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The *Purdue* Decision on Third Party Releases and Its Practical Implications

The Supreme Court issued a landmark and potentially far-reaching decision in *Harrington v. Purdue Pharma L.P.*, No. 23-124 ("*Purdue*"), on June 27, 2024. We set forth the facts and our initial observations below, with a more complete description of the decision at the end of this bulletin.

What Did the Court Decide?

The Facts	Purdue Pharma L.P., under the direction and control of the Sackler family, is alleged to have materially contributed to the U.S. opioid epidemic, and filed for bankruptcy after being besieged with claims by victims and other parties. The bankruptcy court confirmed Purdue's Chapter 11 plan and released *all* present and future claims, including those for fraud and willful misconduct, against the Sackler family and all of their affiliated entities that could be pursued by *any party*. To obtain the release, the Sacklers agreed to pay as much as $6 billion to Purdue for victim compensation, a fraction of the $11 billion that the Sacklers removed through dividends. The plan was never implemented pending an appeal of the central issue (see below) to the U.S. Supreme Court.
The Issue	Whether a bankruptcy court has the power under the Bankruptcy Code to release claims by nonconsenting nondebtors (victims) against other nondebtors (the Sacklers) in an underlying bankruptcy case (Purdue).
The Ruling	In a 5-4 decision written by Justice Gorsuch, the Supreme Court held that the Bankruptcy Code does *not* authorize nonconsensual third party releases, overturning a long-standing practice in some courts of approving such releases where certain equitable and practical factors were present.
What Was Not Decided?	Among the major issues that the Court did not address were (i) whether a plan ballot soliciting a release that requires a party to affirmatively opt-out of the release is considered "consensual" (ii) whether the non-codified doctrine of equitable mootness may be used to eliminate the appeal of a plan of reorganization that contains a nonconsensual third party release if the plan was already substantially consummated.

What Does the Ruling Mean Beyond *Purdue*?

Increased Solicitation and Impact on Pre-Arranged and Pre-Packaged Bankruptcies	Without the ability to impose nonconsensual third party releases, *all* potential plaintiffs must be *directly* solicited for the purposes of obtaining consent, regardless of whether their vote on a plan otherwise would have been solicited. Broad and direct solicitation is time consuming, expensive and impossible to keep confidential. Pre-arranged or pre-packaged cases rely on speed and privacy and often do not affect the liabilities of trade and other "non-financial" creditors to avoid business disruption. Public companies can have hundreds of thousands (if not millions) of shareholders who typically receive no recovery in a bankruptcy filing and whose plan vote is generally not solicited. Broad solicitation of third party releases to vendors, public company shareholders and others prior to filing for bankruptcy will publicize impending bankruptcies and will cause business disruption that could jeopardize the ability to complete a pre-packaged or pre-arranged bankruptcy and could precipitate a free-fall filing. Solicitation of all of these parties inside of bankruptcy will lengthen the duration of bankruptcy cases and could result in more litigation outside of bankruptcy, including class actions being filed against directors and officers.
Impact on Plan Contributions	Obtaining a consensual release from *all* parties in and outside of a bankruptcy case is rare. Without the ability to enforce a nonconsensual release, sponsors and other third parties seeking a release may reduce their contribution to a bankruptcy plan (including exit financing) in order to reserve capital to deal with litigation or may condition levels of contribution based on the level of releases agreed to under a plan, both of which reduce assets available for estate recoveries. Debtors may also incorporate third party releases into an increased use of "death trap" plan provisions where reduced or no recoveries are provided to classes of claims or interests that either reject a plan or do not provide a threshold level of releases for third parties. As a workaround, nondebtor parties seeking a release may condition their plan contributions on simultaneous approval of a class settlement, for which the class would consist of all potential third party claimants. Doing so would require both the plan confirmation in bankruptcy and the class action fairness hearing to be held simultaneously and could fill the gap left open by the lack of nonconsensual third party releases. Class certification, however, is time consuming, may not be capable of pursuit in bankruptcy courts and could require coordination among state or district courts and bankruptcy courts, and may not bind all parties due to class action opt-out dynamics.
Increased Litigation	Because the ruling does not grandfather in plans where nonconsensual third party releases were previously approved, parties who challenged a third party release in a bankruptcy case and lost may attempt to file direct claims against third parties covered by the release where the confirmation order is still subject to appeal on the theory that the bankruptcy court lacked the authority to grant such a release.

Venue	Among others, courts in Texas did not allow nonconsensual third party releases, but courts in New York and Delaware did. Forum shopping based on where a release could be implemented is now over.
Congressional Action	There is a potential for Congress to amend the Bankruptcy Code to add a construct to enable third party releases, but, given the competing lobbies on either side of the issue, it is unlikely that Congress will act to explicitly extend a release to a nondebtor.

What Survived?

Direct and Derivative Claims	The ability of a bankruptcy estate to settle direct or derivative actions against third parties – such as claims for breach of fiduciary duty or fraudulent transfer – that are otherwise property of a debtor's estate can still be settled and released by a debtor as part of the bankruptcy process.
Scope of Equitable Power	Given the Court's narrow focus on the lack of express authority for a nondebtor release, the scope of a bankruptcy court's ability to use its equitable powers may not be affected. For example, actions such as extending the automatic stay to cover claims against third parties or authorizing the "rollup" of prepetition debt into a postpetition claim should still be permissible, but parts of the *Purdue* decision could be used to argue otherwise, including the footnote on the limitation of section 105(a) of the Bankruptcy Code and the statement that a bankruptcy court should not have a "roving commission to resolve all such problems that happen its way." Slip Op. at 13.
Exculpation Clauses	The Court did not address the legality of exculpation clauses that shield estate fiduciaries from liability for work performed in connection with the bankruptcy, which otherwise have found support in sections 1125(e) (protecting parties involved in the plan confirmation process) and 1103(c) (applying to official committees) of the Bankruptcy Code.

How Did the Court Reach this Decision?

On September 15 and 16, 2019, Purdue and 22 of its subsidiaries (collectively, the "Debtors") filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the Southern District of New York. At the time, the company was facing widespread mass tort litigation over its marketing and sale of prescription opioid medications. Many of the lawsuits also named as defendants members of the Sackler family (the "Sacklers"), who had previously served as directors, officers, and shareholders of the company. None of the Sacklers personally filed for bankruptcy protection, and no Sackler family members are currently on the board of any of the Debtor entities.

The proposed plan of reorganization sought to resolve the pending litigation through a plan settlement that secured $4.325 billion in settlement funds (and the ownership of Stamford, Connecticut-based Purdue) from the Sacklers and contained a provision granting the Sacklers broad immunity from opioid-related claims that could otherwise have been filed against them, including with respect to claims for fraud and willful misconduct. On September 17, 2021, the bankruptcy court approved the plan and entered a confirmation order, which was subsequently appealed by the attorneys general of Maryland, Washington, Rhode Island, Connecticut, Vermont, Delaware, the District of Columbia, and the United States Trustee for Region 2 (the "UST").

Despite over 97% of voting stakeholders voting in favor of the plan, several creditors and the UST objected to the releases and appealed the plan's confirmation order. On appeal, the U.S. District Court for the Southern District of New York vacated the confirmation order, and proponents of the plan appealed to the U.S. Court of Appeals for the Second Circuit. While the appeal was pending, the Sacklers agreed to increase their contribution to $6 billion, after which several objecting parties withdrew their opposition. The Second Circuit reversed the district court's decision, affirmed the bankruptcy court's confirmation of the plan, and concluded that nonconsensual nondebtor releases may be appropriate in certain specified circumstances. The UST filed an application with the Supreme Court to stay the Second Circuit's decision, and the Supreme Court granted the application as a petition for writ of *certiorari*.

Drawing on the text of and context surrounding section 1123(b)(6) of the Bankruptcy Code, as well as the history of pre-code bankruptcy practice, the Supreme Court reversed the Second Circuit, struck down the Sacklers' releases, and held in a 5-4 decision authored by Justice Gorsuch 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." Slip Op. at 19.

In reaching this conclusion, "[t]he question" for the Court "boil[ed] down to whether" bankruptcy judges "may effectively extend to *nondebtors* the benefits of a Chapter 11 discharge usually reserved for *debtors*." Slip Op. at 8. The "answer," according to the majority, was found to derive primarily from the text of section 1123(b) of the Bankruptcy Code itself. That section "addresses the '[c]ontents'—or terms—of the bankruptcy reorganization plan a debtor presents and a court approves in Chapter 11 proceedings[,]" and specifically provides in subsection (b)(6) that a plan may "include any other appropriate provision not inconsistent with applicable provisions" of the Bankruptcy Code. Slip Op. at 8-9. That subsection, plan proponents (and the Justices in dissent) argued, permits a court to order "*any* term not 'expressly forbid[den]' by the bankruptcy code as long as a bankruptcy judge deems it 'appropriate' and consistent with the broad 'purpose[s]' of bankruptcy[,]" and by extension authorizes "appropriate" nonconsensual nondebtor discharge because "the code does not expressly forbid" such relief. Slip Op. at 10.

The Court disagreed. As a matter of statutory interpretation, the Court held that "catchall" provisions like those contained in section 1123(b)(6) of the Bankruptcy Code must "be interpreted in light of its surrounding context and read to 'embrace only objects similar in nature' to the specific examples preceding it." Slip Op. at 10. That "context" derives from the plan provisions contemplated in sections 1123(b)(1)-(5) of the Bankruptcy Code, which, the Court concluded, all concern the debtor's "rights and responsibilities, and its relationship with its creditors." Slip Op. at 11. And, because these subsections authorize "a bankruptcy court to adjust claims without consent only to the extent such claims concern the debtor[,]" the majority held that the "catchall" authorization of section 1123(b)(6) of the Bankruptcy Code must be similarly constrained. Slip Op. at 11.

The Court found this conclusion to be equally supported by the context of the Bankruptcy Code more broadly, which "generally requires the debtor to come forward with virtually all its assets" in exchange for the benefits of a discharge, which the Sacklers unquestionably did not do. Slip Op. at 14. To that end, the Court concluded that pre-Bankruptcy Code practice did not support the relief plan proponents sought, providing a further basis for reversal.

The dissent, for its part, focused on the impact of the ruling on opioid victims and their families, who are deprived of the monetary recoveries they had negotiated and fought for. The dissent argued that the ruling will "harm victims in pending and future mass-tort bankruptcies," Slip Op. at 31, by removing a tool that has been used to ensure fair and equitable recoveries to creditors by increasing the debtor's estate. The dissent also stressed that the Court's ruling cuts against longstanding precedents allowing nondebtor releases pursuant to the broad scope of the statutory language of section 1123(b)(6) of the Bankruptcy Code. Nevertheless, finding that "nothing in present law authorizes the Sackler discharge," the Court reversed the Second Circuit's decision and remanded the case for further proceedings consistent with its opinion. Slip Op. at 19.

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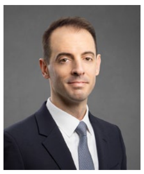

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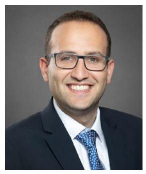

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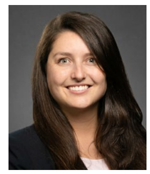

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