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Supreme Court Overturns Purdue Bankruptcy Plan

Releases of Sackler Family Too Broad and Not Authorized by the Bankruptcy Code

SUMMARY

Last week, the Supreme Court overturned the chapter 11 plan of reorganization of Purdue Pharma and its affiliated debtors, sending stakeholders back to the settlement table after nearly four years in bankruptcy.[1] The Court held that the releases of the Sackler family in the chapter 11 plan were too expansive because they included claims against the Sacklers that belonged to individual creditors who did not consent, not merely claims against the Sacklers that belonged to Purdue Pharma itself. The Court's decision settles a long-standing dispute among appellate courts and bankruptcy professionals about whether a chapter 11 debtor can force a settlement of claims against a non-debtor that are owned by individual creditors who do not consent. The decision will require chapter 11 debtors and stakeholders to approach the question of non-debtor releases with new dexterity, but ultimately leaves in place the key benefits of chapter 11 as the best available forum to resolve many mass tort and other complex litigation exposures.

BACKGROUND

Purdue Pharma L.P. and its affiliated debtors ("Purdue") were owned and controlled by the Sackler family. Purdue filed for chapter 11 in September of 2019 in the face of thousands of civil suits seeking damages from Purdue and the Sackler family in connection with OxyContin. The goal of the chapter 11 case was to settle this litigation comprehensively and to distribute the proceeds to victims and other creditors.

The vast majority of the claims faced by the Sacklers belonged to Purdue, such as claims to claw back approximately $11 billion the Sackler family "milked"[2] from Purdue prior to the chapter 11 case and claims for breach of fiduciary duty against Sackler family members who served as officers and directors. But the Sackler family also faced direct claims by individual creditors that did not belong to Purdue, such as claims for deceptive advertising practices.

From the beginning of the chapter 11 case, the Sackler family insisted on a single settlement that resolved all of their litigation exposure, including claims that belonged to individual creditors as well as the claims that belonged to Purdue. The chapter 11 plan of Purdue proposed to settle all opioid-related claims against the Sacklers for $4.325 billion, without separately pricing the estate claims owned by Purdue and the direct claims owned by individual creditors. Minority creditors objected to the release of their direct claims, and the Bankruptcy Court overruled these objections and confirmed the chapter 11 plan.

The minority creditors appealed. They won the first appeal before the District Court for the Southern District of New York and lost the second before the Court of Appeals for the Second Circuit. During the appeals process, the Sackler family increased the settlement amount to over $5.5 billion and some of the minority creditors withdrew their objections. But not all. A very small number of minority creditors continued to object to the release of their individual direct claims. Rather than exclude these remaining direct claims from the chapter 11 plan to resolve the pending appeal, Purdue and the Sackler family insisted on "all-or-nothing" protection, as they had consistently from the beginning of the chapter 11 case. The dispute eventually reached the Supreme Court.

THE DECISION

The Supreme Court sided with the objecting creditors in a 5-4 decision written by Justice Gorsuch. The Court held that a bankruptcy court does not have the authority to order the release of an individual creditor's direct claims against a non-debtor without the consent of the affected creditor. The Court parsed the relevant Bankruptcy Code provisions and, among other things, noted that the discharge provided by chapter 11 operates only for the benefit of the debtor and "does not affect the liability of any other entity."[3] The Sacklers, unlike Purdue, did not file for bankruptcy and did not place "anything approaching their total assets on the table for their creditors."[4] Yet the Sackler family nonetheless sought and negotiated for a bankruptcy discharge for themselves and an injunction "'permanently and forever' foreclosing similar suits in the future . . . without the consent of those affected."[5] The Court interpreted § 1123(b) of the Bankruptcy Code, which lays out what may be included in a plan of reorganization, narrowly and held that this ultimate protection is only available to debtors that have filed for bankruptcy.

The Court took care to limit its opinion to the question of whether a bankruptcy court has the authority to approve the non-consensual release of an individual creditor's direct claims against a non-debtor. The Court did not express a view on what types of claims belong to individual creditors, rather than to a debtor. And the Court expressly stated that its opinion does not limit consensual releases nor express a view on what constitutes a consensual release, rather than a non-consensual one. The Court also made clear that its ruling does not apply to chapter 11 plans that provide for full satisfaction of creditor claims.

A vigorous dissent by Justice Kavanaugh argued that the non-consensual releases of individual creditor claims against non-debtors should be permitted in appropriate circumstances "to address the collective-action problem that a bankruptcy poses."[6]

IMPLICATIONS

The Supreme Court's decision is not the end of the road for chapter 11 as a forum to resolve mass tort and other cases involving potential claims against non-debtor affiliates. Quite the contrary, Purdue leaves in place all of the most important advantages of chapter 11 as a forum to resolve complex litigation. Although 100% finality for affiliated companies may be harder to achieve in the face of opt-out creditors, that outcome is neither impossible nor essential in every mass tort situation, especially after an objective assessment of the viability of individual creditor claims against non-debtor affiliates.

We will provide additional guidance on the future of mass tort bankruptcy after Purdue in the coming weeks, but here are some initial observations:

- Bankruptcy courts can stay claims not only against the debtor but also against its affiliates for a reasonable period of time to allow the consensus-based process of bankruptcy to do its work. This moratorium—on its own—can be of immense value to everyone involved in a mass tort situation.
- Even after Purdue, chapter 11 debtors can release their affiliates from all claims that belong to the debtor. These claims are broadly defined under applicable law and will constitute most of the true exposure of non-debtor affiliates in many mass tort situations, particularly where the debtor itself is the designer, manufacturer and seller of the product at issue.
- In chapter 11 cases where creditors' direct claims against non-debtor affiliates really must be compromised, the debtor may be able to marshal enough value to fund a trust to pay all tort claims in full, as determined by the Bankruptcy Court. These "full satisfaction" bankruptcy plans can protect affiliates even without the express consent of the creditors, achieving the same 100% protection for affiliates that Purdue failed to achieve.
- In cases where payment in full is not possible and non-debtor affiliates demand releases of independent creditor claims, debtors can still use chapter 11 to seek voluntary releases, including of their affiliates. There is a long list of carrots and sticks available to reduce the number of opt-outs, encouraging results that come very close to 100% protection without the doctrinal challenges created by non-consensual releases of independent creditor claims. Significantly, extremely high voluntary participation rates have been the norm in a mass tort context, and we expect this trend to continue.
- Finally, as the Court expressly noted, Congress could amend the Bankruptcy Code to provide the authority for bankruptcy courts to order non-consensual releases of direct creditor claims, as Congress did for asbestos liabilities in 1994.[7] This would be good bankruptcy policy and simplify matters considerably for all the applicable stakeholders in a mass tort case. But mass tort cases will continue to benefit from chapter 11 even if Congress never acts. The promise of bankruptcy as a forum to resolve complex litigation is simply too attractive, even after Purdue.

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ENDNOTES

1 *Harrington* v. *Purdue Pharma L.P.*, 603 U.S. ___ (2024).

2 *In re Purdue Pharma, L.P.*, 635 B.R. 26, (S.D.N.Y. 2021) ("In at least one email in 2014, Jonathan Sackler referred to this distributing of cash flow from OxyContin as a 'milking' program.").

3 *Harrington* v. *Purdue Pharma L.P.*, 603 U.S. ___ at 7 (2024) (citing 11 U.S.C. §524(e)).

4 *Id.* at 1.

5 *Id.* at 8.

6 *Id.* at 5 (Kavanaugh, J., dissenting).

7 *See* 11 U.S.C. § 524(g).

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