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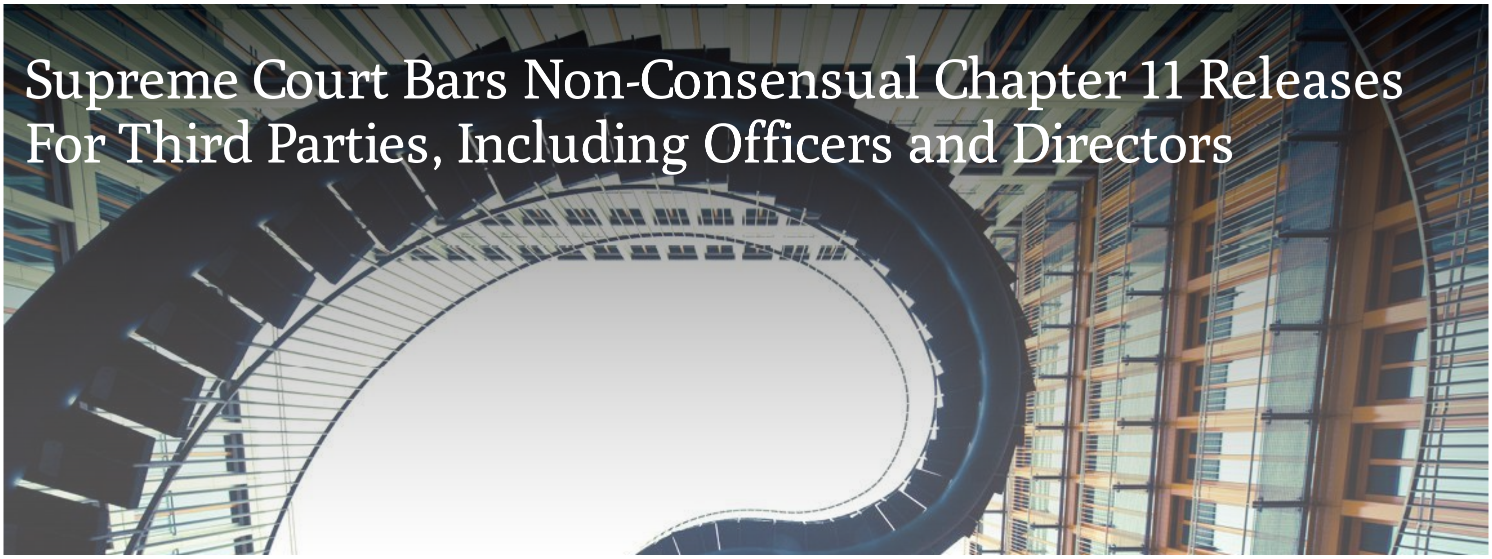
CLIENT ALERT

Supreme Court Bars Non-Consensual Chapter 11 Releases For Third Parties, Including Officers and Directors



JULY 1, 2024

Harrington v. Purdue Pharma L.P. (No. 23-124)

KEY TAKEAWAYS

- The Supreme Court held that the Bankruptcy Code does not authorize a release and injunction concerning claims against non-debtors as part of a Chapter 11 reorganization, overturning a plan that would have released the Sackler family from liability for opioid-related claims.
- The Court's ruling upends what had been a common means of coordinating mass-tort settlements (other than asbestos-related bankruptcies which are governed by a different provision of the Bankruptcy Code)—and, indeed, almost every chapter 11 reorganization—where debtor's affiliates, officers and directors, and controlling shareholders are exposed to large potential liabilities based on a debtor's conduct.
- It remains unclear what impact the ruling will have on reorganization plans involving consensual releases of claims, full-satisfaction releases, or exculpatory clauses, as well as for plans that have been substantially consummated.
- In anticipation of this ruling, many plans have been confirmed using "opt-out" release provisions. That will likely become the new norm.

The Supreme Court announced a major restriction on a common practice for Chapter 11 bankruptcy reorganization plans, sending a multi-billion-dollar settlement involving the Purdue Pharma opioid litigation back to the drawing board. In *Harrington v. Purdue Pharma L.P.*, the high court held that the bankruptcy court could not enter a release benefitting the Sackler family, who were accused of funneling $11 billion from the now-bankrupt Purdue Pharma but had not themselves filed bankruptcy petitions. The plan would have released the Sacklers in exchange for contributing up to $6 billion to pay opioid-related claims against them and Purdue Pharma in connection with OxyContin addiction.

More broadly, the Court's reasoning imposed a categorical bar on releases that would extinguish the claims of non-consenting plaintiffs against non-debtors, even if the non-debtors were officers and directors entitled to indemnification from the debtor's estate. The Court's ruling thus upends a major tool for eliminating derivative claims, meaning those claims that are related to the debtor's conduct but are commenced against affiliates, officers and directors, and controlling shareholders. It also leaves an uncertain legal landscape for other Chapter 11 plan provisions affecting claims against third parties (including insurers and professionals who work on the plan). The Court declined to address whether its ruling would require unwinding Chapter 11 plans with similar non-consensual third-party releases that have already been substantially consummated.

OPIOID LITIGATION AND THE PURDUE BANKRUPTCY

Purdue Pharma launched OxyContin, an opioid prescription pain reliever, in the mid-1990s. Purdue claimed that OxyContin did not present as great a threat of addiction as other opioid pain relievers, which tended to be restricted to cancer patients and those with chronic diseases. Thus, OxyContin was marketed for use in treating a broader range of ailments, such as arthritis. That "less addictive" claim led to an affiliate's pleading guilty to a federal felony for misbranding in 2007, followed by thousands of civil suits against both Purdue and the Sacklers for related injuries. Following the 2007 plea agreement, the Sackler family received about $11 billion in distributions from Purdue, much of which went to overseas trusts and other family-owned companies. Those distributions were criticized as draining 75% of Purdue's total assets and leaving it significantly weakened financially.

Purdue filed for Chapter 11 bankruptcy in 2019. Chapter 11 permits a company (the "debtor") to restructure its debts. A bankruptcy court can confirm the debtor's plan of reorganization only if it satisfies the requirements of 11 U.S.C. § 1123 (outlining what the plan can contain) and at least one class of claims or interests (though not every creditor within each class) either accepts the plan or is not impaired under it.

To resolve the litigation against them, the Sackler family initially offered to contribute $4.325 billion to the Purdue bankruptcy estate over the course of 10 years if (1) the estate extinguished all claims against the Sackler family, including fraudulent transfer claims related to the $11 billion in distributions, and (2) the Chapter 11 plan included a release and injunction concerning all present and future opioid-related litigation against them. Most but not all of the individual plaintiffs voted to accept the settlement, and the bankruptcy court confirmed the plan. As appeals from that confirmation worked their way up, the Sackler family agreed to contribute additional amounts, in an effort to persuade eight states and the District of Columbia to drop their objections to the plan. By the time the case reached the Supreme Court, the plan was opposed by a small number of individual plaintiffs, by some Canadian municipalities and tribes, and by William Harrington, the U.S. Trustee charged with promoting the integrity of the bankruptcy system.

HARRINGTON V. PURDUE PHARMA

The objections to the reorganization plan focused on whether 11 U.S.C. § 1123(b) authorized the bankruptcy court to release the objectors' claims against third parties, rather than just claims against the bankrupt company. At issue was the scope of section 1123(b)(6), a "catch-all" provision that says that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title."

In a 5-4 opinion authored by Justice Gorsuch, the Supreme Court sided with the objectors and held that this provision could not be read as anything not expressly forbidden by the Bankruptcy Code, so long as a bankruptcy judge deems it "appropriate." Instead, the doctrine of *ejusdem generis* required reading the catch-all provision in light of the other five specific types of provisions that could be included in a plan, all of which involved either claims by the debtor or claims against the debtor. While a bankruptcy estate may settle derivative claims between creditors and third parties, that is because such claims are in reality property of the debtor's estate and brought on behalf of the debtor, so they are another example of claims concerning the debtor, the Court held.

A contrary reading of the catch-all provision conflicts with the structure of Chapter 11, the Court continued. Discharge of debts is reserved for debtors in bankruptcy proceedings, and styling the bankruptcy court's order as a "release" rather than a "discharge" does not authorize the erasure of a non-bankrupt debtor's debts. Moreover, the debtor must make substantially all of its assets available to the estate, and any discharge of claims cannot include claims based in fraud or willful and malicious injury. The Sackler family had ***not*** placed all their assets at the disposal of the bankruptcy court (as they would had they themselves declared bankruptcy), and the release was not written to exclude claims for fraud and for willful and malicious injury. Moreover, while the Bankruptcy Code does authorize a court to enjoin claims against third parties without the plaintiffs' consent in asbestos-related bankruptcies, the Court said that authorization is restricted to asbestos cases.

The Court rejected what it characterized as arguments grounded in policy. Justice Kavanaugh's dissent focused on the reasonableness of the Sackler settlement for the plaintiffs (who overwhelmingly approved it despite despising the Sacklers), as well as the importance of bankruptcy in preventing collective action problems among creditors, and the necessity of non-debtor releases in providing relief to injured parties in mass-tort cases ranging from asbestos, Dalkon Shield, and silicone breast implants to abuse cases against the Catholic Church and the Boy Scouts. Courts have been granting non-debtor releases for almost as long as the Bankruptcy Code has existed, he said, and the Second Circuit (which had approved the release in this case) had a robust test for whether a non-debtor release was "appropriate." But the majority said it was not certain that the Sackler settlement was the best that could be obtained, noting that the potential for individual litigation and fraudulent transfer claims may persuade the family to increase its contribution even if it does not secure a global settlement. Moreover, statutes rarely have a single purpose, the majority said, and what mattered was the balance among competing interests that Congress struck. (The release provision in the Boy Scouts case is currently on appeal in the Third Circuit, which was waiting for the Supreme Court's decision in *Purdue* before ruling.)

The dissent also echoed the Second Circuit in emphasizing that the suits against the Sackler family primarily concerned their role as officers and directors of Purdue, for which they would be entitled to indemnification from Purdue, and that such suits are "in essence a suit against the debtor that could deplete the assets of the estate for the benefit of only a few" (cleaned up). But the majority noted that the bankruptcy court's release extended beyond the Sackler family members who served as officers and directors, and the bankruptcy court could disallow or equitably subordinate any indemnification claims brought by the officers and directors to preserve the estate's assets for the benefit of the injured plaintiffs.

The Court concluded, "[A]s important as the question we decide today are ones we do not." It emphasized that nothing in the opinion should call into question "*consensual* third-party releases offered in connection with a bankruptcy reorganization plan," saying that they posed different questions and "may rest" on different legal grounds. The Court also said it was not deciding what qualifies as a consensual release or whether a plan may include a provision under which the debtor pays full satisfaction for claims against a third party in exchange for a release of those third-party claims or has provisions allowing individual creditors to opt out of any releases in the plan. Lastly, the Court said it would not address whether its "reading of the bankruptcy code would justify unwinding reorganization plans that have already become effective and been substantially consummated."

WHAT THIS MEANS

While the most immediate impact of the Court's ruling is to require the parties to the long-running opioid litigation against Purdue and the Sackler family to return to the settlement table, the case has far-reaching implications for bankruptcy practice, including for defendants faced with mass-tort liability (other than asbestos-related claims), and for the directors, officers, liability insurers, and professional service providers of companies seeking Chapter 11 reorganization.

Critically, the Court did not note any way for the officers and directors of a company in Chapter 11 to obtain a release of claims against them without each plaintiff's consent, short of seeking bankruptcy protection themselves. A reorganization plan accepted by each class of creditor cannot release claims against directors and officers over the objection of a hold-out creditor whose claim is impaired. This may significantly increase the potential for personal liability for directors and officers.

The Court's decision also forecloses one means of coordinated settlement of non-asbestos mass-tort claims that has been practiced in some circuits. Individual settlements remain an option, but such settlements are less attractive if plaintiffs cannot offer a global resolution, and they have higher transaction costs. Conversely, Congress could act to authorize nonconsensual third-party releases in Chapter 11 proceedings, as is already the law concerning asbestos-related claims.

The Court's concluding section on questions it was not addressing is also sure to generate further litigation. Litigants may now try to test whether the inclusion of third-party releases requires plans that have been substantially consummated to be unwound. Justice Kavanaugh also noted the similarity between nonconsensual third-party releases and releases of direct claims against a tortfeasor's liability insurer, as well as clauses exculpating the estate's fiduciaries and other professionals from liability for their work on the reorganization plan. The implications of the Court's ruling on these questions are unclear.

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