IN THE NEWS

SC Split, Purdue Win Seen

The U.S. Supreme Court held oral argument in Harrington v. Purdue Pharma L.P. back in December. The controversy revolves around the legal permissibility of non-debtor releases, specifically the release of the Sackler family from civil liability amid the opioid crisis.

04/02/2024 | 8 minute read

Turnarounds & Workouts
By Christopher Patalinghug
January 2024

The U.S. Supreme Court held oral argument in *Harrington v. Purdue Pharma L.P.* back in December. The controversy revolves around the legal permissibility of non-debtor releases, specifically the release of the Sackler family from civil liability amid the opioid crisis. The Supreme Court took on the case after the Court of Appeals for the Second Circuit reversed a district court decision that vacated the bankruptcy court's order confirming Purdue's Chapter 11 exit plan and held nonconsensual third-party releases provided in that plan were not permitted under the Bankruptcy Code. The Second Circuit concluded in May last year that the releases are permissible. All eyes are now on *Purdue* as a landmark Supreme Court decision, which is expected by June 30, 2024, will have the potential to reshape corporate accountability and significantly impact victims' ability to seek redress.

Monique Jewett-Brewster, a shareholder and chair of Hopkins & Carley's Financial Institutions and Creditors Rights Practice Group; and Doug Mintz, partner and co-chair of the Business Reorganization Group, Schulte Roth & Zabel, have shared their insights on the recent Supreme Court trial and the case.

What are the key issues Purdue?

Monique Jewett-Brewster, Hopkins & Carley: The Supreme Court's decision in *Purdue* is one to watch because of the extreme Circuit split on the permissibility of a chapter 11 debtor's inclusion of nonconsensual third party releases of claims against nondebtors in its plan. Interest in this case is high across all constituents in a bankruptcy proceeding. Some constituents (such as debtors) strongly support the validity of such clauses to protect the estate's ability to settle the potential exposure of non-debtor parties crucial to the success of a plan. Others (such as the creditors asserting claims against the non-debtor releasees) argue that such provisions are improper because a discharge of a debt by the debtor does not affect the liability of any other entity under the Bankruptcy Code. Still others take

Related People

Monique Jewett-Brewster
Partner
San Jose
408.299.1428
monique.jewettbrewster@lathropgpm.com

Related Services

Bankruptcy, Restructuring & Creditors' Rights

Related Sectors

Financial Institutions

the position that such provisions are generally impermissible but should be subject to certain judicially-created exemptions.

Here, Petitioner Office of the United States Trustee, the Department of Justice agency with "watchdog" oversight in bankruptcy cases, urges the Supreme Court to issue a blanket ruling that non-consensual third party releases are not authorized by the Bankruptcy Code. In doing so, the

U.S. Trustee argues that the release at issue grants the Sackler family, none of whom filed for bankruptcy relief, with the functional equivalent of a discharge. Such relief, the U.S. Trustee contends, is generally reserved for debtors pursuant to 11 U.S.C. section 524(e). The U.S. Trustee also argues that the bankruptcy court should not be permitted to exceed its statutory authority and redistribute the opposing creditors' private property rights simply because the Sacklers assert that their contribution of $6 billion to the plan is the "best deal available". In so arguing, the U.S. Trustee struck a distinction between permissible consensual third party releases, which (unlike nonconsensual third party releases) do not require the forcible authority of the bankruptcy court to extinguish third party property rights.

In response, Respondents Purdue and Official Committee of Unsecured Creditors both argue that the Supreme Court should reject the U.S. Trustee's invitation to rule that nonconsensual third party releases of claims are categorically unauthorized by the Bankruptcy Code. Purdue contends that such a finding would be irreconcilable with 11 U.S.C. section 1123(b)(6), a "catch-all" provision expressly providing that plans may include "any other appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code. Purdue also argues that the release simply prevents creditors from "jumping the line" and pursuing the Sacklers' assets "through the back door." Noting that the Committee — a fiduciary for all unsecured creditors of the bankruptcy estate — insisted on the inclusion of the release in the plan, the Committee further argues that the Supreme Court's focus should be on the victims, the creditors, and not about the releases' impact on the Sacklers. The Committee also points out that 96% of the personal injury victim class voted the approve the plan because without the release, the plan will unravel, chapter 7 liquidation will follow and there will be no distributions available for creditors.

Doug Mintz, Schulte: The Supreme Court considered specifically the question of whether direct claims by non-debtors against other nondebtor third parties could be released non-consensually through a debtor's plan of reorganization. The Supreme Court will likely consider closely how far 1123(b)(6) extends and if the claims being presented truly are direct claims, rather than derivative. Purdue argues the claims at issue are either derivative claims (that belong to Purdue and can be released) or overlap so closely with any derivative claims of the Debtors that the distinction is meaningless. So even if the Court finds that 1123(b)(6) doesn't extend to direct claims, it could still narrowly side with Purdue — while preserving the possibility that other third-party releases may be improper down the road.

How different or the same are the third party releases proposed in *Purdue* compared to releases in most Chapter 11 exit plans?

Mintz: Bankruptcy plans regularly release third-parties such as equity sponsors and other related parties. Here the potential liability against the Sackler entities — who are personally accused of knowingly causing Purdue to take certain harmful action — are massive and thus significant.

Jewett-Brewster: The release at issue is extremely broad and extends even to claims involving fraud, a result that the U.S. Trustee argues is not contemplated under the Bankruptcy Code. During oral argument, the justices acknowledged that even if the Sacklers filed for personal bankruptcy, the fraud exception to dischargeability still could apply such that they may not be released from personal liability from fraud claims. As such, the release presents a more favorable outcome for the Sacklers than even that which they could hope to achieve had they filed for individual bankruptcy.

In addition, the third party nonconsensual release in the Purdue plan differs substantially from exculpation clauses in non-asbestos trust cases, which often are included in chapter 11 plans. While such a nonconsensual third party release effectively extinguishes prepetition and postpetition claims held by creditors against various nondebtor parties, as with the Sacklers in this case, exculpation clauses typically are more narrowly drafted and tend to exculpate specific parties from claims based on conduct in connection with, or arising out of, the bankruptcy case.

Take us to your thoughts as the Supreme Court hearing was underway. What got your attention the most?

Mintz: It was clear immediately that this issue was not going to fall along the typical ideological lines. That's not totally unusual for a bankruptcy or other commercial case — but it is attention-getting still. The justices pushed the Solicitor General's office pretty aggressively and seemed concerned about the impact of undermining the plan on the many parties that have settled.

Jewett-Brewster: One of the U.S. Trustee's strongest arguments is that the release upsets the basic *quid pro quo* of bankruptcy law, since the Sacklers stand to receive the benefit of a release of all third-party claims against them arising from Purdue's actions without putting all of their assets "on the table" through filing for bankruptcy themselves. Unlike a debtor who has to make all nonexempt assets available to creditors, the Sacklers were able to decide how much they want to contribute to the plan to receive a nonconsensual release of third-party claims. The U.S. Trustee also points out that the Sacklers put more money on the table after the district court reversed the bankruptcy court's approval of the plan and release, such that there can be no support for Respondents' claim that the $6 billion deal is truly the "best possible deal" that creditors can stand to achieve in the case. In any event, the U.S. Trustee argues that the Sacklers could simply settle with all of those creditors who consent, with those who do not consent to the release retaining their claims. Rather than the holdouts who did not consent to the plan, the U.S. Trustee contends that the Sacklers' insistence on obtaining releases from every single victim, whether they consent or not, is the true problem.

I was surprised by certain justices' queries of why the U.S. Trustee would be concerned with, or even have standing, to contest the plan. Section 307 of the Bankruptcy Code expressly confers the disinterested U.S. Trustee with standing to raise and appear and be heard on any issue under the Bankruptcy Code — which is precisely what the U.S. Trustee did here.

What was your first reaction as the Supreme Court trial ended?

Mintz: That seemed much closer than I expected and I'm not sure what they'll do here. But based on the hearing I do not expect they will issue a broad sweeping order affirming or rejecting the validity of all third-party releases. Rather, I expect they'll focus on whether the releases in this case are appropriate under section 1123(b)(6) of the bankruptcy code (or perhaps determine the claims overlap with the company's derivative claims rendering the issue essentially moot).

Jewett-Brewster: Purdue concludes by arguing that the Supreme Court will take a "wrecking ball" to the Bankruptcy Code if the U.S. Trustee prevails in this appeal. Yet, as the U.S. Trustee points out, multiple mass tort cases unrelated to asbestos involve confirmed plans of reorganization that do not permit nonconsensual third-party releases (including without limitation the PG&E chapter 11 case filed to address the utility's mass tort liability for wildfire damages). Thus, one might conclude it is any ruling by the Supreme Court that categorically approves the inclusion of nonconsensual third-party releases in chapter 11 plans that stands to potentially upset decades of precedent.

There are reports the justices appear to be divided on the controversy. Kindly comment on this.

Jewett-Brewster: The justices appeared to be extremely conflicted on the controversy. For example, Justice Thomas appeared to focus on the breadth of section 1123(b)(6)'s catchall provision, while Justice Kavanaugh questioned the U.S. Trustee closely on its challenge to the release based on the "theoretical idea" that the creditors may be able to recover more money from the Sacklers at some date "down the road". Comparatively, Justice Jackson observed the importance of considering both halves of section 1123(b)(6)'s catchall (i.e., that plan provisions be both "appropriate" and "not inconsistent" with other applicable sections of the Bankruptcy Code) when ruling on this question. Justice Gorsuch noted that section 1123(b)(6) may be limited by statutory context, historic equity practice, as well as potential constitutional questions. And Justice Barrett expressed concerns about the Respondents' argument that the release and plan constituted the best possible deal to creditors, where the Sacklers had pulled billions of dollars out of Purdue prepetition and then decided how much money they were willing to make available to the bankruptcy estate.

Mintz: There were not clear, typical "ideological" lines here. And there were competing interests between non-debtor claimants' rights outside bankruptcy, versus the need for efficiency in resolving claims in bankruptcy. That tension of course is what drove the Supreme Court to step in here. There is a mix of interests here, between "justice" for the claimants, versus property rights for non-debtor plaintiffs against defendants that haven't availed themselves of bankruptcy.

Discuss the potential impact of the Supreme Court's ruling (in favor or against the controversial third party releases).

Mintz: Counsel to the UCC suggested a ruling against the Debtors could leave creditors with no recovery. The justices seemed to find that perspective overwrought. It is possible the Court will affirm the third-party releases – this would render the potential actions by the states and hold outs against the Sackler entities moot. Broadly it could give greater certainty to standard thirdparty releases if affirmed. However, we expect a narrower ruling that says the proposed releases here are or are not appropriate — leaving unclear how a court would address different releases in a different case.

Jewett-Brewster: Those watching for the Supreme Court's decision in this pivotal case look forward to having the circuit split on this issue be resolved with binding precedent once and for all.

What's your prediction?

Jewett-Brewster: The majority of the Supreme Court justices will rule in Respondents' favor. While some of the justices appeared to be concerned with allowing the Sacklers to decide how much they are willing to contribute to the plan in exchange for the nonconsensual third party release to their benefit, more seemed to be concerned that the U.S. Trustee challenged a plan that ostensibly resulted in the best possible outcome for the creditors, the vast majority of whom had voted to accept the plan. I also believe that the Supreme Court will be inclined to reject the U.S.

Trustee's request for a finding that such releases categorically violate the Bankruptcy Code, and instead will adopt a ruling that allows the bankruptcy courts the flexibility and discretion to determine whether, on the facts of each case before them, any proposed third party nonconsensual release may be appropriate and not inconsistent with other applicable provisions of the Bankruptcy Code.

Mintz: I'm not much for predicting Supreme Court outcomes! This may be the rare time where a bankruptcy case divides the court. It will not be the usual 9-0 bankruptcy case.