Supreme Court Invalidates Nonconsensual Third-Party Releases In Bankruptcy

On June 27, 2024, the Supreme Court issued its long-awaited decision in *Harrington v. Purdue Pharma L.P.* and in so doing resolved one of the most significant and contentious questions of modern bankruptcy law. At issue in *Purdue* was whether a court may approve, as part of a chapter 11 debtor's plan of reorganization, the nonconsensual release of claims held by non-debtor third parties against other non-debtor third parties. Such releases—known in bankruptcy parlance as "nonconsensual third-party releases"—have been a longstanding feature of chapter 11 plans in many (but not all) circuits, particularly in the mass tort context, where parties with exposure to liability for the debtor's conduct have sought to settle and discharge potential claims under the auspices of the debtor's bankruptcy proceedings. In *Purdue*, the Supreme Court put an end to this practice (other than with respect to asbestos liabilities), holding by a 5-4 vote that the Bankruptcy Code does not authorize courts to release claims against non-debtors held by third parties without those third parties' consent.

I. Nonconsensual Third-Party Releases and the Purdue Plan

Faced with thousands of lawsuits arising from its role in abetting the nationwide opioid epidemic, Purdue Pharma filed for chapter 11 in 2019. Purdue's bankruptcy proceedings focused in significant part on the settlement of claims held by the Purdue estate against Purdue's longtime owners, the Sackler family. Those claims arose from, among other things, the Sackler family's withdrawal of some $11 billion from Purdue in the years preceding its collapse. To settle those claims, the Sacklers proposed to return to Purdue's bankruptcy estate $4.325 billion (later increased to $5.5 – $6 billion), which would be used to compensate opioid victims and their families, as well as to fund various opioid abatement initiatives. In exchange for that sum, the Sacklers sought a release not only of any claims held by Purdue's bankruptcy estate against the Sacklers, but also of any opioid-related claims against the Sacklers that had been or in the future could be asserted by third parties, regardless of whether those parties consented to the release of their claims. Purdue accordingly included in its plan of reorganization a broad release of all opioid-related claims against the Sacklers. The plan was overwhelmingly supported by creditors; by the time the case reached the Supreme Court, the principal objectors were the United States Trustee, a handful of Canadian creditors, and a lone individual.

II. The Court's Decision in *Purdue*

The Court began its decision by describing what it called the "simple bargain" that lies at the heart of the bankruptcy system: "A debtor can win a discharge of its debts if it proceeds with honesty and places virtually all of its assets on the table for its creditors." The Sacklers, the Court noted, have not filed for bankruptcy, but nevertheless procured an order "extinguishing the vast numbers of existing and potential claims against them . . . without securing the consent of those affected or placing anything approaching their total assets on the table for their creditors." The question facing the Court was therefore "whether a court in bankruptcy may effectively extend to *nondebtors* the benefits of a Chapter 11 discharge usually reserved for *debtors*." The Court concluded that it may not.

The Court based its decision on section 1123(b) of the Bankruptcy Code, which lists certain things that a plan of reorganization "may" do (section 1123(a) lists things that a plan *must* do). As the Court explained, the first five paragraphs of section 1123(b) concern the rights and responsibilities of the debtor and its relationship with its creditors; for example, section 1123(b)(3)(A) provides that a plan of

reorganization may "provide for . . . the settlement or adjustment of any claim or interest belonging to the debtor or to the estate." Those five paragraphs are followed by a catch-all provision, section 1123(b)(6), which provides that a plan of reorganization may "include any other appropriate provision not inconsistent with the applicable provisions of this title." Because none of the five preceding paragraphs of section 1123(b) concerns the release of claims against nondebtors held by third parties, the majority of the Court concluded that the authority (if any) to provide for such a release could only be found in the catch-all provision. Construing that provision in light of its surrounding context and the specific examples preceding it (all of which, as noted, concern the debtor), the Court concluded that "the catchall cannot be fairly read to endow a bankruptcy court with the . . . power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants."

Per the Court, that conclusion followed not only from section 1123(b) but also from other provisions of the Bankruptcy Code that the Court deemed inconsistent with the releases at issue. First, the Court noted that a bankruptcy discharge bars suits and collection efforts against *the debtor* and does not affect the liability of third parties. The proposed releases, however, would "defy these rules by effectively affording to a nondebtor a discharge usually reserved for debtors." Second, the Court explained that a bankruptcy discharge requires the debtor to put virtually all of its assets towards satisfying creditor claims and that certain claims—such as for actual fraud and willful and malicious injury—are exempt from discharge. Yet under the Purdue plan, the Sacklers were slated to receive near-comprehensive releases encompassing claims that could not be discharged in bankruptcy, and without making anywhere near their total assets available to satisfy the claims against them. Finally, the Court noted that the Bankruptcy Code expressly authorizes nonconsensual third-party releases in the specific context of asbestos-related bankruptcies, "mak[ing] it all the more unlikely that § 1123(b)(6) is best read to afford courts that same authority in *every* context."

The Court stated that its holding was limited to the particular circumstances of the case before it. Accordingly, the Court made clear that its decision did not affect the validity of *consensual* third-party releases, and it declined to address "whether our reading of the bankruptcy code would justify unwinding reorganization plans that," unlike Purdue's, "have already become effective and been substantially consummated." But despite this attempt to cabin the scope of its decision, the Court's invalidation of nonconsensual third-party releases marks a sea-change in bankruptcy jurisprudence with far-reaching implications.

III. Implications for Bankruptcy Jurisprudence and Practice

The Court's decision in *Purdue* promises to have significant ramifications for the future of bankruptcy law. Among other things, the Court's decision may:

- Put pressure on Congress to find a solution for mass tort cases, including amending Bankruptcy Code section 524(g) to expand the universe of mass tort claims subject to nonconsensual releases beyond asbestos claims. The availability of nonconsensual third-party releases made bankruptcy an attractive venue for attempting to resolve mass tort cases, as third parties with exposure to liability for the debtor's conduct (such as insurers and joint tortfeasors) could obtain releases that would bind all potential plaintiffs. Post-*Purdue*, this is no longer an option, though cases such as *Pacific Gas & Electric* (in bankruptcy) and *Aearo Technologies* demonstrate that consensus can be achieved even without nonconsensual third-party releases;

- Cause debtors to consider filing for bankruptcy outside the United States where nonconsensual third-party releases may be available, such as England, and seek to enforce such releases through ancillary proceedings brought under chapter 15—raising the question whether a U.S. court will grant comity in such circumstances;

- Cause courts to examine with greater rigor the common practice of exculpating nondebtors who assisted the debtor's reorganization efforts, including officers, directors, professionals, and members of statutory committees, by parties who assert they have direct claims against such parties that cannot be released without their consent;

- Fuel litigation over the scope of "derivative" claims in bankruptcy (*i.e.*, claims that belong to the bankruptcy estate under section 541 of the Bankruptcy Code), as the decision reaffirmed the authority of courts to release derivative claims against third parties; while this issue is often governed by state law, claims that interfere or compete with powers granted to the bankruptcy estate or that are shared universally by all creditors are often deemed to be derivative as a matter of federal law;

- Affect the willingness of courts to grant temporary extensions of the automatic stay to nondebtors, as litigants may cite *Purdue* for the broad proposition that the Bankruptcy Code's explicit protections for debtors should not be extended to nondebtor third parties;

- Lead courts to require a higher showing of consent (such as requiring claimants to affirmatively opt-in to plan releases) before approving "consensual" releases contained in plans of reorganization; and

- Put an end to the so-called "Texas Two-Step" approach to managing mass tort liability. In the typical Texas Two-Step, a company pursues a divisional merger under Texas law whereby it places all of its assets into one entity and isolates its tort liabilities into another. The entity holding the liabilities then files for chapter 11, typically with an agreement in place for the non-filing entity to fund the filing entity's bankruptcy and settlement of the tort claims against it. In some cases, courts have enjoined lawsuits against the applicable nondebtor entity to facilitate the reorganization of the debtor and the settlement all claims that could be asserted against the debtor or its affiliates. Other courts have dismissed these bankruptcy cases for cause. Though *Purdue* does not directly address the "Texas Two-Step" approach, the likely end goal of any "Texas Two Step" is to confirm a plan with nonconsensual third-party releases. This practice may not survive *Purdue* given the Court's instruction that relief amounting to a bankruptcy discharge is exclusively reserved for debtors.

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