What Purdue Ch. 11 Means For Future Of Third-Party Releases

By Gregory Hesse and Kollin Bender
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In a highly anticipated decision issued on May 30, the U.S. Court of Appeals for the Second Circuit rendered its opinion in In re: Purdue Pharma LP, approving a Chapter 11 plan's inclusion of a nonconsensual release of creditors' direct claims against nondebtor third parties.[1]

This article describes the history of the case, identifies some of the key takeaways from the decision and outlines where other jurisdictions in the country stand on nonconsensual third-party releases.

Facts and Procedural History of Purdue Pharma

Owned by the Sackler family, Purdue developed, manufactured, marketed and introduced to market OxyContin, an opioid which the company promoted as nonaddictive.

OxyContin has since been blamed for contributing to the opioid epidemic, and the fallout led to litigation against Purdue and the Sacklers. In an effort to resolve thousands of lawsuits, Purdue filed for Chapter 11 bankruptcy on Sept. 15, 2019. The Sacklers opted to not file for bankruptcy.

On Sept. 17, 2021, the U.S. Bankruptcy Court for the Southern District of New York confirmed Purdue's Chapter 11 plan without the approval of all creditors. The plan implemented a settlement between Purdue, the Sacklers and other stakeholders and opioid victims in which the Sacklers agreed to provide approximately $4 billion into nine trusts for the purpose of settling opioid-related claims.

In exchange, the plan included a provision releasing the Sacklers from direct claims asserted against them by the opioid victims. The plan limited the release to claims caused by Purdue's conduct or claims in which Purdue's conduct amounted to a legally relevant factor.

On appeal, on Dec. 16, 2021, the U.S. District Court for the Southern District of New York reversed the bankruptcy court's decision in light of the plan's implementation of the nonconsensual third-party releases. The district court found no statutory authority in the U.S. Bankruptcy Code giving bankruptcy courts the power to approve such releases.

Several parties, including Purdue, the Sacklers and the official unsecured creditors' committee appealed the district court's decision. Nine states ended up dropping the appeal after the Sacklers agreed to contribute an additional $1.175 to $1.675 billion to the plan, raising their total contribution to the Chapter 11 plan to approximately $6 billion.

As a result, the only remaining appellees to the Second Circuit were the U.S. Trustee's Office, some

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Canadian municipalities, indigenous nations and pro se claimants.

The Second Circuit reversed the district court and reinstated Purdue's Chapter 11 plan.

In so ruling, the Second Circuit concluded that the Bankruptcy Code permits the inclusion of nonconsensual releases of direct claims against third parties.

Key Takeaways from the Decision

Statutory Authority for Nonconsensual Releases

The Second Circuit found statutory authority permitting third-party releases in Sections 105(a) and 1123(b)(6) of the Bankruptcy Code.

Section 105(a) states that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."

The Second Circuit decision opined that Section 105(a) gives broad equitable power to bankruptcy courts but that the provision could not be the only justification for imposing nonconsensual third-party releases.

The Second Circuit then pointed to Section 1123(b)(6), which states that "a plan may ... include any other appropriate provision not inconsistent with the applicable provisions of this title."

The Second Circuit further noted that nothing in the Bankruptcy Code explicitly prohibits third-party releases. Reading the two provisions in tandem, the Second Circuit held that bankruptcy courts have equitable authority to impose nonconsensual third-party releases when they are necessary to effectuate a Chapter 11 plan.

The Second Circuit further rejected any argument that the Bankruptcy Code contained authority prohibiting nonconsensual third-party releases. A minority of jurisdictions hold that Section 524(e) bars these releases.[2] Section 524(e) provides that "discharge of a debt of the debtor does not affect the liability of any other entity."

The minority reads this section as a bar to third-party releases, reasoning that Congress did not intend to extend any benefits or protections provided by the bankruptcy process to nondebtor third parties.

In considering this argument, the Second Circuit found that when Congress has limited the powers of bankruptcy courts, it has done so clearly.

According to the Second Circuit, if Congress had meant to limit the courts' powers to release nondebtors, then Section 524(e) would have used a mandatory term such as "shall" or "will," rather than "does."

Section 524(g)'s Influence on Nonconsensual Releases

The Second Circuit cast aside the argument that if Congress desired to approve nonconsensual third-party releases, then it would have expressly done so, as it did when it enacted Section 524(g).

Section 524(g) allows for the injunction of certain claims against nondebtors in actions seeking recovery

of damages caused by an asbestos-containing product.

Congress adopted Section 524(g) to help companies resolve asbestos-related claims on a national basis. In addition to releasing certain nondebtor third parties, the section authorizes the establishment of a trust to pay present and future asbestos-related claims.

The U.S. trustee and other appellees noted that since Purdue was not seeking to resolve claims caused by asbestos-containing products, Section 524(g) was not applicable.

As such, the US Trustee and the other appellees argued that the Bankruptcy Code's inclusion of Section 524(g) to resolve related asbestos claims implies that Congress would have expressly amended the Bankruptcy Code had it desired to permit nonconsensual third-party releases outside the asbestos context.

Dismissing this argument, the Second Circuit first referenced the text of the Bankruptcy Reform Act of 1994, which states that nothing in Section 524(g) "shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization."

The Second Circuit also noted that past precedent did not restrict nonconsensual releases only to asbestos cases.[3] Rather, the releases must be considered using the facts and circumstances of each case.

The Second Circuit did, however, use Section 524(g) as a guide in analyzing the factors used to consider approving nonconsensual releases.

For example, Section 524(g) requires at least 75% of creditors to support the plan and the Second Circuit used this threshold as a bare minimum in determining whether the creditors overwhelmingly voted to accept the plan.

Factors Relevant to Nonconsensual Releases

The Second Circuit outlined seven factors for lower courts to consider before allowing a nonconsensual third-party release:

- Whether there is an identity of interests between the debtors and released third parties, including indemnification relationships;
- Whether the claims against the debtor and nondebtor are factually and legally intertwined, including whether the debtors and the released parties share common defenses, insurance coverage or levels of culpability;
- Whether the scope of the releases is appropriate;
- Whether the releases are essential to the success of the reorganization in that the debtor needs the claims to be settled for its property to be allocated;

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- Whether the nondebtor receiving the release contributed substantial assets to the debtor's reorganization;

- Whether the affected class of creditors overwhelmingly supports the plan with the releases, with a benchmark of 75% acceptance; and

- Whether the contributed sum permits the fair resolution of the enjoined claims, not necessarily full payment of the claims.

Consideration of each factor is required, and bankruptcy courts are required to make specific findings of fact to support each factor. The inquiry is very fact intensive, and this decision should not be viewed as a road map for debtors to follow who desire to include a third-party release in a Chapter 11 plan.

However, the Second Circuit's analysis does offer insight into what facts are important for courts to consider.

The court gave great weight to a few facts in particular, including the factual and legal overlap between the claims against Purdue and the claims against the Sacklers; the fact that Purdue would likely have had to litigate indemnity claims brought by the Sacklers if the releases had not been approved; the Sacklers' $5.5 billion to $6 billion contribution to the plan; and that over 95% of creditors voted to accept the plan.

The Second Circuit also stressed that a financial contribution by the released parties could not be the only reason for the inclusion of a nonconsensual release in a Chapter 11 plan.

Circuit Split Across the Country

With the Purdue decision, the Second Circuit now joins the U.S. Courts of Appeals for the Third, Fourth, Sixth, Seventh and Eleventh Circuits as jurisdictions that allow bankruptcy courts to approve nonconsensual third-party releases under certain circumstances.[4]

Each of these circuits use a similar set of factors in evaluating nonconsensual releases. All of the courts caution bankruptcy courts to approve releases in limited circumstances.

The U.S. Courts of Appeals for the First and Eighth Circuits are silent on this issue, but lower courts have suggested that nonconsensual releases are permissible, using a similar set of factors as the other circuits to analyze whether to approve the releases.[5]

In contrast to the above circuits, the U.S. Courts of Appeals for the Fifth, Ninth and Tenth Circuits do not allow courts to impose nonconsensual third-party releases under any circumstances.[6] This does not mean that all third-party releases are impermissible, only those that are nonconsensual.

Notably, bankruptcy courts in the Fifth Circuit may approve third-party releases as consensual if the plan's ballot provides an option to opt out of the release.[7] Affirmative consent is not necessary and the burden is on the claimants to affirmatively opt out of the release.

Not all circuits view consent this way — some circuits suggest that failing to opt-out and abstaining from voting does not imply consent.[8]

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Given the circuit split regarding the treatment of nonconsensual releases, this issue is far from resolved. U.S. Circuit Judge Richard Wesley's concurrence in the Second Circuit's Purdue decision highlights this point.

Judge Wesley agreed with the Second Circuit's decision because prior precedent in the Second Circuit had approved of third-party releases. He authored his concurrence primarily to address his concerns in giving bankruptcy courts extraordinary authority to impose nonconsensual releases when the Bankruptcy Code is silent on the matter.

He even identified specific aspects of the releases in Purdue's plan that go beyond what is available to an individual debtor who has actually filed for bankruptcy.[9]

The concurrence at times reads more like a dissent and Judge Wesley urged the U.S. Supreme Court to resolve the circuit split in order to create a uniform approach to the treatment of nonconsensual releases in bankruptcy.

Conclusion

The Second Circuit decision is a win for debtors who desire to include third-party releases in their Chapter 11 plans in order to provide mechanisms for debtors to globally resolve mass tort claims asserted against them, along with claims against insiders, affiliates and indemnified parties.

Going forward, nonconsensual third party releases can be approved in the Second Circuit in certain limited circumstances.

Since the inquiry is so fact-intensive, this decision cannot be viewed as a blueprint for debtors seeking to take advantage of nonconsensual third-party releases in bankruptcy, but the Second Circuit does offer insight into facts lower courts will likely deem important in considering whether to approve a nonconsensual third-party release.

Prospective debtors should continue to monitor this issue closely, as the controversial nature of this issue may lead the Supreme Court to heed the advice of Judge Wesley and resolve the circuit split regarding nonconsensual releases once and for all if the case is appealed.

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Notes

1. No. 22-110-BK, 2023 WL 3700458 (2d Cir. May 30, 2023).

2. See Bank of N.Y. Tr. Co. v. 9 Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.), 584 F.3d 229 (5th Cir. 2009); Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss), 67 F.3d 1394 (9th Cir. 1995); Landsing Diversified Props.-II v. First Nat'l Bank and Tr. Co. of Tulsa 12 (In re W. Real Estate Fund, Inc.), 922 F.2d 592 (10th Cir. 1990).

3. See In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005).

4. See Gillman v. Cont'l Airlines (In re Cont'l Airlines), 203 F.3d 203 (3d Cir. 2000); See Nat'l Heritage Foundation v. Highbourne Foundation, 760 F.3d 344 (4th Cir. 2014); See In re Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002); See In re Airadigm Communications, Inc., 519 F.3d 640 (7th Cir. 2008); See SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070 (11th Cir. 2015).

5. See In re Mahoney Hawkes, LLP, 289 B.R. 285 (Bankr. D. Mass. 2002); See In re Armstrong Energy Inc., 613 B.R. 529 (8th Cir. B.A.P. 2020).

6. See Footnote 2.

7. See In re Matter of Highland Cap. Mgmt., L.P., Case No. 19-34054 (N.D. Tex. Feb. 22, 2021).

8. See Patterson v. Mahwah Bergen Retail Grp., Inc., 636 B.R. 641 (E.D. Va. 2022); In re SunEdison, Inc., 576 B.R. 453 (Bankr. S.D.N.Y. 2017).

9. One issue Judge Wesley identified was that no carveout existed in the releases for direct claims based on fraud. Individual debtors cannot seek a discharge for debts arising out of fraud pursuant to section 523(a)(2)(A) of the Bankruptcy Code.

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