After Purdue Pharma: The future of third-party releases in the U.S.

David Conaway examines the impact on cross-border insolvencies since the Purdue Pharma decision

DAVID H. CONAWAY
Attorney at Law, Shumaker, Loop & Kendrick, LLP

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On 5 December 2024, three US Democratic Senators introduced legislation that would codify the US Supreme Court's decision (5-4 ruling) in Purdue Pharma's Chapter 11 proceeding, ruling that the Bankruptcy Code does not authorize any non-consensual third-party releases. If passed, to obtain consensual third-party releases in a Chapter 11 plan, debtors must provide "clear and conspicuous" notice to creditors of releases. Mere approval of a plan, a creditor's failure to object, a creditor not returning a ballot or its silence or inaction would not be consent by a creditor.

On 27 June 2024, in *Purdue Pharma*, the US Supreme Court issued a pivotal decision impacting insolvency proceedings worldwide. It is common in US Chapter 11 proceedings for Plans of Reorganization or Plans of Liquidation (in cases where the main event is a Section 363 sale) to include releases of various parties other than the Chapter 11 debtors. The use of releases of third parties has become extensive, and used strategically to insulate insiders (officers, directors and equity owners) from any liability associated with the debtors' businesses. In fact, companies that otherwise may not file Chapter 11 strategically use a Chapter 11 filing due to the ability to obtain third-party releases.

Purdue Pharma submitted a Chapter 11 plan of reorganization which included a proposed settlement that channeled opioid victims' claims into a trust to be funded by a $6 billion payment (up from the original $4.3 billion proposal) from the Sackler family who founded Purdue Pharma. In exchange for the payment, the Sackler family would be released from all liability regarding opioid claims. The *Purdue Pharma* plan was mailed to known creditors who could vote for the plan, and could opt-out of the third-party releases. The only objection to plan confirmation was filed by the US Trustee asserting that an opt-out release is not consensual, and not permitted by the Bankruptcy Code.

Resolving mass tort liabilities in Chapter 11 has a 40-year history. In 1982, Johns-Manville filed Chapter 11 to channel mass asbestos claims into a trust, funded by the debtor, as the sole source of recovery for claimants, who were enjoined from taking further action. The US Congress codified the Johns-Manville strategy in the Bankruptcy Code as section 524(g). However, the channeling injunction was limited to asbestos related claims. Recently, the Bankruptcy Code channeling injunction has effectively been expanded in Chapter 11 plans for virtually any tort claims. The *Purdue Pharma* decision and the proposed legislation will impact this expansion.

The *Purdue Pharma* Supreme Court ruling has sent reverberations throughout the insolvency world, in the US and abroad. *Purdue Pharma*'s plan releases were perhaps a Black Swan of nonconsensual third-party releases. Purdue Pharma became a national and international public health issue with a reported $40 trillion of tort claims asserted by OxyContin tort victims. Query whether a case of less magnitude and notoriety would have reached the US Supreme Court.

It is not likely that the proposed legislation will be passed into law by Congress. Rather, US Bankruptcy Courts will interpret the *Purdue Pharma* ruling in the context of Chapter 11 plans that contain third-party releases, with "consent". Given Purdue Pharma's prohibition on nonconsensual third-party releases, the issue becomes what does consent mean, and what balloting and voting procedures for a plan of reorganization containing releases will be approved by courts?

Since *Purdue Pharma*, Chapter 11 debtors have continued to submit Chapter 11 plans with third-party releases, that purport to be "consensual" releases. Chapter 11 plans are physically mailed to creditors with a ballot for voting. The ballots usually contain boxes to check regarding third-party releases: "opt-in" or "opt-out" of third-party releases.

In this context, on 25 September 2024, the Delaware Bankruptcy Court (in Smallwood, Inc. Chapter 11), in a well-reasoned opinion, ruled that creditors who did not return ballots are not bound by third-party releases, as there is no indication of consent to the releases. However, creditors who return a ballot to vote for or against the plan, and who do not check the "opt-out" box are bound by the third-party releases. According to the *Smallwood* ruling, there was clear and conspicuous disclosure of the releases, the creditor affirmatively acted by returning the ballot, without opting out. The Delaware Bankruptcy Court concluded this was effective consent.

However, on 5 December 2024, in *LaVie Care Centers, LLC* (282 debtors operating 140 nursing homes), the Bankruptcy Court in Georgia disagreed with the Delaware court's ruling. In *LaVie Care*, the plan ballots to vote contained an opt-out box from the third-party releases. Contrary to *Smallwood*, the Georgia Bankruptcy Court concluded that creditors who did not return a ballot were bound by the releases. In essence, the Court concluded that silence equals consent, as creditors "cannot simply ignore" a ballot.

Clearly US Bankruptcy Courts are developing bases on which third-party releases can be approved as "consensual" releases. The Delaware ruling in *Smallwood* is the better reasoned approach, as silence as consent is not sensible.

The *Purdue Pharma* decision has potentially wide-ranging implications for cross-border insolvencies. Some have opined that the US is now out of step with other countries' insolvency regimes, that routinely approve nonconsensual third-party releases, which will be an impediment to cross-border insolvency proceedings. Specifically, there is risk that a plan or arrangement in a non-U.S. jurisdiction that is contingent on providing third-party releases will not be approved by a US Bankruptcy Court in a Chapter 11 or Chapter 15 proceeding. The basis of the risk is that a US Bankruptcy Court would not grant comity to the foreign order or judgment as violating the US prohibition on third-party releases.

Taking note that the US Bankruptcy Courts have been busy defining what consensual means and developing workarounds to facilitate third-party plan releases, the adverse impact on cross-border insolvencies will likely be significantly reduced.

Normally, to enforce in the US a plan or arrangement under a non-US insolvency regime, a company would commence a Chapter 15 (or Chapter 11) proceeding in the US Relief that can be granted to foreign debtors in a Chapter 15 proceeding can be broader than in a Chapter 11 proceeding.

In Chapter 15 cases, comity requires that: "*deference to the foreign court is appropriate so long as the foreign proceedings are procedurally fair and … do not contravene the laws or public policy of the United States*."

It appears that Bankruptcy Courts are developing additional case law on third-party releases that will support comity in future cases. Rest assured… third-party releases in the US are alive and well… US Bankruptcy Courts will continue to provide guidance on how debtors can achieve consensual third-party releases. Chapter 15 will remain a gateway for foreign insolvency plans or arrangements to become binding on creditors in the US. ■

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