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Second Circuit's *Purdue* Decision Intensifies Debate

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As noted in *Purdue Pharma III*, "Bankruptcy is inherently a creature of competing interests, compromises, and less-than-perfect outcomes. Because of these defining characteristics, total satisfaction of all that is owed — whether in money or in justice — rarely occurs."[2] With these words, the Second Circuit introduced its opinion on the *Purdue Pharma* case, the largest and most publicized case to come out of the opioid epidemic.

Although the Second Circuit's decision squarely addressed the permissibility of nonconsensual third-party releases under the Bankruptcy Code, the court was less thorough in its explanation of the public policy, fairness and due-process concerns implicated in its authorization of releases under equitable and appropriate circumstances. This article examines the Second Circuit's opinion in *In re Purdue Pharma* and the circuit split over the permissibility of nondebtor third-party releases, the potential for U.S. Supreme Court review, possible legislative responses to the decision, and how public sentiment to the decision might evolve in its wake.

The Second Circuit's Opinion

The *Purdue Pharma III* opinion provides bankruptcy courts in the circuit authority to grant nondebtor nonconsensual releases based on the confluence of §§ 105(a) and 1123(b)(6).[3] The Second Circuit further explained that its precedent always allowed for releases in appropriate circumstances.[4] Citing to its earlier opinion in *Metromedia*, the court also explicitly held that third-party releases can be valid outside of the asbestos context.[5]

Laying out a framework to understand when third-party releases may be approved, the court was careful to highlight that the grant of such releases was ripe for abuse and emphasized that the releases should not always be granted when a third party contributes to a reorganization plan.[6] In the Second Circuit, bankruptcy courts now look at seven factors to determine the appropriateness of third-party releases: (1) the identity of interests between debtors and third parties; (2) whether claims against the debtor and third party are intertwined; (3) whether the breadth of a release is necessary to the plan; (4) whether the release is essential to the reorganization; (5) whether the third party contributed substantial assets to the reorganization; (6) whether at least 75 percent of voting creditors approved the plan; and (7) whether there is a fair payment of enjoined claims.[7] The court was also quick to note that even if all considerations prescribed in the test were met, releases should not necessarily be approved, and that specific and detailed findings should support a court's determination of each factor.[8] Finally, the court reiterated that the grant of third-party releases should always be framed carefully against the backdrop of equity.[9]

The Second Circuit found that every factor of its new "appropriateness test" was met in the *Purdue Pharma* case and approved the use of third-party releases there.[10] First, because the Sacklers were Purdue board members and Purdue was a closely held corporation, there was an identity of interests between the Sacklers and Purdue.[11] Second, and for many of the same reasons outlined in the first factor, the court found that there was a factual and legal overlap between the claims against Purdue and the Sacklers.[12] The third and fourth factors were analyzed together, and it was determined that the release was tailored enough to be appropriate in scope and that without the distributions made possible by the release, the plan would fail.[13] Fifth, the court noted that $5.5 billion was the largest-ever contribution in exchange for a release, and determined that this amount was a significant sum.[14] The sixth factor was met because 95 percent of voting creditors accepted the plan.[15] Seventh, the payment of enjoined claims was fair because while no one could hope to recover $40 trillion in claims, the plan fairly allocated the payments made possible by its confirmation.[16] Finally, the court determined

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2 *In re Purdue Pharma LP*, No. 22-110-BK, 2023 WL 3700458, at *1 (2d Cir. May 30, 2023) (*Purdue III*).
3 *Id.* at *16.
4 *Id.* at *17.
5 *Id.* at *18; *see In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 140 (2d Cir. 2005).
6 *See Purdue Pharma III* at *19.
7 *Id.* at *19-20.
8 *Id.* at *20.
9 *Id.* at *21.
10 *Id.* at *23.
11 *Id.* at *21.
12 *See id.*
13 *Id.*
14 *Id.* at *22.
15 *Id.*
16 *Id.* at *23.

that the plan and the Sacklers' concessions were equitable under the circumstances.[17]

The Second Circuit also addressed due-process concerns raised by the U.S. Trustee. First, the court noted that notice of the confirmation hearing was widespread in the media and that direct notice of the hearing had been provided to creditors.[18] In addition, the court held that the six-day confirmation hearing constituted a sufficient opportunity to be heard.[19] As such, the court concluded that the bankruptcy court provided notice and a meaningful opportunity to be heard consistent with the demands of due process.[20] Responding to the contention that granting releases without the opportunity to opt out deprived creditors of due process, the court echoed that the would-be litigants received due process through notice and the procedure at the confirmation hearing.[21]

Circuit Split and Possible Supreme Court Review

The U.S. Department of Justice (DOJ) stated that it intended to file an appeal of the Second Circuit's decision by Aug. 28 and insisted that Purdue should not be permitted to move forward with its restructuring plan in advance of the Supreme Court's opportunity to weigh in on the important issues regarding third-party releases in bankruptcy. Notwithstanding the DOJ's protestations, the Second Circuit ruled on July 25 that the Purdue debtors were authorized to proceed with their confirmed plan. These developments may significantly decrease what many commentators have assessed to be a "slim chance" that the Court will agree to hear the DOJ's appeal, but a brief review of the split in circuits seems in order in light of the Second Circuit's decision.

The Second, Fourth, Sixth, Seventh and Eleventh Circuits all base their allowance of third-party releases on §§ 105(a) and 1123(b)(6), or some combination of the two.[22] Were the Supreme Court to take the appeal, it could overturn the precedents in those circuits and rule against third-party releases in two ways. First, the Court could adopt the view of the Fifth, Ninth and Tenth Circuits and hold that § 524(e) is a statutory bar to third-party releases. Alternatively, the Court could turn to the Bankruptcy Clause to find that third-party releases are outside of the scope of what Congress may authorize.

Section 524(e) states that the discharge of the debtor's debt does not affect any other entity. The Fifth, Ninth and Tenth Circuits have taken this language to mean that Congress did not intend for the benefits of bankruptcy to extend to nondebtor third parties.[23] In *Pacific Lumber*, the Fifth Circuit restated that § 524(e) and the Fifth Circuit case law broadly foreclose nonconsensual third-party releases and even permanent injunctions for nondebtors.[24] Were the Supreme Court to adopt the Fifth, Ninth and Tenth Circuits' reasoning, it provides a ready-made prohibition of third-party releases. However, this approach to the issue would not directly address the due-process concerns, nor would it address the more intuitive fairness concerns implicated by the *Purdue Pharma* case.

The Supreme Court may find reason to disallow nonconsensual third-party releases in the text of the Constitution rather than in the interplay of Bankruptcy Code provisions. Congress's power to make bankruptcy law derives from the Bankruptcy Clause of the Constitution;[25] in *Purdue Pharma*, the bankruptcy court's delegated authority under the Bankruptcy Clause ran against the due-process rights of individual creditors who insisted that their claims were protected from being released nonconsensually.[26] It could be held that the Second Circuit was incorrect to say that general media awareness and the opportunity to appear at a bankruptcy confirmation constituted substantive due process. If the Court were to take this view, then it could encourage a default "opt-in" regime where creditors must affirmatively choose to endorse third-party releases during a plan confirmation.

Notwithstanding the benefits of resolving a circuit split on the issue of third-party releases, accepting *certiorari* in *Purdue* is fraught with complications for the Supreme Court. In the past year, the Court has faced heightened public scrutiny for its perceived disregard of public opinion. Ethical concerns about justices being influenced by personal, financial and political interests, the leak of the *Dobbs* decision, and the overturning of significant precedent, such as *Roe v. Wade*, have subjected the Court to criticism regarding its transparency, impartiality and responsiveness to public sentiment. Affirming the Second Circuit and permitting nonconsensual third-party releases nationwide may aggravate the perception that the Court is out of touch with average Americans.

The Bankruptcy Code is already unfamiliar territory for the general public, so approving the use of third-party releases in cases involving issues as a hotly contested, broadly reaching and impactful as the opioid crisis may create the impression that the Court has endorsed the use of legal loopholes through bankruptcy to benefit rich and powerful interests. In addition, *pro se* litigants have already accused the bankruptcy court of unfairly advancing the "Sacklers' plan" over creditor objections.[27] While it is true that the Sackler family is contributing $6 billon to mitigate the effects of the opioid crisis, many legal commentators and observers in the media contend that the Sackler family has essentially paid its way out of liability while retaining a substantial portion of its wealth.

The Supreme Court could choose to remain silent on the issue of third-party releases, and in light of the challenging legal and (unavoidable) political landscape, the decision to deny *cert.* seems the most likely outcome. Each day the Court waits to address the issue, the circuit split only deepens. As resolving mass torts through bankruptcy becomes more common, the discrepancy between each circuit's treat-

17 *Id.*
18 *Id.*
19 *Id.*
20 *Id.*
21 *Id.* at *24.
22 *Id.* at *16; *In re A.H. Robins Co. Inc.*, 880 F.2d 694, 701 (4th Cir. 1989); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); *In re Airadigm Commc'ns Inc.*, 519 F.3d 640, 657 (7th Cir. 2008); *In re Seaside Eng'g & Surveying Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015).
23 *In re Pac. Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995); *In re W. Real Est. Fund Inc.*, 922 F.2d 592, 600 (10th Cir. 1990).
24 *See Pac. Lumber*, 584 F.3d at 252.
25 U.S. Const. art. I, § 4.
26 *See Purdue Pharma I* at 98.
27 *Id.* at 82.

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ment of third-party releases is more glaring. At present, a mass tort bankruptcy filed in federal court in Texas could come out completely differently than a case filed in New York. It will be interesting to watch what the Court does with an appeal in *Purdue*.

Possible Congressional Responses

The Supreme Court's hesitancy to resolve the circuit split on third-party releases might be due to the Court waiting on Congress to resolve the issue with an addition or modification to the Bankruptcy Code that explicitly approves or disapproves of these kinds of releases. In July 2021, two bills were introduced in the House and Senate that would prohibit a bankruptcy court from releasing a nondebtor's liability without creditor consent.[28] Notably, the proposed bills seem to address the Purdue Pharma trustee's concern that the bankruptcy court did not provide adequate notice because of the dense language used to describe the releases in *Purdue Pharma*.

The proposed § 113(a)(5) would require that notice of release would only be valid if it is presented "in language appropriate for the typical holder of such claim or cause of action."[29] The bill further stipulates that consent to a release could not be obtained by mere acceptance of a proposed plan or a creditor's inaction.[30] However, the proposed change to the Code would still allow the court to impose third-party releases to authorize sales and other transactions free and clear, among other things.[31] The cumulative effect of the bill is to prevent the perceived abuse of the Code to escape liability though nondebtor releases.

State and Local Government Interests

By the time *Purdue Pharma III* reached the Second Circuit, California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, Washington and the District of Columbia dropped their opposition to the Sackler releases pursuant to an agreement that the family would contribute an additional $1.675 billion to the plan.[32] This left as the main opposition to the plan the trustee[33] and *pro se* litigants. The fact that the eight states and the District of Columbia ceased opposition to the plan when the Sacklers agreed to contribute more money demonstrates that, for state and local governments, the most important factor of a third-party release is the size of the contribution, presumably because those additional funds will aid those governments in mitigating the opioid crisis in their respective communities.

Public Reception of the Decision

The Second Circuit's decision in *Purdue* preserves an important bankruptcy tool, particularly for mass tort cases, but it also implicates a fundamental fairness issue. It is undoubtable that the efforts of *pro se* litigants are aided when experienced and well-funded government (or private practice) lawyers pursue claims alongside them. The presence of financially motivated and competent co-litigants contributes to the sense that *pro se* claimants are adequately represented when infrastructure such as creditors' committees form around them. However, when states and other governments fall back, *pro se* litigants are left to their own devices on unfamiliar terrain.

This apparent unfairness may suggest to some that the Supreme Court or Congress should act to prohibit nonconsensual third-party releases in all circumstances. However, a blanket ban on nonconsensual third-party releases would prevent many people and municipalities from receiving funds that they would not otherwise have received to address crises, such as the opioid epidemic. Never granting releases could become just as harmful as always granting releases. Banning all nondebtor releases or always permitting tortfeasors to purchase releases presents a choice between embracing blind justice or cold pragmatism. Nonetheless, the adoption of a judicially manageable standard, such as the seven-factor test articulated by the Second Circuit, offers a reasonable middle ground for addressing nondebtor nonconsensual releases. abi

28 *See* "Nondebtor Release Prohibition Act of 2021" (H.R. 4777; S. 2497).
29 *See id.*
30 *See id.*
31 *See id.*

32 *Purdue Pharma III* at *11.
33 *Id.*