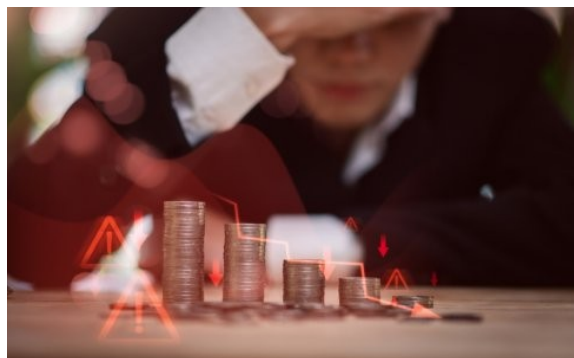


2024: Year in Review: Third-Party Releases After Purdue Pharma

December 18, 2024

By Alben Petrakov



"Lately I've been, I've been losing sleep

Dreaming about the things that we could be"

- Counting Starts, One Republic

The most notable decision in the bankruptcy world in 2024 was the Supreme Court's decision in Purdue Pharma. *Harrington v. Purdue Pharma, L.P.*, 144 S. Ct. 2071 (2024). At the heart of the fight in *Purdue Pharma* were nonconsensual third-party releases where Purdue's chapter 11 plan released all opioid crisis-related claims against the Sackler family^[1].

Why are third-party releases important? A third-party release is a provision in a chapter 11 plan that can eliminate future liability for pre-bankruptcy conduct of non debtors like affiliates and officers and directors of the company that sought bankruptcy protection. For many years, debtors have used third-party releases as an important restructuring tool in chapter 11 cases. Bankruptcy lawyers and judges have been losing sleep over strategies to preserve this tool

Circuit courts were divided on whether bankruptcy courts had the authority to grant nonconsensual third-party releases. The Second and Seventh Circuits permitted nonconsensual third-party releases when the particular release is essential and integral to the reorganization itself. Third Circuit permitted nonconsensual third-party releases in limited circumstances when the releases were fair and necessary to the reorganization. The Fourth, Sixth, and Eleventh Circuits approved third-party releases and applied a multifactor test^[2] to decide the merits of third-party releases. The Fifth, Ninth and Tenth Circuits, however, held that nonconsensual third-party releases were not permitted by the Bankruptcy Code.

The Bankruptcy Code does not include any explicit language that would permit third-party releases in most cases, but courts would approve them under §1123(b)(6) of the Bankruptcy Code, which allows bankruptcy courts to approve any "appropriate" provision in a chapter 11 plan that is "not inconsistent with the applicable provisions of this title." Some courts also relied on §105(a) of the Bankruptcy Code which allows the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

The Supreme Court's *Purdue Pharma* decision eliminated nonconsensual third-party releases. However, Purdue Pharma did not dispose of consensual third-party release and left open the question what would be considered consensual releases and what is going to be the fate of efforts to stay litigation against non debtor parties.

In *Purdue Pharma*, the majority of the creditors voted for the final iteration of the plan which provided for a release of all opioid-

related claims against the Sacklers in exchange for a several billion-dollar contribution to the bankruptcy estate. Under the terms of the plan, Purdue would reorganize as a benefit corporation with the purpose of ameliorating the opioid crisis. The United States Trustee objected to the third-party releases arguing that the Bankruptcy Code does not permit the nonconsensual release of claims against non debtors and raising concerns about the victims' due process rights.

In a five-to-four majority opinion written by Justice Neil Gorsuch, the court held that the Code did not permit nonconsensual third-party releases. The Court reasoning was premised on the text of Sections 1123(b) and 524 of the Bankruptcy Code. Section 1123(b)(6) specifically states that a debtor may include in its plan "any other appropriate provision not inconsistent with the applicable provisions of this title." The Court reasoned that because "[p]aragraph (6) is a catchall phrase at the end of a long and detailed list of specific directions," it must be interpreted within the context of the rest of the subsection. Thus, because paragraph (6) follows a list of provisions relating to the rights, relationships, and responsibilities of the debtor to its creditors, the majority interpreted § 1123(b)(6) to only permit the bankruptcy court to grant orders concerning the relationships between the debtor and its creditors, and not any relationships between non debtors and the creditors.

In addition, the Supreme Court reasoned that the discharge provisions under § 524 limited discharge to the debtor and did not permit the discharge of third parties. The Court noted that § 524(g) already provides an exception to the discharge provisions by authorizing nonconsensual releases of third-party claims under limited circumstances in asbestos-related cases. Accordingly, if Congress intended to broadly authorize nonconsensual third-party releases, it could have included language to that effect.

The full impact of Purdue remains to be seen but several bankruptcy courts grappled with what constitutes a consensual release. In the first opinion on the topic since the Supreme Court's *Purdue* decision in late June, Bankruptcy Judge Christopher M. Lopez of Houston confirmed an opt-out chapter 11 plan with non debtor, third-party releases. The U.S. Trustee objected to the opt-out plan and argued that the releases were coercive and that the releases should be given only by creditors who opt in. Any creditor who voted in favor of the plan could not opt out, and creditors who did not vote would be bound by the releases. In addition, creditors who opted out could not sue unless the bankruptcy court were to determine that the claims were colorable.

Judge Lopez started his analysis by emphasizing that Purdue explicitly dealt with non-consensual third – party releases only and did not change the law in Fifth Circuit. What constituted consent, including opt-out features and deemed consent for not opting out, had long been settled in this District and hundreds of chapter 11 cases have been confirmed with consensual third-party releases with an opt-out. The debtor gave extensive notice about the opt-out provisions in the plan. About 100 creditors opted out, Judge Lopez said in his opinion. Judge Lopez overruled the U.S. Trustee's objection and confirmed the plan because "the third-party releases are consensual and narrowly tailored."

A New York judge in the Bankruptcy Court for the Western District of New York, Chief Bankruptcy Judge Carl L. Bucki of Buffalo, N.Y. denied confirmation of an opt out plan in a case where the corporate debtor offered \$300,000 for distribution among creditors with more than \$282 million in unsecured claims. The proposed plan called for releasing not only the debtor but also the debtor's officers, directors, shareholders and agents. Non debtor releases were also earmarked for the debtor's and the committee's professionals, among others. Unless a creditor affirmatively opted out, they would be deemed releasing claims. In re Tonawanda Coke Corp., ___ B.R. ___, No. BK 18-12156 CLB, 2024 WL 4024385, at *2 (Bankr. W.D.N.Y. Aug. 27, 2024.) Unlike *Purdue*, the released non debtors were not making financial contributions toward the payment of creditors' claims.

Applying section 5-1103 of the New York General Obligations Law, Judge Bogucki held that an opt out plan does not satisfy the requirements for consent under New York law because an agreement to "discharge" an "obligation" had to be in writing and signed by the party against whom it would be enforced.

Judge Craig T. Goldblatt of Delaware held that an opt-out provision is permissible only if the creditor was on notice that it would be subject to a third-party release and the creditor took an affirmative act, such as voting on the plan, but failed to exercise the opt-out right.

A review of cases even pre-dating Purdue on what constitutes a consensual release shows that there is a case to support every view. Some cases apply state law contract principles (usually to deny approval of opt-out releases), and others apply federal bankruptcy principles (usually to approve them). “[C]ourts are markedly split on the issue, with some categorically finding that a release cannot be consensual absent an affirmative act to opt in, and others finding that opt-out mechanisms that (as is the case here) provide adequate notice and a simple opt-out process can result in a consensual release. *In re: LAVIE CARE CENTERS, LLC, et al., Debtors.*, No. 24-55507- PMB, 2024 WL 4988600, at *12 (Bankr. N.D. Ga. Dec. 5, 2024).

The consensual third-party releases will continue to be the main focus next year and the issue will continue to percolate in the bankruptcy and higher courts.

^[1] The Sackler family owned and controlled Purdue Pharma, the maker of oxycontin, which contributed to the opioid crisis. *Empire of Pain*, written by investigative journalist Patrick Keefe recounts the story of Purdue and the investigations and legal proceedings into the marketing practices of oxycontin. There are numerous criminal and civil proceedings initiated by the federal and state governments, foreign authorities and individual victims. Hulu’s *Dopesick* and Netflix’s *Painkiller* illustrate the impact of oxy in a more easily digestible format.

^[2] The Courts in these circuits take into consideration the following factors: (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) the non debtor has contributed substantial assets to the reorganization; (3) the injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) the impacted class, or classes, has overwhelmingly voted to accept the plan; (5) the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) the plan provides an opportunity for those claimants who choose not to settle to recover in full ;and (7) the bankruptcy court made a record of specific factual findings that support its conclusions.