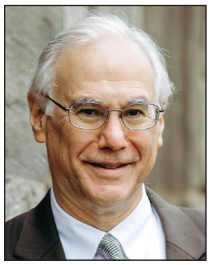
AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By Douglas N. Candeub[1]

Getting (Approximately) to Yes on Nondebtor Releases in Mass Tort Cases After *Purdue Pharma*



Douglas N. Candeub
Morris James LLP
Wilmington, Del.

Douglas Candeub is counsel with Morris James LLP in Wilmington, Del., where his practice includes bankruptcy litigation and appeals.

In its end-of-term decision in the *Purdue Pharma* case, the U.S. Supreme Court held, in a 5-4 split, that the provisions in the debtors' chapter 11 plan that imposed on all their creditors a nonconsensual release of the family who formerly owned and controlled the debtors —and enjoined creditor actions against them — are impermissible under the Bankruptcy Code.[2] Justice Brett M. Kavanaugh, writing for the dissenters, expressed great concern about the decision's probable effect on future mass-tort chapter 11 bankruptcy cases.[3] He wrote that nonconsensual nondebtor releases have been "indispensable"[4] in mass tort chapter 11 bankruptcies, and that precluding their use in reorganization plans will, at a minimum, severely impair the functionality of bankruptcy as a forum for resolving mass-tort cases in the future:

> [The Court's decision] will harm victims in pending and future mass-tort bankruptcies. The Court's decision deprives the bankruptcy system of a longstanding and critical tool that has been used repeatedly to ensure fair and sizable recovery for victims—to repeat, recovery for *victims* — in mass torts ranging from Dalkon Shield to the Boy Scouts.[5]

Unsurprisingly, the majority opinion, written by Justice Neil M. Gorsuch, largely steers clear of predicting the decision's effect on future mass-tort bankruptcies. It states that "[b]oth sides of this policy debate may have their points," but in the end, it is for Congress "to make policy judgments."[6]

Is Justice Kavanaugh right? Chapter 11 practitioners might be apt to believe — or at least hope — he is wrong, and that the *Purdue Pharma* ruling will not undermine the utility of chapter 11 in mass tort cases. In the absence of a legislative change, key issues may include how consent is determined and, for future cases where the principal nondebtor source of funding is liability insurance, the form taken for any settlements between a debtor and its insurers.

The *Purdue Pharma* Case

To briefly review, Purdue Pharma, which bore substantial responsibility for the "opioid epidemic" in the U.S., was owned and controlled by the Sackler family. Prebankruptcy, the Sackler family "milked" the company's revenues, and their net worth was estimated at $14 billion in 2019, the year that Purdue Pharma filed its bankruptcy petition.[7] Much of their wealth was evidently placed in foreign trusts.[8]

1 The views expressed here are solely those of the author. He did not represent any of the parties in *Purdue Pharma*.
2 *Harrington v. Purdue Pharma LP*, 603 U.S. __, 144 S. Ct. 2071 (2024).
3 The phrase "mass tort bankruptcy case" is just descriptive, not statutorily based, but since the dissent focuses on how the decision will affect "mass tort bankruptcies," this article does as well.
4 *Purdue Pharma*, 144 S. Ct. at 2116 (Kavanaugh, J., dissenting) (the "*Purdue Pharma* Dissent").
5 *Id.* at 2104. As a factual matter, Justice Kavanaugh exaggerates in asserting that nonconsensual nondebtor releases have been a "longstanding" tool in bankruptcies. Their first use, in conjunction with a channeling injunction (*i.e.*, an injunction to channel the claims of all present and future personal-injury or property damage claimants exclusively to one or more specially designated trusts, formed and funded pursuant to the plan), was in 1986 in the *Johns-Manville* case. *See Matter of Johns-Manville Corp.*, 68 B.R. 618, 625 (Bankr. S.D.N.Y. 1986); *aff'd sub. nom.*, *In re Johns-Manville Corp.*, 78 B.R. 407 (S.D.N.Y. 1987); *aff'd sub. nom.*, *Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988). Their use since then has been sparse. *See, e.g., In re Cont'l Airlines*, 203 F.3d 203, 214 (3d Cir. 2000) (denying approval of nondebtor releases).
6 144 S. Ct. at 2087.
7 *See id.* at 2078-79; *In re Purdue Pharma LP*, 635 B.R. 26, 44 (S.D.N.Y. 2021) (the "*Purdue Pharma* District Court). *See generally* Patrick Radden Keefe, *Empire of Pain: The Secret History of the Sackler Dynasty* (2022).
8 *In re Purdue Pharma LP*, 633 B.R. 53, 88 (Bankr. S.D.N.Y. 2021) (the "*Purdue Pharma* Bankruptcy Court").

Purdue Pharma's chapter 11 plan that the bankruptcy court ultimately approved, with overwhelming creditor support, provided for the Sackler family to contribute $4.3 billion (over a period of years) to fund the plan, with the Sacklers granted a blanket release of any claims against them as to which Purdue Pharma was a legally relevant factor.[9] The claims of tort victims and general creditors would be channeled to a set of creditor trusts to be established under the plan, and a public benefit company, "NewCo," would be established.

After the district court on appeal vacated the confirmation order, the Sacklers later agreed to raise the family's plan contribution to at least $5.5 billion.[10] In conjunction with that increased funding, most remaining objectors withdrew their appeals, leaving only some individual victims, a set of Canadian creditors, and the Office of the U.S. Trustee.[11]

The fact that the Sackler family members would be the principal nondebtor source for funding the plan — indeed, the principal source, debtor or nondebtor — is perhaps unique for a mass tort chapter 11. The principal nondebtor sources of funding for a plan in a mass tort case are typically the issuers of the debtor's liability insurance policies, with which the debtors negotiate in the hope of reaching settlements. While Purdue Pharma had valuable liability insurance, the plan only called for "the transfer of the Debtors' insurance or insurance rights to the trusts established under the plan to fund and make distributions to creditors or to Newco."[12] The plan did not reflect, or rely on, settlements with insurers.

The Supreme Court accepted *certiorari* to address the issue of the nonconsensual nondebtor releases. In the majority's analysis, the only Bankruptcy Code provision under which it might conceivably be allowed is 11 U.S.C. § 1123(b)(6), a catch-all provision governing terms that may be included in a plan. Construing it, the Court concluded that nonconsensual nondebtor releases are not "appropriate" within § 1123(b)(6), and thus may not be used in a plan. The Court also noted that the "rule of construction" clause in 11 U.S.C. § 524(g), a section otherwise limited to asbestos-related chapter 11 cases, does not justify a different conclusion, nor does § 105(a), which only enables a bankruptcy court to carry out other Bankruptcy Code provisions.[13] Concluding, the Court stated its specific holding thusly:

> [W]e hold only that the [B]ankruptcy [C]ode 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.[14]

Could a Comparable Resolution Be Reached with Substantial Consent?

The majority and dissent both hint at their views on whether they believe that a comparably satisfactory resolution could be achieved in a mass tort bankruptcy chapter 11 plan, where any releases of creditor claims against nondebtors are consensual. Justice Gorsuch expressed this by citing favorably the U.S. Trustee's view that the effect of declaring impermissible all *nonconsensual* nondebtor releases in chapter 11 plans is to increase creditor bargaining power *vis-à-vis* the nondebtors who hope to be shielded under the plan.

This was said to have been demonstrated in the *Purdue Pharma* case itself, where "during the appeal ... the Sacklers agreed to increase their contribution by more than $1 billion in order to secure the consent of the eight [remaining] objecting States."[15] Justice Gorsuch restates the U.S. Trustee's argument that "global" releases are not necessary, and that their absence "doesn't mean that [the Sacklers] wouldn't pay a lot for 97.5 percent peace."[16] Justice Kavanaugh views "any hope for a new deal" in the case as, at best, "questionable" and possibly "pure fantasy."[17]

One defining feature of mass tort cases is the quantity of claimants, which can run into the hundreds of thousands. In *Purdue Pharma*, 618,000 proofs of claim were filed.[18] On remand in *Purdue Pharma*, whether the debtors will be able to obtain consent to nondebtor releases from 97.5 percent of the claimants — to use the U.S. Trustee's example — will be impacted by the mechanism used for determining whether consent was granted (*i.e.*, whether it will include "implied consent"). This issue would similarly be present in any future mass tort case.

In *Purdue Pharma*, the Supreme Court "express[ed] no view on what qualifies as a consensual release."[19] Previously, however, the Court indicated that implied consent may be permissible.[20] By now, many courts have addressed whether they will accept a procedure requiring creditors to affirmatively "opt out" of any such releases, otherwise their consent will be implied, or alternatively, whether they will require that the consent to any nondebtor releases be expressed affirmatively by "opting in." Case law on both sides can readily be found.

That said, bankruptcy court decisions in mass tort cases appear to favor enabling "implied consent."[21] For example, in the *Mallinckrodt* case, the bankruptcy court wrote:

> I am aware ... that this ruling conflicts with those of some of my colleagues who have suggested that consensual releases obtained through an opt-out pro-

9 *Id.* at 104. To be clear, the creditors' claims that were to be released were any direct claims they might have against the Sacklers. It was undisputed that the debtors could control, and waive, any "derivative" claims that a creditor might otherwise be able to assert against the Sacklers. *See Purdue Pharma* District Court, 635 B.R. at 90-91.

10 *In re Purdue Pharma LP*, 69 F.4th 45, 57 (2d Cir. 2023) (the "*Purdue Pharma* Second Circuit").

11 *Purdue Pharma* Dissent 144 S. Ct. at 2080.

12 *Purdue Pharma* Bankruptcy Court, 633 B.R. at 63.

13 144 S. Ct. at 2081-87 & n. 2.

14 *Id.* at 2088. The "injunction" in the plan that the Court is referring to was one "forever stay[ing], restrain[ing,] and enjoin[ing]" claims against [the Sackler family]." *Id.* at 2079.

15 144 S. Ct. at 2087.

16 *Id.*

17 *Purdue Pharma* Dissent, 144 S. Ct. at 2116.

18 *Purdue Pharma* Bankruptcy Court, 633 B.R. at 58.

19 144 S. Ct. at 2088. Recently, one court in a non-mass tort case reportedly required opt-ins, but noted that *Purdue Pharma* did not affect its decision. *In re Red Lobster Mgmt. LLC, et al.*, No. 24-2486 (Bankr. M.D. Fla. July 26, 2024) (reported in *Law360*).

20 *See Wellness Intern. Network Ltd. v. Sharif*, 575 U.S. 665, 684 (2015).

21 *See, e.g., In re Boy Scouts of Am. & Delaware BSA LLC*, 642 B.R. 504, 675 (Bankr. D. Del. 2022); *supp.*, No. 20-10343 (LSS), 2022 WL 20541782 (Bankr. D. Del. Sept. 8, 2022); *aff'd*, 650 B.R. 87 (D. Del. 2023); *aff'd*, 650 B.R. 87 (D. Del. 2023) ("*Boy Scouts*"); *In re Mallinckrodt PLC*, 639 B.R. 837, 881 (Bankr. D. Del. 2022) (large pharmaceutical company that was involved in opioid sales and prebankruptcy was defendant in thousands of opioid-related lawsuits).

cess may never be appropriate. However, neither of those cases involve mass tort bankruptcies like this one. Although the Third Circuit has not explicitly commented on the propriety of nondebtor releases in these circumstances, it has suggested that if they are appropriate anywhere, it would be in a mass tort case like this one.[22]

In any given case, depending on the number of claimants who have "opted out," the opportunity may exist for the nondebtor releasees or plan proponents to seek a separate resolution with the holdouts.

Can Insurance Buyback Agreements Hold Up as a Substitute for Releases?

Justice Kavanaugh's dissent expressed concern about the burdens that could be imposed on any nondebtors contributing to a mass tort debtor's chapter 11 plan.[23] However, insurers are not in the same category as other nondebtors seeking releases in a plan. Their connection to the debtor-insured stems from the insurance contract — a nonexecutory contract, as long as the premiums were paid. Courts all agree that a debtor *owns* its liability insurance contracts,[24] regardless of the variations in how courts treat the available *proceeds* from a liability insurance policy.[25]

Given the status of insurance policies as an asset of the estate, insurers and their chapter 11 debtor-insured facing a mass of tort claims have, over time, come to formulate their settlements as "buyback" transactions.[26] A buyback is similar to the prior types of settlement agreements between the insurer and debtor-insured, except that (1) in a buyback, the transaction is framed as a "sale" of the policy by the debtor back to the insurer that issued it; and (2) the agreement would generally provide that, upon the agreement's execution, the policy would be terminated and voided entirely.[27] For that reason, the term "buyback" is somewhat of a misnomer, since the value (to the insurer) lies in terminating the policy, not merely in transferring ownership.

Chapter 11 debtors seeking bankruptcy court approval of insurance buyback agreements do so pursuant to §§ 363(b) and 363(f) (as a sale "free and clear" of other interests) and Rule 9019 of the Federal Rules of Bankruptcy Procedure (as a settlement). Debtors will also seek a finding that the transaction was in good faith pursuant to § 363(m), since under that provision, if its requirements are met, the sale is not subject to appeal unless the order is stayed. The requests for approval may be made as standalone motions or as a component of a reorganization plan.

The *Purdue Pharma* opinion does not mention bankruptcy sales under § 363; still, varying views have been taken as to whether the insurance policy buybacks that were approved within the *Boy Scouts* confirmation order should be considered impeded or unimpeded by the *Purdue Pharma* decision, and that issue is currently being considered by the Third Circuit in the appeals in that case.[28]

Meanwhile, several bankruptcy courts have rendered decisions that construe *Purdue Pharma* narrowly in various other circumstances.[29] If insurance policy buybacks, whether as standalone § 363 sales or in the context of a reorganization plan, are considered unimpeded by *Purdue Pharma*, one would expect them to take on added prominence in future mass tort chapter 11 bankruptcies.

If no alternatives work, there is still Congress. abi

Editor's Note: *ABI held a webinar shortly after the Supreme Court issued its decision in this case. To listen to the abiLIVE recording, please visit abi.org/newsroom/videos. ABI also published a digital book,* The Purdue Papers, *a compilation of 3,500+ pages of amicus briefs, petitions and other related background material. To order your downloadable copy, visit store.abi.org.*

Reprinted with permission from the ABI Journal, Vol. XLIII, No. 10, October 2024.

22 *Mallinckrodt*, 639 B.R. 881 (citation omitted).
23 *Purdue Pharma* Dissent, 144 S. Ct. at 2113.
24 *See, e.g., First Fidelity Bank v. McAteer*, 985 F.2d 114, 117 (3d Cir.1993).
25 Liability insurance proceeds are treated differently because they "will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract." *Sosebee v. Steadfast Ins. Co.*, 701 F.3d 1012, 1023 (5th Cir. 2012).
26 The first decision reported in Westlaw in which a bankruptcy court approved a transaction labeled a liability insurance "buyback" between a chapter 11 debtor and an insurer was in October 2009. *In re Chemtura Corp.*, No. 09-11233 (REG), 2009 WL 10806754 (Bankr. S.D.N.Y. Oct. 29, 2009). Buybacks have been approved in such recent mass tort cases as *Boy Scouts* and *USA Gymnastics*. *See Boy Scouts*, 642 B.R. at 569-70; *In re USA Gymnastics*, No. 18-09108-RLM-11, Doc. No. 1776 at 16 (Bankr. S.D. Ind. Dec. 16., 2021) (plan-confirmation order).
27 In a chapter 7 case, different issues arise, for reasons beyond the scope of this article.
28 *See* Supplemental Briefing, *In re Boy Scouts of Am. & Delaware BSA LLC*, Nos. 23-1664 & 23-1666 (3d Cir.).
29 *See, e.g., In re Parlement Techs. Inc.*, 2024 WL 3417084, at *3 (Bankr. D. Del. July 15, 2024); *In re Coast to Coast Leasing LLC*, 2024 WL 3454805, at *3 (Bankr. N.D. Ill. July 17, 2024).