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Immunity with No Side Effects: Sackler Family Granted Releases of Liability in Purdue Pharma Bankruptcy Case

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On May 7, 2021, we issued a client alert regarding Purdue Pharma's bankruptcy case and the Sackler family's attempt to have Purdue's reorganization plan release them of their personal liability for the American opioid epidemic.[i] We updated that alert on December 21, 2021 when a federal judge in the Southern District of New York blocked Purdue Pharma's reorganization plan due to its including the aforementioned releases, otherwise known as "third-party releases."[ii] Less than a month later, we alerted our clients again when that Southern District judge's decision was appealed to the Second Circuit Court of Appeals.[iii]

The issue the Second Circuit was charged with resolving: whether Purdue Pharma's chapter 11 reorganization plan could grant the Sacklers broad releases of personal liability against opioid litigation, even when the Sacklers have not sought bankruptcy themselves and the plaintiffs in those opioid cases do not consent to the Sacklers' release.[iv]

Now, the Second Circuit has determined that not only can bankruptcy judges in courts throughout the Second Circuit grant third-party releases in many cases, but the Sacklers themselves can receive releases through Purdue Pharma's case.[v]

Notably, the court began by reminding us that bankruptcy is an equitable process and that its judges sit in courts of equity. This concept finds its roots in old England's Chancery Courts which had their origins in Church law. As Court of Appeals Judge Lee stated in the first sentence of her opinion: "Bankruptcy is inherently a creature of competing interests, compromises, and less-than-perfect outcomes."

The court first found third-party releases permissible under Bankruptcy Code sections 105(a) and 1123(b)(6), which state respectively that a bankruptcy court "may issue any order, process, or judgment that is necessary or

appropriate to carry out the provisions of [the Bankruptcy Code]," and that a bankruptcy plan "may . . . include any . . . appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]."[vi]

The court insisted that together, sections 105(a) and 1123(b)(6) grant a "residual authority" consistent with "the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships."[vii] As such, the court rejected the view of a minority of circuits that section 524(e), which states "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt," bars the imposition of third-party releases.[viii]

The court found such on the grounds that the "does not affect" language in section 524(e) "does not purport to limit the bankruptcy code's powers to release a non-debtor from a creditor's claims."[ix] Finally, the court noted that none of the Second Circuit's previous decisions prevent its decision here, and, in fact, support third-party releases.[x]

Next, the court laid out a seven-factor test for determining whether a third-party release may be included in a given chapter 11 plan.[xi] It defined the seven factors as follows:

i. Whether there is an identity of interests between the debtors and released third parties, including indemnification relationships, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

ii. Whether claims against the debtor and non-debtor are factually and legally intertwined, including whether the debtors and released parties share common defenses, insurance coverage, or levels of culpability;

iii. Whether the breadth of the releases is necessary to the plan;

iv. Whether the releases are essential to the reorganization, in that the debtor needs the claims to be settled in order for the *res* to be allocated, rather than because the released party is somehow manipulating the process to its own advantage;

v. Whether the non-debtor contributed substantial assets to the reorganization;

vi. Whether the impacted class of creditors "overwhelmingly" voted in support of the plan with the releases (which the court explained signifies "approval by a minimum of 75% of voting creditors in favor of the plan");

vii. Whether the plan provides for fair payment of enjoined claims, with the determinative question being whether the contributed sum permits the fair resolution of the enjoined claims.[xii]

The court explained how to apply the test, noting "[a]lthough consideration of each factor is *required*, it is not necessarily *sufficient* . . . the bankruptcy court is required to support each of these factors with specific and detailed findings . . . [likely through] extensive discovery into the facts surrounding the claims against the released parties."[xiii] It further cautioned releases must be imposed against a "backdrop of equity . . . [g]iven the potential for abuse, courts should exercise particular care when evaluating these types of releases."[xiv]

Finally, the court determined the Sacklers could receive third-party releases through Purdue Pharma's reorganization plan by applying its new test.[xv] Relevant to the court's approval were the fact that the Sacklers were basically "senior managers" of Purdue, the factual and legal overlap between claims against Purdue and claims against the Sacklers, the Sacklers' $6 billion dollar contribution to Purdue's reorganization (particularly compared to the $40 trillion dollar total value of the claims against them), and the fact that over 95% of the personal injury classes voted to accept the plan.[xvi]

Judge Richard C. Wesley "reluctantly" concurred in the opinion.[xvii] He did so on the grounds that the Second Circuit had shown approval of third-party releases in the past.[xviii] However, he noted that there is no explicit provision in the bankruptcy code allowing for third-party releases and suggested the Supreme Court should step in and resolve the issue of whether or not third-party releases should be allowed.[xix]

Indeed, there is a circuit split on the issue. While the Fifth, Ninth, and Tenth Circuits have barred third-party releases, the Sixth and Seventh Circuits, as well as the Second Circuit now, have ruled that owners who contribute substantially to the resolution of their companies' bankruptcies are eligible to receive third-party releases.[xx]

Recently, the Boy Scouts of America bankruptcy case was appealed to the Third Circuit on the grounds of third-party releases included in the Boy Scouts' reorganization plan, and the Fifth Circuit Highland Capital case was appealed to the Supreme Court partially for the Court to decide whether section 524(e) allows third-party releases in Chapter 11 cases.[xxi]

There is disagreement as to whether there's a chance the Supreme Court will review the Second Circuit's Purdue Pharma Decision. The Sacklers have agreed to pay $6 billion dollars to various states, counties, cities, towns, Native American tribes, and individual victims who became addicted to OxyContin or died from overdoses as a result of their addictions.[xxii] In addition to the Sacklers' payment, Purdue itself will pay $1.4 billion in opioid settlements and other insurance-based recoveries.[xxiii] Since those expecting payments from Purdue and the Sacklers have been waiting years, if not decades, for the money they deserve, it is unlikely most of Purdue Pharma and the Sacklers' opposition would be willing to appeal.[xxiv]

Still, the new seven-factor test the Second Circuit created could prove burdensome in future applications, and there is still a circuit split brewing over the issue of whether third-party releases are barred to begin with.[xxv] Combine these facts with the fact that the United States Trustee still insists that third-party releases violate plaintiffs' constitutional due process rights, and there is undeniably an issue ripe for Supreme Court review here.[xxvi]

Only time will tell if the Supreme Court will review the Purdue Pharma case. We will continue to monitor developments in this case as well as the law at issue.

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Footnotes

[i] https://www.cullenllp.com/blog/purdue-pharma-is-protection-of-third-parties-by-the-automatic-stay-an-oxymoron/

[ii] https://www.cullenllp.com/blog/purdue-pharma-restructuring-plan-effectively-blocked-for-now/

[iii] https://www.cullenllp.com/blog/will-the-third-party-releases-be-sacked-leave-to-appeal-granted-in-perdue-case/

[iv] *See Purdue Pharma, L.P. et al. v. City of Grande Prairie et al. (In re Purdue Pharma L.P.)*, No. 22-110, 2023 WL 3700458 at *2 (2d Cir. May 30, 2023).

[v] *See id.*

[vi] *Id.* at *16 (quoting 11 U.S.C. §§ 105(a), 1123(b)(6) (2018)).

[vii] *Id.* (quoting *U.S. v. Energy Resources Co., Inc.*, 495 U.S. 545, 549 (1990)).

[viii] *Id.* at *17 (quoting 11 U.S.C. § 524(e) (2018)).

[ix] *Id.* (quoting *Airadigm Commc'ns, Inc. v. FEC (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640, 656 (7th Cir. 2008)).

[x] *See id.* at 17-19; *see generally In re Drexel Burnham Lambert Group, Inc. ("Drexel")*, 960 F.2d 285, 293 (2d Cir. 1992), *In re Metromedia Fiber Network, Inc. ("Metromedia")*, 416 F.3d 136, 142 (2d Cir. 2005), *MacArthur Co. v. Johns-Manville Corp. ("Manville I")*, 837 F.2d 89, 91 (2d Cir. 1988).

[xi] *See id.* at 19.

[xii] *Id.* at 19-20.

[xiii] *Id.* at 20 (emphasis added).

[xiv] *Id.* at 21.

[xv] *See id.* at 23.

[xvi] *See id.* at 21-23.

[xvii] *Id.* at 25.

[xviii] *See id.*

[xix] *See id.*

[xx] *See id.* at 8, In re Purdue Pharma L.P.: Second Circuit Reverses S.D.N.Y and Holds Bankruptcy Court Has Subject Matter Jurisdiction and Statutory Authority to Approve Sackler Family Releases | Vinson & Elkins LLP -

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[xxi] *See id.*; *Nat'l Union Fire Ins., Co. of Pittsburgh, Pa. et al. v. In re Boy Scouts of Am. & Delaware BSA, LLC et al. (In re Boy Scouts of Am. & Delaware BSA, LLC)*, 650 B.R. 87 (D. Del. 2023), *appeal docketed*, No. 23-1780 (3d Cir. May 1, 2023); *In re Highland Cap. Mgmt., L.P.*, 48 F.4th 419 (5th Cir. 2022), *petitions for cert. filed*, Jan. 5, 2023 (No. 22-631) (pending); Jan. 16 2023 (No. 22-669) (pending).

[xxii] An Appeals Court Gave the Sacklers Legal Immunity. Here's What the Ruling Means. - The New York Times (nytimes.com).

[xxiii] Purdue Pharma can protect Sackler owners in opioid bankruptcy, court rules | Reuters.

[xxiv] *See New York Times Article.*

[xxv] *See JD Supra Article.*

[xxvi] *See New York Times Article.*

Practices

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