BANKRUPTCY – THIRD-PARTY RELEASES

The United States Court of Appeals for the Second Circuit held that the bankruptcy code grants bankruptcy courts authority to approve a Chapter 11 plan that contains non-consensual third-party releases of direct claims against non-debtors. Also, the Second Circuit reaffirmed a seven-factor test that courts should consider before approving a plan containing non-consensual third-party releases of direct claims against a non-debtor. *In Re Purdue Pharma L.P.*, 69 F.4th 45 (2d Cir. 2023).

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In *In Re Purdue Pharma L.P.*, the Second Circuit addressed whether the bankruptcy code (the "Code") grants bankruptcy courts the authority to confirm a Chapter 11 plan containing non-consensual releases of third-party direct claims against non-debtors. The mechanics of such releases, which have become more commonplace in mega-bankruptcies spurred by mass tort liability, allow a party who has not entered bankruptcy proceedings, to use a bankruptcy debtor to shield themselves from liability.[1]

Bankruptcy Court Proceedings

On September 15, 2019, Purdue Pharma L.P. and its related entities (the "Debtor") declared bankruptcy in the Southern District of New York. Crucially, Purdue Pharma's owners, the Sackler family (the "Sacklers"), did not declare bankruptcy.[2] On September 17, 2021, the bankruptcy court confirmed a modified version of Debtor's proposed plan (the "Plan"), which included a $4.325 billion contribution to the Debtor's estate by the Sacklers in exchange for non-consensual releases ("Releases") that "permanently enjoined certain third-party claims against the Sacklers."[3] The bankruptcy court modified the Releases, narrowing the language to only enjoin third-party claims where the Debtor's conduct was "a legal cause or is otherwise a legally relevant factor" of any released action against the Sacklers."[4] Before confirming the Plan, the bankruptcy court considered whether the modified Plan was equitable and whether the bankruptcy court had statutory authority to permit non-consensual third-party releases.

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[1] James Nani, *Sacklers' Fate at Supreme Court Poised to Reshape Bankruptcy Law*, BLOOMBERG LAW (Aug. 11, 2023, 1:47 PM), https://news.bloomberglaw.com/business-and-practice/sacklers-fate-at-supreme-court-poised-to-reshape-bankruptcy-law?utm_source=rss&amp%3Butm_medium=BUNW&amp%3Butm_campaign=00000189-e119-db22-afbb-f1dffd4c0001.

[2] *In Re* Purdue Pharma L.P., 69 F.4th 45, 60 (2d Cir. 2023).

[3] *Id.* at 61–62.

[4] *Id.* at 61.

Was the confirmed Plan equitable?

The bankruptcy court determined the confirmed Plan's terms were equitable under a factor test from *In re Iridium Operating LLC,* 478 F.3d 452 (2d Cir. 2007)..[5] The bankruptcy court stressed the near unanimous approval of the Plan,[6] the potential difficulty in collecting from the Sacklers and their related entities if the Plan did not include the Releases,[7] that continued litigation would lead to extensive escalation of costs and time,[8] and that, since the DOJ had a superpriority claim to $2 billion from the Debtor's estate, the contributed funds from the Sacklers were crucial to allow any meaningful recovery.[9]

Did the bankruptcy court have statutory authority to approve the Releases?

The bankruptcy court addressed its own statutory authority to enjoin third-party claims against a non-debtor. First, the bankruptcy court concluded it had subject matter over the Releases[10] and that no due-process concerns were violated.[11] Next, the bankruptcy court relied on Code sections 105(a) and § 1123(b)(6) in holding that "[t]o properly be subject to a third-party claims release under a plan . . . the third-party claim should be premised as a legal matter on a meaningful overlap with the debtor's conduct."[12] The bankruptcy court reasoned that an absence of

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[5] *Id.* at 62. The factors included: (1) The probability of success, should the issues be litigated, versus the present and future benefits of the settlement; (2) the likelihood of complex and protracted litigation if the settlement is not approved, with its attendant expense, inconvenience and delay, including the difficulty of collecting on a judgment; (3) the interests of the creditors, including the degree to which creditors support the proposed settlement; (4) whether other interested parties support the settlement; (5) the competence and experience of counsel supporting, and the experience and knowledge of the court in reviewing, the settlement; (6) the nature and breadth of the releases to be obtained by officers and directors or other insiders; and (7) the extent to which the settlement is the product of arms-length bargaining. *In re Iridium Operating LLC*, 478 F.3d at 464–66.

[6] *Id.* (noting that over 95% of voters approved the plan).

[7] *Id.* Although the Sacklers are worth some $11 billion, they are a large family whose assets are "widely scattered and primarily held" in spendthrift trusts, which are largely unreachable in bankruptcy proceedings. *Id.* at 63.

[8] *Id.* at 62. The estate of the Debtors was estimated at approximately $1.8 billion, while the claims against the Debtors and the Sacklers were estimated at more than $40 trillion. *Id.* at 60.

[9] *Id.* at 63.

[10] *In re* Purdue Pharma L.P. ("Purdue I"), 633 B.R. 53, 95–98 (Bankr. S.D.N.Y. 2021).

[11] *In Re Purdue Pharma L.P.*, 69 F.4th at 64.

[12] *Purdue I*, 633 B.R. at 105.

overlap between the third-party claims and the Debtor's conduct would leave the Releases "too broad" and encompass "closely related, though independent, claims."[13] As such, by narrowing the Releases and creating meaningful overlap, the bankruptcy court concluded it acted within its authority when confirming the Plan.

Still, the bankruptcy court sought to ensure the Releases were appropriate for the Plan. Looking to *In re Metromedia Fiber Network, Inc.*[14] and other case law, the bankruptcy court considered six factors in its determination that the Releases were appropriate:

> (1) the third-party releases were narrowly tailored; (2) monetary contributions were critical to the Plan; (3) the success of the Plan hinged on the third-party releases; (4) the affected class of classes overwhelmingly accepted the Plan; (5) the amount being paid under the Plan was substantial; and (6) claimants would be compensated fairly under the Plan.[15]

In justifying the appropriateness of the Releases, the bankruptcy court relied on the "significant overlap in third-party claims against both the Debtors and the Sacklers," the "potential difficulty in collecting on any judgment," the "existence of spendthrift trusts," and the "Estate's limited resources that litigation would likely deplete."[16] Ultimately, the bankruptcy court confirmed the Plan.

District Court Proceedings

On December 16, 2021, the Southern District of New York vacated the bankruptcy court's confirmation of the Plan. The Southern District of New York held that bankruptcy courts do not hold statutory authority to permit third-party releases such as the ones found in the Plan.[17] The district court's principal reasons for vacating the Plan's confirmation were the Code's failure to expressly allow third-party releases and that the no case from the Second Circuit has located authority in the Code to grant such third-party releases.[18]

Although the district court agreed the bankruptcy court had subject matter jurisdiction over all claims that "might have some

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[13] *Id.*

[14] 416 F.3d 136, 105–09 (2d Cir. 2005)

[15] *In Re Purdue Pharma L.P.*, 69 F.4th at 64 (citing *In re Metromedia Fiber Network, Inc.,* 416 F.3d at 105–09).

[16] *In Re Purdue Pharma L.P.*, 69 F.4th at 64–65.

[17] *In re* Purdue Pharma, L.P. ("Purdue II"), 635 B.R. 26, 89–90 (S.D.N.Y. 2021).

[18] *In Re Purdue Pharma L.P.*, 69 F.4th at 65–66.

conceivable effect on the estate of the debtor,"[19] the district court disagreed that the bankruptcy court had statutory authority to release third-party direct claims against the Sacklers because "the Sacklers were not the Debtors, and the Bankruptcy Code does not authorize the 'non-consensual' release of 'direct/particularized claims asserted by third parties against non-debtors.'"[20]

Further, the district court observed that the Second Circuit's holding in *Metromedia* was inconclusive on whether such third-party releases are "consistent with or authorized by the Bankruptcy Code."[21] While the district court has interpreted the language of *Metromedia* to find third party releases permissible, the Second Circuit failed to identify "unique instances" where such releases would be permissible.[22] As such, the district court found the Second Circuit's position lacked the clarity to be dispositive on the issue.[23]

Looking beyond the Second Circuit, the district court noted that the Supreme Court has yet to rule directly on whether the Code provides authority for third-party releases.[24] Even so, the Supreme Court has held that "a bankruptcy court lacks the power to award relief that varies or exceeds the protections in the Bankruptcy Code," and that bankruptcy courts lack power to award such relief "even in 'rare' cases, and [ ] even when those orders would help facilitate a particular reorganization."[25]

Ultimately, the district court vacated the Plan's confirmation, holding that the Code fails to vest statutory authority in bankruptcy courts to grant third-party releases[26] and the Second Circuit has not held otherwise. The district court further rejected the notion that a "bankruptcy court possess[es] residual equitable authority to impose the [third-party] [r]eleases" and that the bankruptcy court did not hold the authority to approve the Plan with the Releases even though the Releases

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[19] *In Re Purdue Pharma L.P.*, 69 F.4th at 66. The district court agreed that bankruptcy court had subject-matter jurisdiction over the claims because: "(1) the third-party claims raised questions as to the distribution of the Estate's property, (2) the third-party claims might have altered the liabilities of the Debtors and changed the amount available to the *res*, (3) the claims had a high degree of interconnectedness with claims against the Debtors, and (4) Purdue's insurance obligations to members of the Sacklers who were officers of Purdue could have burdened the *res*." *Id.* (citing *Purdue II*, 635 B.R. at 85–89).

[20] *In Re Purdue Pharma L.P.*, 69 F.4th at 66 (citing *Purdue II*, 635 B.R. at 101).

[21] *In Re Purdue Pharma L.P.*, 69 F.4th at 66.

[22] *Id.*

[23] *Id.*

[24] The Supreme Court has taken up this appeal. Oral Arguments are schedule to take place in December 2023 with a ruling expected in sometime in 2024.

[25] *In Re Purdue Pharma L.P.*, 69 F.4th at 66 (quoting *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 94–96).

[26] *Id.*

were required for the Plan's confirmation.[27] The district court's ruling was appealed to the Second Circuit.

Second Circuit Proceedings

Before the appeal was heard, eight states and the District of Columbia ("Nine") appealed the confirmation of the original Plan, prompting the Sacklers to contribute an additional $1.175-$1.675 billion to the Debtor's estate.[28] The bankruptcy court granted the motion to confirm the revised Plan, but noted that ultimate confirmation would require orders from either the district court or the Second Circuit.[29] This new settlement agreement caused the Nine to withdraw their opposition to the Plan, leaving only the U.S. Trustee, several Canadian municipalities and indigenous nations, and several individual *pro se* claimants to defend the district court's holding before the Second Circuit.[30]

The Second Circuit applied the *de novo* standard of review for conclusions of law from the bankruptcy court and indicated the Second Circuit may uphold a bankruptcy court decision on any ground.[31] The two primary points on appeal were "(1) whether the bankruptcy court had the authority to approve the nonconsensual releases of direct third-party claims against the Sacklers, a non-debtor, through the Plan; and (2) whether the text of the Bankruptcy Code, factual record, and equitable considerations support the bankruptcy court's approval of the Plan."[32] The Second Circuit answered both questions in the affirmative, awarding a win to the Debtor and the Sacklers.

Were the Releases within the scope of claims a bankruptcy court may enjoin?

A bankruptcy court holds authority to approve consensual third-party releases and third-party releases of derivative claims since these claims "really belong to the estate of the debtor."[33] However, since the Plan enjoins a mixture of direct and derivative claims the Plan stands to releases some direct claims against Sacklers.[34]

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[27] *Id.* at 67 (citing *Purdue II*, 635 B.R. at 101–02).
[28] *Id.*
[29] *Id.* at 68.
[30] *Id.*
[31] *In Re Purdue Pharma L.P.*, 69 F.4th at 69.
[32] *Id.*
[33] *Id.* at 70.
[34] *Id.* at 69–70.

Direct claims are "causes of action brought to redress a direct harm to a plaintiff caused by a non-debtor third party, whereas derivative claims are "ones that arise from harm done to the estate and that seek relief against [the] third part[y] that pushed the debtor[s] into bankruptcy."[35] For example, a deceptive marketing claim is a direct claim against the Sacklers since deceptive marketing caused direct harm to a plaintiff, whereas a claim of fraudulent transfer would be a derivative claim since fraudulently transferring assets out of the Debtor's estate caused harm to the debtor's estate.

Section 524 of the Code grants bankruptcy courts authority to release claims through its power to discharge a debtor from personal liability for any debt.[36] This discharge enjoins creditors from pursuing collection on a discharged debt if the debtor has provided "all its financial information and puts those assets towards its estate."[37] Interestingly, Section 524(e) of the Code states that, "[e]xcept as provided in subsection (a)(3) of this section, 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." Thus, Section 524(e) appears to forbid the types and scope of the Releases sought by the Sacklers. However, the Second Circuit distinguished the Releases, reasoning they do not provide "umbrella protection against liability nor extinguish all claims" against the Sacklers.[38]

As such, the Second Circuit concluded the scope of the Releases was sufficiently limited to bring the Releases within the authority of the bankruptcy court. Thus, the principal dispute before the Second Circuit is whether a bankruptcy court holds the statutory authority to release direct claims against non-debtors for which the non-debtor's conduct is legally relevant. The Second Circuit answered in the affirmative following an analysis of the bankruptcy court's subject matter jurisdiction over the released claims and whether the text of the Code provided the bankruptcy court authority to approve the Releases.

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[35] *Id.* at 70 (quoting Marshall v. Picard (*In re* Bernard L. Madoff Inv. Secs. LLC), 740 F.3d 81, 89 (2d Cir. 2014)). The Court noted the potential claims against the Sacklers include both direct and derivative claims. "The potential claims released against the Sacklers include, inter alia, fraudulent transfer, constructive fraudulent transfer, deceptive marketing, public nuisance, unfair competition, fraudulent misrepresentation, violation of state consumer protection acts, civil conspiracy, negligence, and unjust enrichment." *Id.*

[36] *In Re Purdue Pharma L.P.*, 69 F.4th at 70.

[37] *Id.* (citing 11 U.S.C. § 524).

[38] *Id.* at 71.

Did the bankruptcy court have subject matter jurisdiction over the Releases?

A bankruptcy court's jurisdiction under the Code is broad – but there are limits. One of which being third-party non-debtor claims that do not directly affect the *res* of the bankruptcy estate.[39] In analyzing whether the third-party claims against non-debtors directly affected the *res* of the Debtor, the Second Circuit observed that litigation of direct claims against the Sacklers would "surely impair the bankruptcy court's ability to make a fair distribution of the [Debtor's] assets" since such litigation "would almost certainly result in the drawing down of . . . the [Debtor's] estate."[40] Thus, any recovery from the *res* of the Debtor's estate would be greatly diminished by direct claims against the Sacklers.

In its explanation, the Second Circuit first pointed out that the direct third-party claims against the Sacklers share "substantial overlap" with derivative claims the Debtor's estate might bring against the Sacklers.[41] Because of this substantial overlap, the Second Circuit believed the litigation of the direct claims against the Sacklers may impact the Debtor's ability to pursue and recover the Debtor's estate's derivative claims against the Sacklers.[42]

Second, the Second Circuit noted that an indemnification agreement between the Debtor and the Sacklers would drain the estate if the non-debtors prevail in their claims against the Sacklers.[43] This indemnity agreement contained a carve-out to bar indemnification of the Sacklers if the Sacklers failed to act in "good faith," however, "the question of bad faith in this case is hotly disputed."[44]

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[39] *Id.* (citing Johns-Manville Corp. v. Chubb Indemnity Ins. Co. ("Manville III"), 517 F.3d 52, 66 (2d Cir. 2008)).

[40] *Id.* (citing Pfizer Inc. v. Law Offices of Peter G. Angelos (*In re* Quigley Co.), 676 F.3d 45, 57 (2d Cir. 2012).

[41] *Id.* at 71–72.

[42] *In Re Purdue Pharma L.P.*, 69 F.4th at 72.

[43] *Id.* The Sackler-Purdue Indemnity Agreement was executed in 2004 by Purdue's Board of the Directors. The Board "voted to indemnify Purdue's directors and officers against claims made in connection with their service to the company." *Id.* at 58. Protections under this agreement were "expansive and had no immediate time limit." *Id.* at 59.

[44] *In Re Purdue Pharma L.P.*, 69 F.4th at 72 (quoting *Purdue II*, 635 B.R. at 88). At first glance, this "good-faith" backstop appears to provide meaningful limits to the Sackler-Purdue Indemnity Agreement. In 1995, directly following its approval by the FDA, OxyContin was marketed as posing a low risk for addiction; however, "[s]tarting in 2000, state governments began to alter Purdue to widespread abuse of OxyContin, and, in 2001, the FDA required Purdue to remove from its label that OxyContin had a low risk of addiction." *Id.* at 58. In 2007, internal emails show that Sackler family members began anticipating litigation against Purdue, and possibly themselves. Between 2008 and 2016,

Ultimately, the Second Circuit determined that the impact of the non-debtor claims and the Sackler-Purdue Indemnity Agreement "*might have* any conceivable effect on the bankrupt's estate," bringing the Releases within the subject matter jurisdiction of the bankruptcy court.[45]

Does a bankruptcy court have statutory authority to release third-party claims?

Turning to the question of whether the Code grants the bankruptcy court statutory authority to approve third-party releases, the Second Circuit relied on Sections 105(a) and 1123(b)(6) of the Code and caselaw from the Second Circuit to answer in the affirmative.

Do Sections 105(a) and 1123(b)(6) of the Code grant authority?

The Second Circuit agreed with the bankruptcy court and held that reading Sections 105(a) and 1123(b)(6) in conjunction grant the bankruptcy court authority to approve the Releases.[46] Section 105(a) states, "[t]he court may issue *any* order, process, or judgement that is necessary or appropriate to carry out the provisions of [the] Bankruptcy Code."[47] Similarly, Section 1123(b)(6) states, "a plan may . . . include *any* other appropriate provision not inconsistent with the applicable provisions of this title."[48] The Second Circuit determined that Sections 105(a) and 1123(b)(6) implicitly grant a bankruptcy court the authority to include third-party releases against non-debtors in a plan – that is, explicit authority is not needed.[49]

Although Section 105(a) appears to grant bankruptcy courts broad discretion to do seemingly whatever is needed to approve a plan, the Second Circuit notes that its circuit precedent holds that Section 105(a) alone fails to justify third-party releases.[50] Undeterred, the Second Circuit cited to *United States v. Energy Resources Co. Inc.,*[51] a case where the Supreme Court held that Section 105(a), working in conjunction with Section 1123(b)(6), grants bankruptcy courts "a '*residual authority*' consistent with 'the traditional understanding that bankruptcy courts, as courts of equity,

Purdue distributed approximately $11 billion to Sackler family trusts and holding companies. *Id.* at 59.

45 *Id.* (citing SPV Osus Ltd. V. UBS AG, 882 F.3d 333, 339–40 (2d Cir. 2018) (emphasis added by Second Circuit).

46 *In Re Purdue Pharma L.P.*, 69 F.4th at 72–73.

47 11 U.S.C. § 105(a) (2019) (emphasis added).

48 11 U.S.C. § 1123(b)(6) (2019) (emphasis added).

49 *In Re Purdue Pharma L.P.*, 69 F.4th at 73.

50 *Id.* The Court cited Second Circuit, Fifth Circuit, Eight Circuit, and Third Circuit cases noting that Section 105(a) must be "linked" or "tied" to another Section in the Code. *In Re Purdue Pharma L.P.*, 69 F.4th at 73.

51 495 U.S. 545 (1990).

have broad authority to modify creditor-debtor relationships."[52] The Second Circuit supports this analysis by noting that Section 1123(b)(6) is "limited only by what the Code expressly forbids, not what the Code explicitly allows."[53] Further, cases from the Sixth and Seventh Circuits support that Section 1123(b)(6) grants bankruptcy courts the power to permit third-party releases.[54]

Does Section 524(e) limit authority to grant third-party releases?

Section 524(e) of the Code sits as a possible roadblock to the Plan's confirmation, which limits the reach of a bankruptcy court's power to impose discharges. Section 524(e) states, "except as provided in subsection (a)(3) of this section, 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."[55]

Circuits are split on whether Section 524(e) prevents third-party releases. Some Circuits hold that Section 524(e) prevents third-party releases on grounds that, "the debtor[ ] . . . has invoked and submitted to the bankruptcy process, that [debtor] is entitled to its protections" and that "Congress did not intend to extend such benefits to third-party bystanders."[56] In opposition to this, the Second Circuit does not view Section 524(e) as a bar on third-party releases, but instead notes that Congress' selection of prepositional phrasing ("on, or . . . for, such debt"), in lieu of mandatory words (such as "shall" or "will"), is evidence that Congress did not intend to limit Section 524(e)'s power to release a third-party non-debtor.[57] As such, the Second Circuit declined to recognize that Section 524(e) prevents bankruptcy courts in its jurisdiction from using Sections 105(a) and 1123(b)(6) as sound statutory authority to impose third-party releases.

Does Second Circuit case law recognize statutory authority to impose third-party releases?

The Debtor and the Sacklers argued that case law from the Second Circuit holds that third-party releases are allowed in appropriate

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[52] *In Re Purdue Pharma L.P.*, 69 F.4th at 73. (citing *Energy Resources Co. Inc.*, 495 U.S. at 549) (emphasis added by the Second Circuit).
[53] *Id.* at 74.
[54] *Id.*
[55] 11 U.S.C. § 524(e) (2019).
[56] *In Re Purdue Pharma L.P.*, 69 F.4th at 74 (citing *In re* W. Real Estate Fund, Inc., 922 F.2d 592, 600-02 (10th Cir. 1990)) (quoting 11 U.S.C. § 524(e)).
[57] *Id.* at 74–75. (citing Airadigm Commc'ns, Inc. v. FEC (*In re* Airadigm Commc'ns, Inc.), 519 F.3d 640, 656 (7th Cir. 2008)).

circumstances, but Appellees argued that third-party releases have never been appropriate in non-asbestos cases in the Second Circuit.[58]

The Second Circuit agreed with the Debtor and the Sacklers, citing its opinion in *Drexel*, saying, "[i]n bankruptcy cases, a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtors reorganization plan."[59] To further support its position, the Court discusses two cases: *Manville I*[60] and *Metromedia*.

Manville I

In *Manville I*, insurers of Manville, a bankrupt distributor of asbestos products, provided a $770 million settlement to Manville's estate in exchange for third-party releases similar to the Releases sought by the Sacklers. The Second Circuit concluded that the releases in *Manville I* were not necessarily impermissible discharges because they failed to provide the insurers the "umbrella protection of a discharge" and "did not extinguish the claims against the insurer, but rather channeled [the claims] away from the insurers and redirected them to the proceeds of the settlement."[61] The Second Circuit noted that the rights of the insurers were inseparable from the debtor's rights – which put the released claims squarely in the jurisdiction of the bankruptcy court.[62]

The Second Circuit pointed to the fact that the *Manville I* opinion leaned on Section 105(a)[63] and that releasing the third-party insurer by way of a settlement to the estate was "essential" to a "workable reorganization."[64] The Second Circuit observed that even though *Manville I* is an asbestos case, the premise still stands that bankruptcy courts in the Second Circuit may confirm plans with third-party releases.[65]

Appellees argued that using an asbestos case to justify third-party releases is inapplicable because the Code expressly authorizes third-party releases in asbestos cases under Section 524(g). Appellees reasoned that had Congress intended for third-party releases to be available, it would have expressly granted this power to extend outside asbestos cases.[66] In response, the Second Circuit noted that when the pertinent asbestos

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[58] *Id.* at 75.
[59] *Id.* (citing *In re* Drexel Burnham Lambert Group, Inc. ("Drexel"), 960 F.2d 285, 293 (2d Cir. 1992).
[60] MacArthur Co. v. Johns-Manville Corp. ("Manville I"), 837 F.2d 89, 92–93 (2d Cir. 1988).
[61] *In Re Purdue Pharma L.P.*, 69 F.4th at 75.
[62] *Id.* (quoting *Manville I*, 837 F.2d at 92-93).
[63] *Id.*
[64] *Id.* at 76. (citing *Manville I* at 94).
[65] *Id.*
[66] *Id.*

language was added to Section 524(g) through the Bankruptcy Reform Act of 1994, it was premised that the added language should not "be construed to modify, impair, or supersede any other authority the [bankruptcy] court has to issue injunctions in connection with an order confirming the plan."[67] As such, the Second Circuit refused to conclude that Section 524(g) confines third-party releases are confined to asbestos cases.

Metromedia

In *Metromedia*, certain non-debtor directors and officers of a fiber optics company "'received[d] a full and complete release, waiver and discharge from . . . any holder of a claim of any nature . . . arising out of or in connection with any matter related to' Metromedia or its subsidiaries."[68] Although third-party releases were rejected in *Metromedia*, the Second Circuit pointed out that this was due to "insufficient fact findings, and not because [the Second Circuit] found that such releases would not ever be approved."[69] The Second Circuit made clear in *Metromedia* that, while other Circuits have limited third-party releases to only asbestos cases, the Second Circuit allows such releases if "the injunction plays an important part in the debtor's reorganization plan."[70] Additionally, the Second Circuit noted that third-party releases were allowed in some circuits when the debtor's estate received substantial consideration for the releases.[71] Finally, the Second Circuit reemphasized that, for third-party releases to be approved in the Second Circuit, the releases themselves must be "important to the plan" and that the "breadth" of the releases must also be "necessary to the Plan."[72]

Seven-Factor Test for Third-Party Releases

Finally, the Second Circuit reaffirmed a seven-factor test provided in *Metromedia* that guides courts in determining whether third-party releases are appropriate for a given estate. Aware of the wide sweeping implications of its ruling in this case, the Second Circuit acknowledged the "potential . . . abuse" posed by third-party releases.[73] Further, the Second Circuit stressed that permitting third-party releases must be "imposed

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[67] *In Re Purdue Pharma L.P.*, 69 F.4th at 76.
[68] *Id.* (citing *In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 141 (2d Cir. 2005)).
[69] *Id.*
[70] *Id.* at 76–77.
[71] *Id.* at 77.
[72] *Id.* (citing *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 143).
[73] *In Re Purdue Pharma L.P.*, 69 F.4th at 77 (quoting *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 140).

against a backdrop of equity" and that even though each factor must be supported with specific and detailed findings, approval of releases is not guaranteed.[74]

1. Courts should determine whether the relationship between the debtor and non-debtor is "such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate."[75]

This factor flows from *Metromedia*, where "the enjoined claims . . . indirectly impact[ed] the debtor's reorganization by way of indemnity or contribution."[76] In its analysis, the Second Circuit observed that the Sacklers named in third-party claims were "chiefly . . . directors and officers of the Debtor" and "took a major role in corporate decision making.[77] As such, the Second Circuit determined that claims against the Sacklers were essentially claims against the Debtor and its estate.

2. Courts should consider whether claims against the debtor and non-debtor are "factually and legally intertwined" such that debtors and non-debtors "share common defenses, insurance coverage, or levels of culpability."[78]

The Second Circuit noted that the bankruptcy court sufficiently created overlap between the claims against the Debtor and non-debtors by narrowing the Releases to only include claims where the Debtor's conduct or claims against the Debtor are a legal cause or a legally relevant factor to the claim against the non-debtor seeking the Releases.[79]

3. Courts should consider whether the scope of the releases is appropriate – noting that a release is proper in scope when its "breadth" is "necessary to the Plan."[80]

The Second Circuit characterized its analysis as determining whether the Releases were "essential to the reorganization" of the

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[74] *Id.* at 79.
[75] *Id.* at 78 (citing Class Five Nev. Claimants (00-2516) v. Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002).
[76] *Id.* (citing *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 142).
[77] *Id.* at 79.
[78] *In Re Purdue Pharma L.P.*, 69 F.4th at 78.
[79] *Id.* at 80.
[80] *Id.* at 78. (citing *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 143).

Debtor.[81] The Second Circuit provided two reasons the Releases were essential. First, the Releases were needed to "ensure that the value of the *res* is settled."[82] Given the need to litigate claims brought by the Sacklers against them, such litigation would further deplete the value of the estate and limit recovery, presenting the need to fund the estate to create any possibility for worthwhile recovery.[83] Second, the Debtor's estate was valued at only $1.8 billion, and with the Department of Justice's superpriority on recovering $2 billion before any funds were distributed to other parties, the large settlement from the Sacklers would be needed to provide any relief whatsoever to opioid victims.[84]

Countering this, the Trustee argued that the Sacklers themselves created the conditions that required the Releases in the first place, and thus are undeserving of the Releases.[85] The Second Circuit makes clear it will not determine the worthiness of the Sackler's receipt of these Releases, and noted that the indemnity agreement, which agrees to pay for the defense of any action brought against the directors and officers of Purdue Pharma, was entered into well before the question of bankruptcy ever surfaced.[86] As such, the Second Circuit notes that Purdue's board did not approve the indemnity agreement with bankruptcy in mind and that the "Releases are both needed for the distribution of the *res* and to ensure the fair distribution of any recovery for claimants."[87]

4. Courts should consider whether the releases are essential to the reorganization, essentially meaning that, without the releases, "there is little likelihood of [a plan's] success."[88]

The Second Circuit's analysis under this factor is included in its discussion of Factor Three.

5. Courts should consider whether the non-debtor contributed substantial assets to the reorganization.[89]

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[81] *Id.* at 80.
[82] *Id.*
[83] *Id.*
[84] *In Re Purdue Pharma L.P.*, 69 F.4th at 80.
[85] *Id.*
[86] *Id.* at 80-81. The Indemnity Agreement was approved by Purdue's board in 2004, while Purdue filed for bankruptcy in 2019. *Id.* at 81.
[87] *Id* at 81.
[88] *In Re Purdue Pharma L.P.*, 69 F.4th at 78. (citing *In re* Master Mortgage Investment Fund, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994)).
[89] *Id.*

The Second Circuit focused on the *impact* of the Sacklers' contribution had on Debtor's estate.[90] Given that the Debtor's estate was only $1.8 billion without the addition of the Sackler's contribution, and that the Department of Justice would essentially receive all of that $1.8 billion,[91] the Second Circuit determined that the Sackler's contribution greatly impacted the estate and potential recovery available to the claimants.[92]

6. Courts should consider whether the impacted class of creditors "overwhelmingly" voted in support of the plan with releases.[93]

The Second Circuit was not satisfied with the 75% minimum requirement for voters as outlined in 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb) – noting that 75% is the bare minimum, and that support in excess of 75% should be generated for third-party releases to be overwhelmingly supported.[94] The Second Circuit pointed out that over 95% of personal injury claimants voted to approve the plan and that the Nine no longer objected the Plan.[95] Further, the only party contesting the Plan is the Trustee, who is a government entity without a financial stake in the litigation.[96]

7. Courts should consider whether the plan provides for the fair payment of enjoined claims.[97]

In the past, plans containing third-party releases provided payment for all, or substantially all, of the enjoined claims.[98] However, recognizing that all claims against the Debtor and the Sacklers would not be paid in full, the Second Circuit focused on whether the Sackler's contribution to the Plan would lead to a *fair resolution* of the enjoined claims – not full payment of all or most claims.[99]

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[90] *Id.* at 81.
[91] *In Re Purdue Pharma L.P.*, 69 F.4th at 60.
[92] *Id.*
[93] *Id.* at 78 (citing *In re Master Mortgage Investment Fund*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994)).
[94] *Id.* at 78-79.
[95] *Id.* at 82.
[96] *Id.*
[97] *In Re Purdue Pharma L.P.*, 69 F.4th at 79.
[98] *Id.* (citing *Dow Corning Corp.*, 280 F.3d at 658).
[99] *Id.*

In recognizing that all claims would not be paid in full, the Second Circuit determined that providing a fair recovery through the Sackler's multi-billion dollar contribution would be better than allowing a protracted and greatly depressed recovery that would ensue if the Releases were not approved.[100] The Second Circuit pointed out that the Sackler's personal wealth is dwarfed in comparison to the $40 trillion estimated value of the total claims.[101] Further, given the sheer volume of claimants again the Debtors and Sacklers, the Second Circuit concluded the Releases are necessary to provide some level of recovery to the claimants.[102]

Conclusion

By ruling that a bankruptcy court holds statutory authority to approve a Chapter 11 plan containing non-consensual third-party direct claims against non-debtors, the Second Circuit brings attention to a 30+ year circuit split on these controversial releases.[103] Currently, every Circuit besides the Fifth, Ninth, and Tenth Circuits permit non-consensual third-party releases.[104] Given this Circuit split, and the fact that fundamental notions of fairness are at stake, the Trustee has appealed the Second Circuit's ruling and the Supreme Court has decided to take the case.[105] Oral arguments are currently scheduled for December 2023, with a decision come in 2024.

The Supreme Court will adjudicate the following question: Whether the Bankruptcy Code authorizes a court to approve, as part of a plan or reorganization under Chapter 11 of the Bankruptcy Code, a releases that extinguishes claims held by nondebtors against nondebtor third parties without the claimants' consent.[106]

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100 *Id.*
101 *Id.* at 82.
102 *Id.*
103 Nani, *supra* note 1.
104 *In Re Purdue Pharma L.P.*, 69 F.4th at 64.
105 Harrington v. Purdue Pharma, L.P., No. 23-124, 2023 WL 5116031, (U.S. Aug. 10, 2023)
106 *Id.*