SQUIRE PATTON BOGGS

# Purdue Pharma:

## Supreme Court Rejects Nonconsensual Third-party Releases

US – July 2024

On June 27, 2024, the Supreme Court ruled in a 5-4 decision that a bankruptcy court does not have the statutory authority to discharge creditors' claims against a non-debtor without the creditors' consent.[1] The decision in *Harrington v. Purdue Pharma* settles a longstanding dispute in the bankruptcy world that will have a significant impact on Purdue and its hundreds of thousands of creditors, and more generally on how Chapter 11 reorganizations will be prosecuted in the future.

### Factual Background

The nonconsensual third-party releases in the *Purdue* case stem from a global settlement that Purdue negotiated with the overwhelming majority of its creditors and the Sackler family (the "Sacklers"). As part of the settlement, the Sacklers agreed to contribute over US$6 billion in exchange for consensual releases for civil liability (but not criminal liability) from Purdue, all of the creditors who agreed to the settlement and the non-consensual release from a small minority of creditors who opposed the settlement. The Sacklers sought to avoid civil lawsuits arising from their ownership and control of Purdue and the company's deceptive marketing practices of OxyContin. In 2007, a Purdue affiliate pled guilty to a federal felony for misbranding OxyContin as less addictive than other opioids and less subject to abuse. After the plea agreement, the Sacklers began taking as much as 70% of Purdue's yearly revenues, with the family's distributions between 2008 and 2016 totaling approximately US$11 billion. Much of these funds were diverted to overseas trusts and family-owned businesses.

Purdue and its affiliates filed Chapter 11 cases on September 16, 2019. The Sacklers originally proposed to return US$4.325 billion of the US$11 billion they had withdrawn from the company in exchange for (a) an order extinguishing any claims that the estate may have against family members, including fraudulent transfer claims, and (b) a release and injunction to bar opioid-related claims from being brought against them, including claims for fraud and willful misconduct. Purdue agreed to these terms and included them in its plan of reorganization.

The bankruptcy court confirmed the plan over the objection of thousands of creditors, including eight states, the District of Columbia, the city of Seattle and various Canadian municipalities and Tribes, but the district court vacated the decision, holding that the bankruptcy court did not have authority to extinguish claims against the Sacklers without the consent of the opioid victims who had brought, or who could subsequently bring, the claims.

Following this ruling, the Sacklers agreed to contribute up to an additional US$1.675 billion, and the states and District of Columbia agreed to drop their objections to the plan. The Second Circuit ultimately reversed the district court and revived the bankruptcy court's order confirming the now-modified plan. The US Trustee filed an application with the Supreme Court to stay the Second Circuit's decision, which the Supreme Court granted, and the Supreme Court granted a writ of *certiorari* to resolve the split among the circuits as to the authority of a bankruptcy court to approve nonconsensual third-party releases.

### Key Aspects of the Decision

The majority began its legal analysis by looking to section 1123(b) of the Bankruptcy Code, which governs what provisions may be included in a plan. Specifically, the majority focused on the catch-all provision contained in section 1123(b)(6) which provides that a Chapter 11 plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." The majority found that reading section 1123(b)(6)'s catch-all provision to authorize nonconsensual third-party releases would be a radically different power than the other powers enumerated in section 1123(b)(1)-(5), all of which concern the rights and responsibilities of the debtor. Relying on the statutory canon of construction *ejusdem generis*, under which a catch-all provision must be read in light of its surrounding provisions, the majority rejected the argument that section 1123(b)(6) authorized the bankruptcy court to approve nonconsensual third-party releases.

The majority found three additional reasons, beyond the statutory construction concerns discussed above, why section 1123(b)(6) cannot provide authority to approve the releases. *First*, the plan proponents' reading of section 1123(b)(6) would provide a non-debtor (*i.e.,* the Sacklers) with a discharge, which is usually reserved for the debtor alone. *Second*, the release would afford the Sacklers with a discharge of non-dischargeable claims (*e.g.,* claims for willful and malicious injury) without the Sacklers agreeing to pay anything approaching the full amount of their assets (which assets, it bears noting, were pilfered from the company).

1 Under section 524(g) of the Bankruptcy Code, a bankruptcy court may, however, enter an injunction that channels asbestos mass-tort liability to a trust set up to compensate persons injured by the debtor's asbestos.

*Third*, the Bankruptcy Code provides for nonconsensual third-party releases, but only in the context of asbestos cases, *see* 11 U.S.C. § 524(g), thus making it difficult to justify reading section 1123(b)(6) to provide for nonconsensual third-party releases in every context. According to the majority, a policy change allowing for nonconsensual third-party releases is a matter for Congress and not the court.

For all these reasons, the majority 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." Despite this seemingly broad ruling, the majority made clear that its ruling should not be construed to call into question consensual third-party releases. The majority also was clear that it was not "express[ing] 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." Furthermore, the majority stated that "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."

The dissent, in issuing a "respectful but emphatical[]" rebuttal concerning the majority's legal and policy conclusions, declared that the majority's decision "is wrong on the law and devastating for more than 100,000 opioid victims and their families" and that it "rewrites the text of the US Bankruptcy Code." Specifically, the dissent argued that section 1123(b) does not concern only debtors and that section 1123(b)(3) specifically allows for the settlement of claims held by third-parties. Further, the dissent stated that the phrase "appropriate provision" in section 1123(b)(6) was broad and empowered a bankruptcy court to exercise "reasonable discretion." Lastly, the dissent made a parallel and opposite policy argument, stating that the majority's decision will violate the collective-action problem the Bankruptcy Code tries to solve by incentivizing claimants to rush to obtain judgments against the Sacklers, which could deplete the estate through Purdue's indemnification of its officers and directors, leaving nothing for other creditors or opioid claimants.

## Implications of the Supreme Court's Ruling

So where does *Purdue* leave us now? On a simplistic basis it appears that nonconsensual third-party releases are prohibited going forward. However, the Supreme Court specifically left open the possibility of utilizing nonconsensual third-party releases in plans providing for full payment of creditor claims. This of course raises the legal question of what "full payment" means and the evidentiary burden required to carried to show when a plan provides for "full payment."

And, while consensual releases are not impacted by the *Purdue* decision, the Supreme Court did not address in its decision what qualifies as a consensual release. Will bankruptcy courts require plans to provide for "opt-in" third-party releases, where each creditor is requested to take specific and clear action to elect, as part of its plan ballot, to participate in the third-party release? Or will bankruptcy courts allow plans to provide for "opt-out" releases, where creditors are deemed to have consented to the third-party releases unless they specifically opt-out? Action vs inaction. Before the *Purdue* decision, courts disagreed on whether "opt-in" or "opt-out" procedures were required for consents in various plan contexts. We expect that courts will continue to disagree even after the *Purdue* ruling.

One effect of the *Purdue* decision is likely to be a change in the leverage of creditors in negotiations over plan treatment of claims, particularly committees and future claims representatives in mass-tort bankruptcies. For instance, since consent is required for third-party releases, we can expect dissenting creditors to be more aggressive in negotiating for improved treatment where plan funding is provided by third parties seeking releases. Moreover, since the Supreme Court specifically left open the possibility of utilizing nonconsensual third-party releases in full payment plans, creditors will now have strong leverage to negotiate for full payment, particularly where plan distributions are being funded by entities and individuals affiliated with the debtor who will want releases in consideration for their plan contributions.

Additionally, the *Purdue* decision underscores the importance of obtaining a stay pending appeal of any confirmation order. The Supreme Court was clear that it was not deciding whether the presence of nonconsensual third-party releases in a plan that had already become effective and had been substantially consummated would justify reversal of the confirmation order. Therefore, parties objecting to a confirmation order must, at the first instance, seek and obtain a stay of the confirmation order to preserve their ability to object to nonconsensual third-party releases.

Finally, *Purdue* leaves open the possibility, currently untested, of utilizing Chapter 15 of the Bankruptcy Code as a work-around of the Supreme Court's prohibition of nonconsensual third-party releases. Specifically, *Purdue* was limited to plans proposed under Chapter 11. Not before the Supreme Court, and not addressed in the decision, was whether a US bankruptcy court could or should recognize under Chapter 15 a plan approved in a foreign insolvency proceeding where nonconsensual third-party releases are permitted. It therefore remains an open question whether a US bankruptcy court would give recognition to such a plan under Chapter 15, and whether Chapter 15 is a viable work-around to the *Purdue* decision.