PUBLICATIONS | 07.02.2024

Supreme Court Weighs in on Non-Consensual Third-Party Releases in Chapter 11 Cases

The Supreme Court determined, by a 5-4 margin, to ban non-consensual third-party releases in Chapter 11 plans, rejecting the Second Circuit's seven-part multifactor analysis for considering such releases and sending the *Purdue* plan back to the lower courts. Writing for the Court, Justice Gorsuch ruled that nothing in the Bankruptcy Code authorized the nonconsensual release or discharge of claims against the Sacklers, who "have not filed for bankruptcy and have not placed virtually all their assets on the table for distribution to creditors, yet . . . seek what essentially amounts to a discharge."

This decision represents a pivotal change, resolving a circuit split which many argue was mandated by the U.S. Constitution's uniformity requirement under Art. I, Section 8, Clause 4, in which Congress shall have Power to enact "*uniform* Laws on the subject of Bankruptcies." Although the decision undoubtedly will impact bankruptcy cases going forward—especially those that address mass tort liabilities—one of the most notable aspects of the Court's decision is the litany of questions that the Court left unanswered.

History of Purdue Pharma

Purdue Pharma was a "family company," owned and controlled by the Sacklers. Not only did they occupy nearly all senior-level management positions as both directors and officers, but they likewise were intimately involved with the firm's marketing of pharmaceuticals, chiefly OxyContin, leading to it becoming the most prescribed brand name narcotic medication in the United States. Between 1996 and 2019, Purdue generated approximately $34 billion in revenue, elevating the personal net worth of the Sackler family to an estimated $14 billion. Following a 2007 felony plea by an affiliate of Purdue for deceptive marketing practices, thousands of civil lawsuits were filed by individuals and governments.

As litigation challenges mounted, the Sacklers siphoned approximately $11 billion from Purdue, draining its assets by 75% and leaving it significantly weakened financially to the point of insolvency. In 2019, Purdue filed for Chapter 11 protection, with the Sacklers promising to return initially $4.325 (and later $6) billion in withdrawals in return for both the extinguishment of any claims the estate may have against family members—including for negligence, fraudulent transfer, and willful misconduct—as well as the perpetual enjoinment against future claims. While the bankruptcy court approved the "Sackler discharge," the district court vacated. However, after a lengthy appeal in which the Sacklers proposed an additional $1.175 to $1.675 billion contribution, a split-Second Circuit approved the plan. The U.S. Trustee subsequently petitioned the Supreme Court to stay implementation pending review.

Ruling

The ruling hinges on the interpretation of Section 1123 of the Bankruptcy Code, which addresses the contents or terms of a plan of reorganization. Section 1123(a) lists requirements that a plan *shall* include, while Section 1123(b) delineates provisions that a plan *may* include. In particular, Section 1123(b)(6) acts as a "catch-all" provision, allowing for a debtor to include in its plan "any other appropriate provision not inconsistent with the applicable provisions of this title." In *Purdue*, the Debtors and Sacklers argued that because the Bankruptcy Code did not expressly forbid non-consensual third-party releases, the Bankruptcy Court had authority to approve such releases if deemed "appropriate." The Supreme Court disagreed. It concluded that Section 1123(b)(6)'s catch-all provision must be read within the context of the other powers enumerated in Section 1123(b)(1)-(5)—all of which concern the rights and responsibilities of the debtor. Applying the statutory canon ejusdem generis, the Court ruled that the permissive standard of Section 1123(b)(6) cannot be read so broadly as to authorize non-consensual third-party releases that bear no relation to the enumerated powers specifically set forth in Section 1123(b)(1)-(5).

The Court continued, finding three additional reasons why Section 1123(b)(6) does not authorize a bankruptcy court to approve non-consensual third-party releases. First, approval of the release would provide a non-debtor (the Sacklers) with an effective discharge without that party itself submitting to the rigors of bankruptcy protection. Second, a release would afford the Sacklers a discharge for traditionally non-dischargeable claims, such as fraud and willful misconduct, extinguishing non-consenting claimants' Constitutional due process rights. Put differently, the Sacklers not only were receiving the benefit of a *de facto* discharge without filing bankruptcy, but the scope of that effective discharge exceeded what any debtor would be entitled to under chapter 11. Third, the only example of non-consensual releases authorized under the Bankruptcy Code are those arising under Section 524(g) within the context of debtors facing asbestos liability. The Court found Congress' inclusion of non-consensual releases only in asbestos cases militates against expanding this grant of authority beyond statutory approval. Finally, every bankruptcy law referenced by the parties and their *amici*, from 1800 until 1978, generally reserved the benefits of discharge to the debtor who offered a fair and full surrender of its property. Other than the addition of Section 524(g) through an amendment to the Bankruptcy Code in 1994, Congress has never signaled an intent to so profoundly reshape the current Bankruptcy Code or jurisprudence to extend the extraordinary relief of non-consensual releases to non-debtor third parties beyond asbestos liabilities.

Impact

This ruling, while limiting the pervasive discharge power of the bankruptcy system, will not fully diminish Chapter 11's role in consolidating and decisively handling mass tort cases for a number of reasons. First, even though non-consensual third-party releases are now barred, *consensual* releases remain allowable. The Court left for another day what constitutes a consensual release, including whether parties being fully informed about the scope of a release and afforded the opportunity to "opt out" can be deemed to have consented. The need to obtain consent from all impacted parties may shift the balance of power in plan negotiations in favor of creditors that will be impacted by the proposed releases. Creditors may demand more favorable terms in exchange for their consent or threaten to withhold that consent entirely in favor of negotiating a better deal for themselves. The Court similarly did not decide whether a plan that actually pays creditors in full (and not just purports to do so) should be allowed to provide for non-consensual third-party releases on the theory that a creditor cannot recover more in bankruptcy than whatever it is owed by a debtor. Nor did the decision establish parameters for courts to reconsider whether and when third-party releases contained in plans that have been confirmed and consummated should be reconsidered in light of the Court's ruling in *Purdue*.

Second, it is unlikely that the decision will dissuade corporate debtors from utilizing chapter 11 to centralize and channel mass tort liabilities. Those debtors, however, may be joined in bankruptcy by third parties that share joint and several liability with the debtor. Alternatively, parties-in-interest may utilize Section 363 as an alternative to plan restructurings. Section 363 permits the sale of estate property "free and clear" of any liens, claims, or encumbrances, which may include tort claimants' claims against a debtor's assets.

Finally, Congress, having now received clarification from the Court, may elect to amend the Bankruptcy Code as it did for asbestos cases, creating a new provision akin to Section 524(g) to specifically allow for a bankruptcy court to grant non-consensual releases. Such an amendment may apply to specific mass tort liabilities—such as opioid or sex abuse claims—or it could be drafted to apply more broadly to adapt to new classes of mass tort bankruptcies that arise.

Regardless of the ways in which debtors will adjust their approach to dealing with mass tort liabilities in bankruptcy, one thing remains clear: much work remains to be done by the lower courts to clarify, interpret, and refine the *Purdue* opinion handed down by a divided Supreme Court.

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