubt be arguments both that the Boy Scouts' plan has not been substantially consummated, and arguments to the contrary. The very strong likelihood is that the Boy Scouts' plan and trusts established and funded by insurance carriers will not be disturbed on equitable (or other) mootness grounds.

What is a Consensual Third Party Release; Opt-In, Opt-Out, Etc.

Part IV of the majority opinion states that consensual third party releases are not affected by its decision: "Nor do we have occasion today to express a view on what constitutes a consensual release. . . ." Consensual releases have long been used particularly in courts in Circuits, such as the Fifth, which prohibited non-consensual third party releases. In the Fifth and other Circuits,

creditors are typically given the opportunity to opt-out of such releases. Disclosure statements are supposed to make such opt-out rights clear. If a creditor does not specifically opt-out, the release is deemed consensual in the Fifth Circuit and some other courts. In such courts, when a creditor does nothing, i.e., doesn't vote to accept or reject a plan and doesn't opt-out of giving a third party release, such silence is deemed of consent. Other courts, including some in the Third Circuit, have required an affirmative opt-in, or specific consent to a third party release for it to be deemed consensual. It remains to be seen whether the opt-out mechanism will continue to be deemed sufficient for a consensual release and in which districts; but it would appear that bankruptcy courts in the Fifth Circuit may now be viewed as more favorable for mass tort cases given long standing precedent there for the required opt-out mechanism.

What Is a Paid In Full Release

Part IV of the majority opinion states that it was not “pass[ing] upon” the propriety of a plan that “provides for the full satisfaction of claims against a third-party non-debtor.” If paid in full meant cash payment in the full allowed amount of a claim on the plan effective date it would be very simple and a non-issue. But that's not the case. Typically a paid in full release is predicated on expert testimony which establishes to the court's satisfaction that the trust or other vehicle established to pay allowed claims in full is, or will be, fully funded and that all anticipated claims will eventually be paid in full under the claims resolution process promptly after allowance. In a scenario where a court concludes, based on the evidentiary record, that claimants would be paid in full, does such plan, in fact, provide for the full satisfaction of claims against a third-party non-debtor? Plainly, a claimant can only be paid once; but a judicial determination that such claimant would ultimately be paid in full does not necessarily make it so.

Petition Date Injunctions Extending the Automatic Stay to Non Debtors

The Supreme Court's Purdue decision forbidding non-consensual third party releases does not mean that Chapter 11 will no longer be used to resolve mass tort claims (in non-asbestos contexts). Even though Purdue's prohibition on non-consensual third party releases likely increases claimants' leverage over non-debtors, the bankruptcy bar, which has pockets of extreme creativity, will work around Purdue's prohibition of non-consensual third party releases and achieve largely global resolutions. For example, upon filing of the petition, the debtor will typically obtain, in a mass tort or similar case, an order extending the automatic stay to non-debtor third parties such as officers and directors, controlling stockholders and others who arguably are liable to certain of the debtor's creditors. Nothing in Purdue suggests that such “provisional injunctions” would not be issued by bankruptcy courts, particularly where debtors will now likely maintain, from the start, that any plan for the debtor would have consensual or full pay third party releases. The leverage such injunctions provide the debtor in a mass tort context is very meaningful, and it is an integral step towards a consensual or global resolution.

Post-Confirmation Channeling Injunctions Or the Like

Similarly, “gatekeeping provisions” which can be used in mass tort and other cases are likewise not barred by Purdue. A “gatekeeping provision” is not a release. It is an injunction preventing lawsuits against non-debtors, unless the designated court determines there is a colorable claim. Properly framed, a “gatekeeper” provision in a plan is a tool that likely will be used by debtors to

attempt to “control” non-releasing claimants who seek to pursue litigation against non-debtors that are funding plans and are seeking to maximize the scope of consensual releases.

Channeling or similar post-petition injunctions, but now without non-consensual third party releases, may likewise still be in the debtor’s toolbox to maximize the extent of consensual releases. Channeling injunctions were originally created under Section 524(g) of the Bankruptcy Code to allow debtors in asbestos cases to resolve all known and future claims by funneling such claims into a settlement trust. Those injunctions involved a non-consensual release of third parties. In non-asbestos cases, courts have enjoined lawsuits by known and future claimants against settling insurers and “channeled” all such claims into claims resolution processes and procedures. In addition to using so-called channeling injunctions to establish trusts funded by insurance proceeds, the goal of such injunctions is to avoid piecemeal litigation in multiple forums. It is likely that while a channeling injunction will not limit the potential recovery amount of non-releasing claimants, future mass tort debtors will likely attempt to channel the litigation into, for example, a centralized and “organized” process but with an option for the claimant to opt-out. It would appear that the Takata injunction precedent should be a starting point in formulating such a path or process.

Derivative Claims

As indicated, the Purdue decision only affects non-consensual third party releases of claims directly owned by the claimant/plaintiff. Purdue does not affect derivative claims, which belong to the debtor, not the claimant. For example, in most circuits, a claim based on a liability theory of “piercing the corporate veil” is owned by, and belongs to, the debtor, not the claimant or creditor. Nothing in Purdue has any effect on a debtor releasing or in any way compromising a claim it owns. A direct claim for negligence, malfeasance or the like against a non-debtor third party, however, belongs to the claimant. A non-consensual release of such claim is plainly affected by Purdue. We can likely expect future mass tort or similar debtors to argue that many claims against non-debtors actually belong to the Debtor, and thus are derivative claims, and that such claims can be released by the debtor without the claimant’s consent.

Exculpation

Purdue raises many other considerations for issues going forward. For example, to address a few, Purdue should have no effect on exculpations that are typically provided under Chapter 11 plans to protect estate fiduciaries against alleged claims relating to post-petition acts and omissions committed in connection with administering and/or prosecuting the debtor’s reorganization. A plan exculpation is not a release and the rationale for such exculpations is generally that estate fiduciaries should not be subject to litigation in connection with their post-petition actions in connection with, or in furtherance of, the debtor’s reorganization, absent unusual circumstances. Legitimate debate can be had over whether exculpations cover gross negligence or willful misconduct or just merely negligence. But, in any event, Purdue has no bearing on such exculpations.

Chapter 15 Considerations

Finally, for those who try to look under every rock to determine the full scope of Purdue, Purdue's effect in the Chapter 15 context may pique the curiosity of some. In some countries, including England, non-consensual third-party releases are allowed. Suppose a foreign company files a reorganization or insolvency proceeding in its local jurisdiction and the foreign debtor's creditors include some U.S. citizens with claims against the foreign debtor's controlling shareholders, which also include some U.S. citizens. Suppose the foreign debtor seeks recognition of its reorganization under Chapter 15 of the Bankruptcy Code so that it can be enforced in the U.S. with the U.S. non-debtors defendants getting releases from U.S. claimants without their consent? Will the U.S. bankruptcy court recognize such foreign proceeding's non-consensual third party releases, or will such releases be viewed by the Chapter 15 court as "manifestly inconsistent" with U.S. law or public policy?

Conclusion

The Supreme Court's Purdue opinion, from the majority's succinct and simplistic approach to the minority's emphatic and lengthy dissent, is interesting. Perhaps the commentators who suggested that the minority opinion was intended to be the majority until a last-minute Justice switch are correct. But it doesn't really matter. Mass tort and similar cases will continue to be filed under Chapter 11 when such relief is warranted and other alternatives are not sufficient. The "guardrails" imposed by the Purdue majority on creative debtors' (and courts') ability to use non-consensual third party releases to get to a desired, reasonable and seemingly fair result will be more difficult but nonetheless achievable notwithstanding that mass tort claimants may now be seen to have more leverage in the process.



Clifford J. White III

Justice Neil Gorsuch's majority decision in *Purdue Pharma* was crisp, straight-forward, and to the point. The majority decided that "nothing in present law authorizes the Sackler discharge." The majority found that "the Sacklers seek to pay less than the code ordinarily requires and receive more than it normally permits." In response to the dissenting justices' policy arguments in favor of non-consenting third-party releases, Justice Gorsuch wrote that "we are the wrong audience" because "if a policy decision like that is to be made, it is for Congress to make."

The majority appropriately did not go beyond the issues before it and expressly noted it was not opining on what constitutes consent or whether offending chapter 11 plans that have been substantially consummated should be unwound. It is not hard to contemplate other issues that may be raised in the aftermath of the *Purdue* decision.

Here is my top ten list of issues and actions that may arise from the decision:

1. Purdue Pharma will negotiate a better plan that respects the rights of victims to sue the Sacklers. In fact, immediately after the court decision was handed down, the Sackler family issued a statement saying they were ready to negotiate again. That was a predictable response, if also a far cry from what Purdue's lawyers and the Sacklers declared many times in stentorian tones during the bankruptcy court proceedings. After the court just said no to similarly objectionable relief in the *Asena* and *Aero* cases,¹¹ it did not take long for new settlements, inside or outside of bankruptcy, to be completed. Future mass tort bankruptcy cases will require consent and hold-outs who want their day in court will receive the due process and other rights to which they are legally entitled. ALERT: The bankruptcy court will hold a status conference on July 9th to consider extending the temporary injunction against lawsuits and mediation. Query: will the bankruptcy court (with a different judge) be as sympathetic to the Purdue and Sackler arguments as the last court?

2. Chapter 11 practice will be chastened by the court's decision and start adhering more closely to the confines of the Bankruptcy Code. Justice Gorsuch's reasoning puts practitioners on notice. The teaching of the majority decision is not confined to mass torts cases or even to releases. Numerous chapter 11 practices, such as 24-hour bankruptcies and other corporate-debtor-friendly innovations adopted by magnate bankruptcy courts should finally be subject to closer scrutiny. The high court rejected the view that "everything not expressly prohibited is permitted."

3. There will be one less reason to forum and judge shop. Magnate districts tend to take the most liberties with the Code, including on non-consensual third-party releases. Even in the Fifth Circuit, where such releases were prohibited before *Purdue*, an end-run was tried. (Recall Bankruptcy Judge Jones's mediated settlement in the *Tehum Care Services* case which was later rejected after the Jones scandal was revealed.) The high court ruling on releases should make end-runs harder as well.

4. Mass tort cases in bankruptcy may become more victim friendly and less lawyer friendly. Mass tort cases will still be filed in bankruptcy courts. For many cases, bankruptcy will still provide an efficient forum in which to carry out negotiations. But there will be rules. Neither parties nor the courts will be able to make it up as they go along. Parent companies and affiliates will not skate through as if they had filed their own bankruptcy cases. Releases will be confined to derivative claims and probably claims based on certain conduct by certain parties during the case. Maybe victims will be treated better, as well. It is worth remembering that victims under the *Purdue* plan would have gotten, in the aggregate, less money than the

¹¹ In *Asena*, the district court on appeal strongly rejected the non-consensual releases. Within a few weeks, a new plan without involuntary releases was successfully proposed. In *Aero*, the bankruptcy court dismissed the case on grounds that the debtor did not qualify for bankruptcy relief and the debtor settled with tort claimants in an amount many times higher than the offer described in bankruptcy court.

professionals. Also, as pointed out by Justice Gorsuch, tort lawyers would have gotten a slice of the payments and the bigger payments would have stretched out over 10 years.

5. Congress just may act. Given concerns already expressed in both the business and class action lawyer communities, Congress may begin to study proposals for governing mass torts in bankruptcy, maybe even this year. Although the debate may start with trying to find a way to create a section 524(g) asbestos approach for other mass torts, additional related proposals may quickly emerge, such as: venue and judge-shopping reform; policing the integrity of post-confirmation trusts, including through stricter audits and claims reviews; and controls on attorney fees that unjustifiably erode victim compensation. Constitutional protections surely will hem in overly-creative solutions and even prompt reforms of asbestos bankruptcies as well.

6. Consent will be better defined by the courts or Congress. The Supreme Court expressly avoided this issue and thereby implicitly recognized that additional “knowing and informed consent” requires further consideration. Currently, there is far too much inconsistency between, and even within, districts on what constitutes consent. The biggest issue is opt-in or opt-out. Some judges approve opt-outs on grounds that failure to sign a statement opting out constitutes knowing and confirmed consent. That is particularly dubious in mass tort cases in which providing adequate notice is a huge challenge. Watch the Purdue and Sackler professionals try to create a loophole as big as a Mack truck in defining consent. Over time, I think most courts will require a signed “opt-in” form before taking away the property right to sue.

7. Equitable mootness and related issues will receive more attention. The Supreme Court also recognized that issues may arise concerning unwinding plans already confirmed. The *Boy Scouts* case is already on appeal. This and other cases will help raise and resolve related controversies, including by ending the equitable mootness doctrine which too often insulates bankruptcy court decisions from effective Article III court review.

8. There are Constitutional issues galore that must be sorted out. This applies both to litigation in court and any Congressional legislation to allow non-consensual releases. The right to due process and a jury trial are just two. Martin Bienenstock and others did a masterful job identifying these issues in *amicus* briefs filed in *Purdue* in the Supreme Court.

9. Courts will need to settle issues over the definition of derivative vs. direct claims. This may be the key factual and legal issue over which future third-party release controversies revolve. Derivative claims can be settled by the estate; direct claims cannot. As pointed out by the majority, the dissent tried to morph the definition of derivative claim (generally understood to mean a claim owned by the debtor) into any non-debtor claim in which the debtor’s conduct is a “legally relevant factor.” Justice Gorsuch rejected that contrivance, but it would not be hard to imagine aggressive debtor and tort lawyers trying to muddy the waters again.

10. The U.S. Trustee Program should be emboldened to appeal more often. The USTP won two cases in the Supreme Court this term, including in *Purdue Pharma*, as well as the *FTX* case in the Third Circuit vindicating the statutory provision making examiners mandatory under certain circumstances. (In total, the USTP pursues or defends upwards of 100 appeals per year.) One of the best ways the Program brings value to the bankruptcy system is to raise issues for judicial resolution. And bankruptcy courts are not the courts of last resort. I will never forget the judge in *Purdue* excoriating the USTP for its objection to the releases just struck down by the Supreme Court. He said DOJ's action to hold up the settlement was "reprehensible." Fortunately, he did not have the last word.

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