

WILL THE SUPREME COURT GRANT THE SACKLER FAMILY A DISCHARGE OF THEIR DEBT
THROUGH PURDUE PHARMA L.P.'S BANKRUPTCY PLAN?*

INTRODUCTION

In early August 2023, the Supreme Court stayed the Second Circuit Court of Appeals' decision, *In re Purdue Pharma L.P.*, and granted certiorari to hear oral argument in December of 2023.¹ The parties were asked to brief and argue “[w]hether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by non-debtors against non-debtor third parties, without the claimants’ consent.”² In short, the parties were directed to argue the permissibility of nonconsensual third-party releases. These releases are at the core of the *In re Purdue Pharma L.P.* Chapter 11 reorganization plan.³ To help readers understand the impact of the Supreme Court’s forthcoming decision, this blog explains what nonconsensual third-party releases are and why these releases have created a circuit split. It also points to pre-Code guidance that, if the Supreme Court chooses to rely upon it, lends support for the impermissibility of nonconsensual third-party releases.

A. *Nonconsensual Third-Party Releases and Their Role in Mass Tort Bankruptcies*

Nonconsensual third-party releases have been at the forefront of bankruptcy debates for decades, growing in popularity as mass tort Chapter 11 bankruptcies have become more frequent. Chapter 11 of the Bankruptcy Code enables a debtor to rehabilitate and restructure its business pursuant to a court-approved plan.⁴ The primary policies of Chapter 11 are preservation of the going concern of the company and maximization of creditor recovery to promote fair and equitable

* Jasnoor Hundal, J.D. Candidate, Temple University Beasley School of Law, 2024. Ms. Hundal is the recipient of the “Distinguished Student” Award from the American College of Bankruptcy for the Third Circuit (<https://www.americancollegeofbankruptcy.com/news-events/honored-students/>). This recognition resulted, in part, from the article this post is derived from and the various opportunities the author was afforded to gain practical experience in bankruptcy law. The author extends a special thank you to Professor Jonathan Lipson for his guidance throughout the research and writing process and for his work to connect her with bankruptcy opportunities.

¹ *Harrington v. Purdue Pharma L.P.*, No. 23-124, 2023 WL 5116031 (Aug. 10, 2023).

² *Id.*

³ 633 B.R. 53 (Bankr. S.D.N.Y. 2021), *vacated*, 635 B.R. 26 (S.D.N.Y. 2021), *rev'd in part sub nom*, *Purdue Pharma, L.P. v. City of Grande Prairie*, 69 F.4th 45 (2d Cir. 2023), *cert. granted sub nom*, *Harrington v. Purdue Pharma, L.P.*, No. 23-124, 2023 WL 5116031 (Aug. 10, 2023).

⁴ *U.S. Bank Nat'l Ass'n v. Vill. At Lakeridge, LLC*, 138 S. Ct. 960, 960 (2018).

distribution among all classes.⁵ Ideally, a Chapter 11 proceeding will result in a consensual plan of reorganization with a degree of realistic success for all concerned parties.⁶ A confirmed plan operates to discharge the debtor of all pre-petition debt not paid in the plan, subject to certain limitations.⁷

Section 524 of the Bankruptcy Code discusses the effect of discharge.⁸ Section 524(e) states that “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.”⁹ It has become common practice for non-debtor parties, like the parent and parties related to the corporation, to seek release through the reorganization plan so that they, alongside the debtor, can also receive a “fresh start.”¹⁰ This practice is where the debate about the permissibility of third-party releases begins.

If a consensual release cannot be achieved or is not practical, a court may still bind all creditors and shareholders to a third-party release, jurisdiction permitting.¹¹ “A nonconsensual release is essentially a final judgment against the claimant, in favor of the non-debtor, entered without any hearing on the merits.”¹² Section 1129(b) expressly allows majority creditors to bind the minority creditors and allows the court to “cramdown” the plan, in order to “foreclose the possibility that a small minority would prevent confirmation.” This function of § 1129(b) is

⁵ 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (16th 2022); *Bank of Am. Nat’l Trust & Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 453 (1999).

⁶ COLLIER ON BANKRUPTCY, *supra* note 5, ¶ 1100.01.

⁷ 11 U.S.C. § 1141.

⁸ *Id.* § 524.

⁹ *Id.* § 524(e).

¹⁰ See Jonathan C. Lipson, *The Rule of the Deal: Bankruptcy Bargains and Other Misnomers*, 97 AM. BANKR. L.J. 41, 63 (2023); *Practice Note: Third-Party Releases in Plans*, Lexis (updated Jan. 4, 2022).

¹¹ See *Airadigm Communs., Inc. v. FCC (In re Airadigm)*, 519 F.3d 640, 657 (7th Cir. 2008); *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694, 702 (4th Cir. 1989); *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2022); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636 (2d Cir. 1988.); *Gillman v. Cont’l Airlines (In re Cont’l Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000); *SE Prop. Holdings, LLC v. Seaside Eng’g & Surveying (In re Seaside Eng’g & Surveying)*, 780 F.3d 1070 (11th Cir. 2015); *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 760 (5th Cir. 1995); *In re W. Real Est. Fund*, 922 F.2d 592, 602 (10th Cir. 1990); see also e.g., *In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021) (discussing the various Circuits which grant nonconsensual third-party releases and effectively bind dissenting creditors), *vacated*, 635 B.R. 26 (S.D.N.Y. 2021), *rev’d in part sub nom.*, *Purdue Pharma, L.P. v. City of Grande Prairie*, 69 F.4th 45 (2d Cir. 2023), *cert. granted sub nom.*, *Harrington v. Purdue Pharma, L.P.*, No. 23-124, 2023 WL 5116031 (Aug. 10, 2023).

¹² *In re Purdue Pharma L.P.*, 635 B.R. at 82.

effectively being extended to grant release to non-debtor third parties who have not filed bankruptcy petitions of their own.¹³ Nonconsensual releases operate under the theory that the reorganization plan cannot succeed without the releases—if the minority had the option to opt out of the releases, then that would make clear that the releases were not “necessary” to the plan.¹⁴ Nonconsensual releases place impaired classes in a vice. If the parties otherwise favor the plan and want to reap the benefits of the debtor’s reorganization, they have no choice but to assent to releasing their rights to claims against related non-debtor third parties. Even if they deny the plan because of the third-party release provision, they will still be bound to release their claims if a majority affirmatively votes for the Plan. Herein lies the crux of the debate— should the majority be allowed to bind the minority in regards to their individual non-debtor claims through a bankruptcy process that the non-debtor has not subjected itself to?

There is arguably no bigger gap in the Code than the lack of express guidance on nonconsensual third-party releases. The federal circuit courts are split on the permissibility of such releases and offer varying interpretations of the Bankruptcy Code to justify their positions. A few circuits interpret § 524(e) literally and hold that discharge is strictly limited to the debtor.¹⁵ Other circuits rely on the equitable powers conferred upon bankruptcy courts under § 105(a) to grant any ‘necessary or appropriate’ order to carry out the provisions of the Bankruptcy code—nonconsensual third-party releases are accordingly permissible per the bankruptcy court’s discretion.¹⁶

B. Pre-Code Guidance Suggests that Nonconsensual Third-Party Releases are Impermissible Under the Code

Where statutory gaps and ambiguity exist in the Code, the Supreme Court has instructed courts and practitioners to rely on pre-Code guidance.¹⁷ The precursor to § 105(a) is § 2a(15) of the 1898 Act; § 105(a) contains analogous language and functionally grants bankruptcy courts the

¹³ See § 1129(b); *In re Mallinckrodt PLC*, 639 B.R. 837, 855 (Del. B.R. 2022).

¹⁴ See *In re Boy Scouts of Am.*, 642 B.R. 504, 596 (Bankr. D. Del. 2022) (debtors contended that the releases were “necessary” to successful reorganization because they were so intertwined with the contributions that without them, settlement could not have been achieved).

¹⁵ *Feld*, 62 F.3d at 760; *In re W. Real Est. Fund*, 922 F.2d at 602.

¹⁶ 11 U.S.C. § 105(a); *Airadigm Commc’ns Inc.*, 519 F.3d at 657.

¹⁷ *Kelly v. Robinson*, 479 U.S. 36, 53 (1986); *Pa. Dep’t of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990).

same equitable discretion that § 2a(15) did.¹⁸ One of the seminal cases discussing the authority conferred upon bankruptcy courts through § 2a(15) is *Continental Illinois National Bank v. Chicago, Rock Island & Pacific Railway Co.*¹⁹ This case has been cited as support for the assertion that bankruptcy courts are courts of equity and are thus authorized to grant nonconsensual third-party releases where they deem such releases necessary to the reorganization.²⁰ *Continental Illinois*' instruction does not reach that far. While it is true that *Continental Illinois* established bankruptcy courts as courts of equity,²¹ *Continental Illinois* does not stand for the presumption that this equitable power can be imposed outside of the scope of the debtor's reorganization. On the contrary, *Continental Illinois* specifically states that the extent of this equitable authority is limited to making orders as necessary to enforce the Act and enable a reorganization."²² One cannot infer that discharge of non-debtors is 'necessary' to a reorganization—*Continental Illinois* never contemplated such a concept and neither did subsequent pre-Code case law which cited to that decision.²³

Other pre-Code cases have also echoed this principle²⁴—alteration of a non-debtor's liability is not necessary to a debtor's reorganization;²⁵ alteration of a non-debtor's liability does not interfere with the debtor's assets;²⁶ § 2a(15) cannot be used to grant relief to non-debtors who have not subjected themselves to the bankruptcy process.²⁷ Pre-Code case law simply did not contemplate the concept of third-party releases and does not provide support for them.

¹⁸ Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 32 (2006); 1 COLLIER ON BANKRUPTCY § 2(15), at 327–39 (14th ed. 1976); 11 U.S.C. § 105(a).

¹⁹ 294 U.S. 648 (1935).

²⁰ See *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 68 B.R. 618, 625 (Bankr. S.D.N.Y. 1986).

²¹ See *Cont'l Ill. Nat'l Bank*, 294 U.S. at 676.

²² *Id.*

²³ See *Steelman v. All Continent Corp.*, 301 U.S. 278, 285–87 (1937) (temporarily enjoining the prosecution of a suit because it could have led to the transfer of assets away from debtor in aid of a fraudulent conspiracy—the property at issue was property of the debtor's estate and would have impacted creditor's recovery only; non-debtor discharge was not contemplated).

²⁴ See generally *In re Nine N. Church St.*, 82 F.2d 186 (2d Cir. 1936); *In re Diversey Bldg. Corp.*, 86 F.2d 456 (7th Cir. 1936).

²⁵ *In re Nine N. Church St.*, 82 F.2d at 188; *In re Diversey Bldg. Corp.*, 86 F.2d at 458.

²⁶ *In re Diversey Bldg. Corp.*, 86 F.2d at 457; *In re Nine N. Church St.*, 82 F.2d at 189.

²⁷ *In re Diversey Bldg. Corp.*, 86 F.2d at 458; see also *In re Nine N. Church St.*, 82 F.2d at 188 (holding that bankruptcy courts are exceeding the limits of their equitable power when they alter a non-debtor's liability through the use of bankruptcy tools and at the detriment of objecting creditors).

Congress did not contemplate the release of third-parties when it wrote the Code—using § 105(a) to read this substantive content right into the Code would be contrary to the purpose of Chapter 11 as Congress envisioned it.²⁸ The Supreme Court echoed this sentiment in *Law v. Siegel*.²⁹ In *Law*, the Supreme Court discussed the broad equitable powers of § 105(a) in conjunction with § 524(e), a more specific provision of the Code which had set forth a “number of carefully calibrated exceptions and limitations.”³⁰ The Supreme Court held that it is “hornbook law that § 105(a) ‘does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.’”³¹ While § 105(a) grants bankruptcy courts authority to “carry out” provisions of the Code, bankruptcy courts may not “contravene specific statutory provisions” in exercising this equitable power.³² The Supreme Court concluded that bankruptcy courts are not authorized to create other additional exceptions; doing so would undermine Congress’s “meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions” within the Code.³³

The Court has not yet determined whether a use of §105(a) equitable powers to discharge the debt of non-debtor parties, like the Sacklers, over the objection of the debtor’s creditors, is a permissible application of the provision. However, a reading of § 105(a), bearing the above statutory interpretation principles in mind, leads to the conclusion that § 105(a) cannot be the basis for authority to grant nonconsensual third-party releases. In order to remain consistent with its previous stance, the Supreme Court should find that nonconsensual third-party releases are an impermissible abuse of the Bankruptcy Code.

²⁸ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 98 (Bankr. S.D.N.Y. 2021) (explaining that Section 105(a) does not allow the bankruptcy court “to create substantive rights that are otherwise unavailable under applicable law”(quoting *Deutsche Bank AG v. Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d Cir. 2005))), *rev’d in part sub nom*, *Purdue Pharma, L.P. v. City of Grande Prairie*, 69 F.4th 45 (2d Cir. 2023), *cert. granted sub nom*, *Harrington v. Purdue Pharma, L.P.*, 216 L. Ed. 2d 1300 (2023).

²⁹ 571 U.S. 415 (2014); *accord Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451 (2017).

³⁰ *Law*, 571 U.S. at 424.

³¹ *Id.* at 421 (quoting 2 COLLIER ON BANKRUPTCY ¶ 105.01[2], at 105–06 (16th ed. 2013)).

³² *Id.*

³³ *Id.* at 424.