Parsing Justices' Toss Of Purdue's Controversial Ch. 11 Plan

By **Justin Ellis, Mark Kelley and Lois Ahn** (July 1, 2024)

Last week, the U.S. Supreme Court issued a landmark decision for the restructuring world in Harrington v. Purdue Pharma LP, one of the highest profile bankruptcy decisions in the history of the court.[1]

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Holding that the U.S. Bankruptcy Code does not allow for nonconsensual releases of claims against nondebtors, the court prevented the Sackler family from using the Purdue bankruptcy to settle thousands of civil opioid lawsuits without the consent of all of the plaintiffs.

The decision has profound implications for bankruptcy cases, especially in the mass tort arena. Although bankruptcy may well remain an important tool for managing mass tort liabilities, Purdue shifts the playing field by providing significant leverage to claimants.

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The decision also has potentially major implications in many other areas of bankruptcy practice outside of mass torts.

The Decision

The case arose out of the bankruptcy of Purdue, the manufacturer of the highly addictive opioid OxyContin. After entering the market in the mid-1990s, OxyContin rapidly saturated the market and Purdue made billions.[2] The Sackler family, which owned and controlled Purdue, became one of the wealthiest families in America.[3]

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As OxyContin's addictive qualities came to light, victims filed thousands of lawsuits alleging more than $40 trillion in damages.[4] To protect themselves personally, the Sacklers withdrew approximately $11 billion from Purdue — approximately 75% of the company's assets.[5] Purdue then sought Chapter 11 protection in 2019.[6]

As part of the proposed bankruptcy plan, the Sacklers offered to contribute $4.325 billion to the bankruptcy estate in exchange for a release from all current and future opioid-related claims against them, including claims for fraud, willful misconduct and fraudulent transfer.[7] The vast majority of claimants consented to the plan, but some did not.[8]

The U.S. Bankruptcy Court for the Southern District of New York confirmed Purdue's Chapter 11 plan that included the release and an injunction to enforce it.[9]

The district court vacated the decision, holding that the bankruptcy court lacked authority to release claims against nondebtor third parties without the claimants' consent.[10] A divided panel of the U.S. Court of Appeals for the Second Circuit then reversed the district court and affirmed the reorganization plan.[11]

The Supreme Court reversed in an opinion by Justice Neil Gorsuch, joined by Justices Clarence Thomas, Samuel Alito, Amy Coney Barrett and Ketanji Brown Jackson. The

majority's largely textualist decision held that nonconsensual releases are not authorized by Section 1123(b)(6) of the Bankruptcy Code,[12] a catchall provision following a list of terms that may be included in a Chapter 11 plan.[13]

Because subsection (b)(6) can only authorize terms that are similar to the enumerated terms, the court held, and because the enumerated terms of Section 1123(b) all concern the debtor's relations with its creditors, Section 1123(b)(6) does not grant the power to impose nonconsensual releases of claims against nondebtors.[14]

The majority also reasoned that the relief the Sacklers sought was inconsistent with the "simple bargain" underlying the Bankruptcy Code.[15] That bargain allows a debtor to discharge its debts if it acts honestly and places "virtually" all its assets on the table for creditors.[16]

At the same time, the code prevents the discharge of claims for fraud, willful and malicious injury, and wrongful death.[17] In the court's view, the Sacklers had flouted both parts of that bargain.

First, they neither filed for bankruptcy nor made all their assets available for creditors, and second, they sought a release they could not have obtained even if they had done so. In other words, the court said, they sought "to pay less than the code ordinarily requires and receive more than it normally permits."[18]

Finally, the court rejected arguments based on the policy consequences of its decision. The court acknowledged a debate about whether nonconsensual third-party releases were necessary to deal with holdouts in bankruptcy and that such releases had been in use for some time.[19]

But the court stated that the decision of what releases to authorize must be left to Congress, not the judiciary.[20] The court thus held that bankruptcy courts may not authorize releases and injunctions under a plan that "effectively discharge" a nondebtor without the consent of affected claimants.[21]

The Dissent

Justice Brett Kavanaugh penned an emphatic dissent, joined by Chief Justice John Roberts and Justices Sonia Sotomayor and Elena Kagan.

In that opinion, the dissenters criticized the majority decision as a ruinous result that is sure to create chaos and cause opioid victims to suffer greatly.[22]

The dissent explained that bankruptcy was a solution to the collective action problem that arises when a debtor's assets cannot satisfy all of its obligations.[23] To avoid a race to the courthouse, bankruptcy pauses claims and encourages a fair distribution of the debtor's property.[24]

The dissent asserted that nondebtor releases had become a well-established tool to resolve these problems, particularly in mass tort bankruptcies.[25]

Those releases are also a key feature of bankruptcy plans when officers and directors are indemnified by the debtor.[26] Since claims against indemnified parties are "essentially the same as creditor claims against the debtor," according to the dissent, nondebtor releases also avoid drain on the estate through a creditors' race to enforce those claims.[27]

The dissent also disagreed with the majority's textualist reasoning. It argued that the use of the term "appropriate" in Section 1123(b)(6) gives bankruptcy courts discretion to deal with complex scenarios like those that plague mass tort bankruptcies.[28]

And because the Sacklers' releases concerned claims arising from the debtor's acts, it followed the "common thread" of the enumerated terms in Section 1123(b).[29] In any event, the dissent argued, other subsections of Section 1123(b) concern nondebtors, too, so nondebtor releases are not a radical departure.[30]

For the Purdue bankruptcy, the dissent called the decision "devastating" and warned of the loss of the claimants' best chance for meaningful recovery.[31]

Without the releases, the dissent reasoned, the Sackler family is unlikely to contribute a significant settlement payment to the bankruptcy estate.[32]

And because claims against the Sacklers face liability and collectability issues — in addition to indemnification issues — the dissent was not optimistic that claimants would recover without such settlement.[33]

The Decision's Implications

Although the decision is guaranteed to make waves, the full extent of its impact remains to be seen. One thing is certain: Claimants in mass tort bankruptcies now have far more leverage in the plan formation process.

Although the majority acknowledged the problem of holdouts, it did not directly address the collective-action issues emphasized in the dissent.

Courts and practitioners will be looking for creative new ways to deal with that problem. One possible tool is to channel estate claims toward post-confirmation litigation trusts. Another tool may be aggressive interpretations of what claims belong to the estate and thus, under Purdue, may be released.

The decision will also pose challenges to a specific form of mass tort bankruptcy that has gained prominence: the so-called Texas two-step. In these bankruptcies, a solvent parent spins off tort liability into a new company through a Texas divisive merger, and the new company declares bankruptcy.

The parent company then often receives a third-party release from liabilities assigned to the spinoff, preventing claimants from suing the parent.

The U.S. Court of Appeals for the Third Circuit rejected a Texas two-step reorganization even before Purdue on different grounds,[34] but Purdue is likely to pose additional obstacles.

Another emerging trend in bankruptcy — gatekeeper provisions — could be affected as well. These are provisions in bankruptcy plans that require a bankruptcy court to ensure that lawsuits are colorable before they are filed against participants in the bankruptcy.

This allows the court to prescreen bad faith litigation aimed at disrupting the bankruptcy plan's effectiveness.[35] Given that Purdue casts doubt on injunctions preventing litigation against nondebtors, such gatekeeper injunctions could be subject to challenge as well.

Other forms of releases in bankruptcy, such as exculpation provisions for fiduciaries and professionals, or releases against post-petition lenders, may also face challenges.

Parties to restructuring and funding assert that those protections are necessary to encourage their participation in the bankruptcy process. If those releases are no longer available, estates may need to fashion new incentives to bring parties — and the capital they contribute — to the negotiating table.

Temporary restraints on litigation against nondebtors may also be vulnerable following Purdue. While Section 362 of the code provides for an automatic stay of litigation against the debtors, no clear statutory authority allows extending that stay to nondebtors.

But many courts have allowed extending the stay where litigation against nondebtors would adversely affect the estate.[36] Some courts have allowed stays as to nondebtors simply to avoid distracting the debtor from its reorganization.[37]

Staying claimants' litigation against nondebtors can be an important tool to bring those claimants to the negotiating table. But if courts apply Purdue's restriction on anti-suit injunctions to extensions of the automatic stay, that tool may be in jeopardy.

More broadly, the decision's plain-text approach to the code could be interpreted as a check on more expansive approaches to bankruptcy court practice. Citing the need for flexibility and business judgment, bankruptcy courts often read their statutory powers broadly. Lower Article III courts may see Purdue as a signal that this flexibility needs to be reined in.

Moreover, even if appellate courts move toward stricter readings of the code, legal and practical limits on appellate review of bankruptcy court decisions, such as equitable mootness, may slow or restrain change. Practitioners will watch, and look for ways to take advantage of, this potential tension between bankruptcy and appellate courts.

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[1] No. 23-124, 2024 WL 3187799 (U.S. June 24, 2024).

[2] Id. at *3.

[3] Id.

[4] Id. at *3-4; id. *20 (Kavanaugh, J., dissenting).

[5] Id. at *3.

[6] Id. at *3-4.

[7] Id. at *4.

[8] Id.

[9] In re Purdue Pharma L.P., 633 B.R. 53 (Bankr. S.D.N.Y.).

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

[11] In Re Purdue Pharma L.P., 69 F.4th 45 (2d Cir. 2023).

[12] 11 U.S.C. §1123(b)(6).

[13] 2024 WL 3187799, at *7.

[14] Id.

[15] Id. at *3.

[16] Id.

[17] Id.

[18] Id.

[19] Id. at *11.

[20] Id.; id. at *10 n.6.

[21] Id.

[22] Harrington v. Purdue Pharma L. P., No. 23-124, 2024 WL 3187799, at *37 (U.S. June 27, 2024) (Kavanaugh, J., dissenting).

[23] Id. at *15.

[24] Id.

[25] Id. at *16.

[26] Id. at *13, *16.

[27] Id. at *18.

[28] Id. at *14-15.

[29] Id. at *34-35.

[30] Id. at *28.

[31] Id. at *12-13.

[32] Id. at *25.

[33] Id. at *23-24.

[34] In re LTL Mgmt., LLC, 64 F.4th 84 (3d Cir. 2023). MoloLamken represented the Official Committee of Talc Claimants before the Third Circuit.

[35] See, e.g., NexPoint v. Highland Cap. Mgmt., No. 21-10449 (5th Cir. 2022). MoloLamken represents the NexPoint parties in this case before the Supreme Court.

[36] See, e.g., Queenie, Ltd. v. Nygard Int'l, 321 F.3d 282, 287 (2d Cir. 2003).

[37] See, e.g., In re SVB Fin. Grp., No. 23-10367 (MG), 2023 WL 2962212, at *6 (Bankr. S.D.N.Y. Apr. 14, 2023); In re W.R. Grace & Co., 386 B.R. 17, 35 (Bankr. D. Del. 2008); In re Calpine Corp., 365 B.R. 401, 410 (S.D.N.Y. 2007); In re Zenith Lab'ys, Inc., 104 B.R. 659, 665 (D.N.J. 1989).