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I SHALL (NOT) BE RELEASED: WITH PURDUE PHARMA DECISION, US SUPREME COURT REMAKES CHAPTER 11 LANDSCAPE

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They say every man needs protection, they say that every man must fall.[1]

For over 40 years, “the bankruptcy community has recognized the resolution of mass tort claims as a widely accepted core function of bankruptcy courts,” and a “key feature in every mass tort bankruptcy” has been the non-debtor release.[2]

These releases are granted in favor of parties that have not filed their own bankruptcies (e.g., directors, officers, shareholders, and affiliates of bankrupt companies). They can benefit all parties by encouraging large, global settlements that efficiently resolve voluminous, unwieldy claims without the need to compete with other creditors or rely on difficult post-judgment collection procedures to obtain a full recovery.

No longer. In the Supreme Court’s recent *Purdue Pharma* decision, the Court held in a 5-4 ruling that the Bankruptcy Code does not authorize any non-consensual third-party releases (other than regarding asbestos liabilities). This overturns jurisprudence that has prevailed in the majority of US appellate courts and promoted comprehensive resolutions of complex litigation. As discussed below, the potential consequences of this decision for the US bankruptcy system and non-US insolvency regimes (where, in some jurisdictions, third-party releases are a non-controversial tool in the restructuring toolkit) are significant, and major changes in the restructuring industry could follow.

HOW DID WE GET HERE?

The foremost goal of any plan of reorganization is to give the debtor a “fresh start” so that it can continue operating unburdened by unwieldy pre-bankruptcy liabilities. Most significantly, pre-bankruptcy claims against the debtor are consolidated in the bankruptcy court and are paid out under the plan depending on the relative priority of different classes of claims. Junior claims may be paid at a discount or get completely wiped out, depending on the circumstances. The plan can also provide for the discharge of any claims against the debtor that are not to be paid under the plan.

But before a plan can be approved, impaired creditors and other stakeholders must be given the opportunity to vote to accept or reject the plan, and the plan cannot be confirmed without the support of at least one voting class. This support may be difficult to achieve if the debtor lacks sufficient resources or business prospects to meaningfully pay claims with the only real prospects for recovery coming from non-debtor third parties.

Enter non-consensual third-party releases. These Chapter 11 plan provisions prevent non-debtor parties like creditors (often tort plaintiffs) from pursuing released legal claims against other non-debtor parties (often co-defendants of the debtor) without the consent of the releasing creditors. These releases can benefit all parties by facilitating a global resolution of claims and potentially resulting in meaningful, equitable distributions on claims through a streamlined claims resolution process without the need to chase recalcitrant defendants for collection of a money judgment or to compete with other successful plaintiffs for limited or hard-to-reach funds. However, non-consensual releases have been challenged on various grounds, including that non-consenting parties are being deprived of due process[3] and that the Bankruptcy Code does not actually authorize such releases.

The issue came to a head when Purdue Pharma L.P.—a closely held company owned and formerly managed by members of the Sackler family—sought to use the bankruptcy process to shield the family from opioid-related liabilities in exchange for payments of billions of dollars to the Purdue estate. Purdue, manufacturer of the opioid pain reliever OxyContin, held the drug out as being less addictive than other opioid pain relievers. Between 1996 and 2019, Purdue generated roughly $34 billion in revenue, primarily from OxyContin sales. However, litigation concerning the consequences of OxyContin addiction—and Purdue's marketing practices—grew in the mid-2000s, prompting the Sacklers to withdraw roughly $11 billion in cash from Purdue during the decade leading up to its bankruptcy filing.

When Purdue filed its Chapter 11 case in 2019, the Sacklers were no longer in charge of the company. But the company needed a way to manage OxyContin litigation and liabilities. So Purdue negotiated a plan and settlement with the Sacklers under which the family would contribute $4.325 billion to Purdue over time to satisfy opioid claims and Purdue would reorganize as a public benefit company with the aim of mitigating opioid addiction harms. But, as a part of the settlement, the Sacklers required that the plan include an injunction preventing third parties from asserting opioid-related claims against, or seeking to recover related damages from, the Sacklers and their other business entities.

Purdue's Chapter 11 plan was put to a vote and an overwhelming majority of voting creditors supported the plan.[4] But the plan garnered objections from thousands of opioid plaintiffs who opposed the non-consensual releases, as did the US Trustee and other governmental and tribal bodies. Following a six-day trial with 41 witnesses, Judge Robert Drain largely overruled those objections and confirmed Purdue's Chapter 11 plan, with certain modifications. He noted that the released claims "are very closely related on the facts to the estates' claims for alter ego, veil piercing, and breach of fiduciary duty/failure to supervise settled under the plan" and that there were no procedural or jurisdictional defects in the granting of the releases.[5]

Judge Drain noted that Second Circuit precedent allowed for non-debtor releases where:

> The release is 'important' to the plan, the estate receives substantial consideration in return, the enjoined claims would be channeled to a settlement fund rather than extinguished, the released claims would otherwise indirectly impact the debtors' reorganization by way of indemnity or contribution, and the plan otherwise provided for the full payment of the enjoined claims.[6]

Considering these factors, he said he believed that Purdue's plan would "unravel" without the releases and related settlements and that, absent the plan, claimants would likely receive less.[7] Thus, the non-consensual third-party releases in the Purdue plan and the Sackler settlement were approved.[8]

The US Trustee and other objecting parties appealed. In the first round of appeals, the District Court reversed Judge Drain's confirmation order, holding that the Bankruptcy Code does not authorize non-consensual third-party releases other than in asbestos cases.[9] The District Court concluded that Second Circuit precedent was silent as to the question and, looking at the issues anew, that the residual sources of authority under Sections 105(a) and 1123 of the Bankruptcy Code were not so broad as to approve such releases, despite the fact that "the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction."[10]

The Purdue debtors and other parties that supported the plan next appealed to the Court of Appeals for the Second Circuit, seeking a holding that non-consensual third-party releases are permitted under the Bankruptcy Code.[11] And that is exactly what they got. Much like other jurisdictions, the Second Circuit adopted a seven-factor test for approval of non-consensual releases of third parties, which accounted for the degree to which the released claims and claims against the debtor are intertwined, the importance of the releases to the reorganization, the contributions made by the releasing parties to the debtor's estate, whether affected creditors "overwhelmingly" support the plan, and whether the plan provides for "fair payment of enjoined claims."[12] Applying those factors, and considering the detailed factual findings made in the Bankruptcy Court, a divided Second Circuit panel reversed the District Court and held that confirmation of the Purdue Chapter 11 plan, including approval of the non-consensual third-party releases, was appropriate.[13]

THE SUPREME COURT'S DECISION

Following the Second Circuit's decision, the US Trustee sought a stay of the effectiveness of the Purdue plan pending Supreme Court review, which the Court treated as a *certiorari* petition that it granted solely as to the question of whether the Bankruptcy Code authorizes non-consensual third-party releases of the sort approved in Purdue's plan. The Court held that it does not. [14]

Reviewing the Bankruptcy Code's comprehensive statutory scheme, the Court noted that a discharge in a bankruptcy case generally applies only to claims against the debtor pursuant to Section 524(e) of the code, and that the Sacklers sought to obtain "what essentially amounts to a discharge" without placing "virtually all their assets on the table for distribution to creditors[.]"[15] The Court reviewed the provisions of Section 1123 and found that the ability for a plan to include "any other appropriate provision" was not sufficiently broad to encompass such releases because the catch-all had to be "interpreted in light of its surrounding context" and that, in that context, only relief relating to the debtor itself was likely contemplated.[16]

However, the Supreme Court was careful to limit the scope of its ruling. Among the issues expressly not decided were: (1) whether consensual third-party releases may be included in a Chapter 11 plan; (2) what qualifies as "consensual" for those purposes; (3) whether a different rule applies when a plan provides for the full satisfaction of claims against the third-party non-debtor; and (4) whether plans containing now-unlawful releases that have already been substantially consummated are subject to modification.[17] As noted below, those and other key issues are likely to be heavily litigated going forward as parties attempt to work around, or expand the consequences of, the Court's *Purdue Pharma* decision.

WHAT COMES NEXT?

Do you have a clue what happens now? Oceans rise. Empires fall. It's much harder when it's all your call. [18]

The Supreme Court's *Purdue Pharma* decision will be a game-changer in the restructuring industry, and the potential consequences in areas of US and international restructuring law and practice are bound to play out in the near future. Ironically, by refusing to release the Sacklers, the Court's decision may ultimately result in a lower recovery for the very victims of the opioid crisis that has plagued the country in recent years.[19] Going forward, debtors and other parties involved in pending Chapter 11 cases will need to consider how to achieve their restructuring goals without the benefit of non-consensual third-party releases and any settlements or other plan constructs that would have depended on these releases.

Consensual Releases: The *Purdue* decision on its face applies only to non-consensual releases and expressly reserves the question of whether consensual releases may be granted pursuant to a Chapter 11 plan, as well as what acts or omissions can constitute consent. Under pre-*Purdue* practice, plans often included an "opt-out" mechanism that allowed claimants to be excluded from any grant of third-party releases. Now, we can expect more tension over whether declining or neglecting to "opt out" sufficiently satisfies the consent requirement for third-party releases. Some debtors may elect to pursue "opt-in" releases, under which a claimant is only a releasing party if it affirmatively agrees to provide these releases. However, these opt-in releases may be of limited utility given the potentially low participation and opt-in rates that could be obtained from a large, diffuse creditor body (particularly in mass tort cases).

Gatekeeping Injunctions: One approach that has become more prevalent in recent years is to include "gatekeeping" injunctions in Chapter 11 plans. These injunctions do not actually release any claims but instead require that the claimant seek the bankruptcy court's authority to pursue such claims. Even jurisdictions that have historically barred third-party releases may approve gatekeeping injunctions in some circumstances.[20] We may, therefore, see parties try to more aggressively use gatekeeping injunctions to shield non-debtors from having to defend against litigation claims. But these provisions also can be controversial, and the lack of a separate statutory basis approving of them subjects them to potential objections on *Purdue Pharma* grounds.

Exculpation: Unlike third-party releases, which generally relate to pre-bankruptcy conduct, exculpation provisions in Chapter 11 plans are typically used to shield debtors, committees, and other key bankruptcy case participants, as well as their lawyers and other advisors, from claims arising from the conduct of the bankruptcy case itself. Like third-party releases, however, exculpation provisions are not expressly authorized by the Bankruptcy Code. Although there are other potential non-statutory grounds for approving exculpation provisions that courts could use to distinguish these provisions from releases of pre-bankruptcy claims,[21] the continued viability of these provisions remains in question.[22]

Revisiting Confirmed Chapter 11 Plans: The Supreme Court expressly left unanswered the question of whether a Chapter 11 plan incorporating non-consensual releases can be revisited after it has been substantially consummated. Ordinarily, outside the appellate process, a confirmation order can only be revoked if procured by fraud (and then only within the first 180 days post-confirmation),[23] and a confirmed plan can only be modified before it is substantially consummated.[24] But, given the major change in law in the majority of circuits that enforced non-consensual third-party releases, parties may seek to use all available tools to seek to have confirmed and consummated plans modified to eliminate non-consensual releases.

The Decision to File: Pursuing Chapter 11 may be the only feasible option for severely distressed companies despite the Supreme Court's bar against third-party releases. In cases where a company can still operate, but would benefit using Chapter 11 to manage unwieldy litigation, its key decisions-makers—such as major shareholders, directors, and officers—may become more reluctant to subject their company to the Chapter 11 process if they know they cannot also use the process to manage their own personal liability relating to the business.

Legislation: Because the *Purdue Pharma* decision was based solely on the Court's interpretation of the Bankruptcy Code, Congress could amend the Bankruptcy Code to permit non-consensual third-party releases. Indeed, as the Court noted, Congress did exactly that in enacting Section 524(g) of the Bankruptcy Code to permit injunctions that shield third parties from asbestos claims. But whether Congress will broaden Section 524(g) to apply to non-asbestos claims is uncertain, particularly given that legislation is in the works—referred to as the SACKLER Act—that would expressly prohibit a bankruptcy court from releasing claims held by governmental and tribal authorities against non-debtors.

Non-US Regimes & Chapter 15: The *Purdue Pharma* decision also has the potential to reshape how crossborder restructurings are handled. Multinational entities may have the ability to choose the country in which their main restructuring proceeding will be handled and then have the opportunity to seek recognition of that restructuring in other countries where they do business or own property. In the United States, Chapter 15 of the Bankruptcy Code provides for recognition of foreign restructuring proceedings.

Importantly, the relief that can be granted in Chapter 15 is not limited to what a debtor could obtain in a Chapter 11 case. Instead, "deference to the foreign court is appropriate so long as the foreign proceedings are procedurally fair and . . . do not contravene the laws or public policy of the United States."[25] Thus, rather than being driven by US statute or policy, the analysis in Chapter 15 focuses on considering the authority of the foreign court, the procedural safeguards in place preventing abuse, and the preference to grant comity to foreign proceedings.[26]

Third-party releases are commonplace in some jurisdictions outside the United States, including in the United Kingdom in the context of schemes of arrangement.[27] Given the broader availability elsewhere of these releases post-*Purdue Pharma*, multinational companies with the option to do so may seek to conduct their main restructuring proceedings outside the United States if these releases are an important part of the company's restructuring, where they would have instead chosen Chapter 11 before *Purdue Pharma*. And, even then, courts in Chapter 15 recognition proceedings may look more closely at these releases and consider whether the blanket unavailability of them under US law weighs against the comity-based justifications for recognizing foreign releases.

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These are just some examples of the potential fallout from the *Purdue Pharma* decision. The approach to interpreting the Bankruptcy Code set forth in the decision may also affect the viability of other forms of relief pursued in bankruptcy courts that are not explicitly contemplated in the Code. And there may be implications for other statutory schemes where some rights or powers are inferred from generic "catch-all" provisions. While the full range of consequences from the decision is not yet known, what is certain is that *Purdue Pharma* will influence bankruptcy-related decision-making for the foreseeable future.

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[1] Bob Dylan, "I Shall Be Released" (1967).

[2] A. Casey & J. Macey, In Defense of Chapter 11 for Mass Torts, 90 U. Chi. L. Rev. 973, 974, 977 (2023).

[3] As the *Purdue* decision resolved the third-party release question on purely statutory grounds, discussion of due process considerations is beyond the scope of this Legal Update.

[4] *In re Purdue Pharma L.P.*, 633 B.R. 53, 61 (Bankr. S.D.N.Y.) ("For the personal-injury claims classes, the vote was 95.7 percent (Class 10(b)) to over 98 percent (Class 10(a)). In each class the percent voting in favor of the plan was above 93 percent with the exception of the class of hospital claims, which was over 88 percent (and no member of that class is pursuing an objection to the plan).").

[5] *Id.* at 95, 100.

[6] *Id*. at 105.

[7] *Id.* at 109.

[8] *Id.* at 115.

[9] *In re Purdue Pharma, L.P.*, 635 B.R. 26, 115 (S.D.N.Y. 2021).

[10] *Id.*

[11] Prior to the Second Circuit's decision, the Sackler family increased their settlement contributions by more than $1 billion, which resulted in the withdrawal of the eight objecting states' and District of Columbia's plan objections and appeals.

[12] *In Re Purdue Pharma L.P., 69 F.4th 45, 77-89 (2d Cir. 2023.*

[13] *Id.* at 83.

[14] *Harrington v. Purdue Pharma L. P.*, No. 23-124, 2024 WL 3187799, at *11 (U.S. June 27, 2024).

[15] *Id*. at *5.

[16] *Id.* at *6-7.

[17] *Id.* at *11.

[18] Jonathan Groff, What Comes Next? Hamilton (2016).

[19] The Sackler family has much of their wealth tied up in overseas spendthrift trusts, which are difficult-to-impossible for individual creditors to reach, leading Judge Drain to conclude that rejecting the settlement and releases to preserve third-party claims would likely result in worse recoveries for opioid victims than if those claims were released. *Purdue Pharma L.P.*, 633 B.R. at 88-89, 109. *See Purdue Pharma L. P.*, 2024 WL 3187799, at *12, 23 (Kavanaugh, J. dissenting) (describing the outcome as "devastating for more than 100,000 opioid victims and their families" because "opioid victims are now deprived of the substantial monetary recovery that they long fought for and finally secured after years of litigation" and noting concerns about "the ability to collect any judgments from the Sacklers due to the difficulty of reaching their assets in foreign countries and in spendthrift trusts.").

[20] *See, e.g.*, *Matter of Highland Cap. Mgmt., L.P.*, 48 F.4th 419, 439 (5th Cir. 2022) (approving of gatekeeping injunctions as to certain estate fiduciaries).

[21] *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1085 (9th Cir. 2020) (holding that, while non-debtor releases are not permitted, exculpation provisions may be acceptable because they cover "only liabilities arising from the bankruptcy proceedings and not the discharged debt.").

[22] *See Highland Cap. Mgmt.*, 48 F.4th at 437 (5th Cir. 2022) (limiting exculpation provisions to "the debtor, the creditors' committee and its members for conduct within the scope of their duties, and the trustees within the scope of their duties" while declining to exculpate individual decision-makers or professionals) (citations omitted).

[23] 11 U.S.C. § 1144.

[24] 11 U.S.C. § 1127(b); *see In re NorthEast Gas Generation, LLC*, 639 B.R. 914, 921 (Bankr. D. Del. 2022) (holding that the Bankruptcy Code prohibits plan modifications following substantial consummation).

[25] *JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418, 424 (2d Cir. 2005) (citations omitted).

[26] *See In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1067 (5th Cir. 2012) (holding that comity did not require

domestic enforcement of non-consensual third-party releases granted in Mexican proceeding where plan was only approved due to votes of insider claimants and equityholders retained their interests while releasing unsecured creditors were to be paid a small fraction of their claims).

[27] *In re Avanti Commc'ns Grp. PLC*, 582 B.R. 603, 618 (Bankr. S.D.N.Y. 2018).

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