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BANKRUPTCY UPDATE

Second Circuit Establishes 7-Factor Test for Nonconsensual Releases in Purdue Pharma Bankruptcy Reversal

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Purdue Pharma is a privately-held manufacturer of OxyContin, a synthetic opioid, that accounted for roughly 91% of its U.S. revenue. Decision and Order on Appeal, *In re Purdue Pharma,* No. 7:21-cv-07966-CM, 10 (S.D.N.Y. Dec. 16, 2021) (SDNY decision). Allegedly, Purdue intentionally misled the FDA and medical community by falsely claiming that OxyContin was nonaddictive in order to aggressively increase sales. Purdue's marketing effort was so successful that it earned $34 billion in total revenue between 1996 and 2019. This caused a dramatic increase in opioid abuse, addiction, and overdoses in the United States. From 1999 to 2019, nearly 247,000 people in the United States died from prescription opioid overdoses.

Purdue defended and settled dozens of lawsuits between 2019 and 2020, but the lawsuits were increasing in frequency and starting to name members of the Sackler family, the founders and owners of Purdue, as defendants. Purdue faced potential financial and operational ruin and the Sacklers faced significant financial liability.

Purdue Pharma Files for Bankruptcy And the Sacklers Seek Releases

In September 2019, Purdue Pharma and certain affiliates filed for Chapter 11 in the Bankruptcy Court for the Southern District of New York. Prior to the bankruptcy, Purdue had agreed on a settlement framework with 24 states (the consenting states) whereby the company would seek to restructure as a public benefit trust, the Sackler family would contribute approximately $3 billion to fund recoveries to creditors, and the bankruptcy

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plan would include comprehensive releases for the Sacklers from all opioid-related civil claims (nonconsensual third-party releases). Twenty-four other states opposed the settlement (the nonconsenting states). Hawaii never joined the litigation and Oklahoma already settled their claims.

More than 614,000 claimants filed proofs of claim against Purdue, alleging trillions of dollars in aggregate liability. In the first of three rounds of mediation, the Sacklers increased their contribution to approximately $4.25 billion, of which nearly $750 million would be placed in a trust for personal injury victims (including families of deceased opioid victims and individual survivors of opioid addiction), several hundred million would go to other litigants, with the remainder going to states and municipalities exclusively to abate the raging opioid crisis. In return, various parties such as hospitals, insurance companies, and personal injury victims agreed to the settlement with Purdue and the Sacklers. The nonconsenting states still opposed any settlement with Purdue or the release of the Sacklers.

In September 2019, Purdue Pharma and certain affiliates filed for Chapter 11 in the Bankruptcy Court for the Southern District of New York.

After a second round of mediation, all but nine of the nonconsenting states dropped their objection to the settlement after the Sacklers agreed to make public millions of previously undisclosed documents, including confidential and privileged communications and emails, and agreed to provide an additional $50 million dollars, also to be used exclusively to abate the opioid crisis.

Purdue then proposed a bankruptcy plan of reorganization incorporating the foregoing settlements. Roughly 120,000 creditors voted on the plan, and over 95% of all voting creditors voted in favor of the plan. The bankruptcy court held a six-day confirmation hearing, during which certain objections to the plan were raised, including by the Office of the U.S. Trustee, which is the component of the Department of Justice responsible for overseeing the administration of bankruptcy cases (the UST), and the remaining nine nonconsenting states. Among other things, they objected to the plan on the basis that the nonconsensual third-party releases that the Sacklers were to receive were not authorized by the Bankruptcy Code and violated Constitutional due process requirements.

On Sept. 17, 2021, the Bankruptcy Court approved the plan. Soon thereafter, the UST and the remaining nine nonconsenting states appealed to the U.S. District Court for the Southern District of New York. The primary basis of their appeals was that the nonconsensual third-party releases were not authorized by the Bankruptcy Code and that they violated Constitutional due process requirements.

The District Court Vacates The Plan Confirmation Order and the Parties Appeal

On Dec. 16, 2021, in a 135-page decision, the district court overturned the Bankruptcy Court's decision confirming the plan, holding that the Bankruptcy Code does not authorize nonconsensual third-party releases in nonasbestos cases. Purdue, the Sacklers, the consenting states, and other parties supporting the settlement, including the Ad Hoc Group of Individual Victims, which represented approximately 60,000 of the 120,000 victims who filed claims and who overwhelmingly supported the settlement, appealed the district court's decision to the U.S. Court of Appeals for the Second Circuit.

After a third and final round of mediation, the remaining nonconsenting states and Purdue reached a new settlement agreement under which the Sacklers agreed to increase their total contribution to $5.5-$6 billion. In addition, in what was a first for a bankruptcy case, the Sacklers agreed that victims may confront them in open court, and that institutions may remove their namesake from said institutions. The settlement was still contingent on the Sacklers receiving their nonconsensual third-party releases.

While all of the states and other parties who had a financial stake in the outcome of the bankruptcy were now on board with the plan, the UST remained opposed to the plan and continued to pursue its appeal. The Second Circuit heard oral argument in April 2022. The primary issue on appeal was whether the Bankruptcy Code authorizes nonconsensual third-party releases in nonasbestos cases and whether such releases violated due process requirements.

The Second Circuit's Long-Awaited Decision

On May 30, 2023, the Second Circuit issued its decision reversing the district court and affirming the Bankruptcy Court. See I*n re Purdue Pharma,* No. 22-110 (3rd Cir. May 30, 2023) (Docket No. 978-1).

The three-judge panel, noting that the claimants included "many sufferers of opioid addiction and the families of those lost to opioid overdoses" across the United States and Canada, ruled the Bankruptcy Court had statutory authority to approve nonconsensual third-party releases and that, at least in the case of Purdue, the releases did not violate due process requirements.

The court held that two provisions of the Bankruptcy Code, Sections 1123(b)(6) and 105(a), jointly, create the statutory basis for the court's authority. Section 1123(b)(6) of the Bankruptcy Code states that "a plan may ... include any other appropriate provision not inconsistent with the applicable provisions of this title." Section 105(a) provides bankruptcy courts with broad residual authority, stating that "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provision of [the Bankruptcy Code]." The court then established a seven-factor test for evaluating nonconsensual third-party releases. See *In re Purdue Pharma,* No. 22-110 at 62–68.

First, "whether there is an identity of interests between the debtors and the released third parties, including indemnification relationships, 'such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete the assets of the estate,'" (quoting *In re Dow Corning*, 280 F.3d 648, 658 (6th Cir. 2002)). The court found that many of the named Sacklers were directors and officers of the debtors and that the Sacklers "took a major role in corporate decision-making, including Purdue's practices regarding its opioid products that was more akin to the role of senior management."

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Second, "whether claims against the debtor and nondebtor are factually and legally intertwined." The court acknowledged that the claims against the debtors and the Sacklers were indeed factually and legally intertwined.

Third, whether the scope of the releases is appropriate. In the court's view, a release is proper in scope when its "breadth" is "necessary to the plan." The court held that the scope of the releases was appropriate because the releases were required to ensure that the valuation of the res was settled and that the res was not depleted completely.

Fourth, whether "without the releases, 'there is little likelihood of [a plan's] success,'" (quoting *In re Master Mortgage Investment Fund,* 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994)). The court agreed that the releases are necessary and essential to Purdue's reorganization as there would be no reorganization without the Sacklers' contribution.

Fifth, "whether the nondebtor contributed substantial assets to the reorganization." The court held that $5.5 billion – purportedly the largest contribution in history for such releases—is a "significant sum."

Sixth, "whether the impacted class of creditors 'overwhelmingly' voted in support of the plan" containing the releases, (quoting Master Mortgage, 168 B.R. at 935). The court noted that over 95% of almost all creditor classes voted in favor of the plan. The court also pointed out that "the main challenge to this appeal [was] not by creditors, but by the [UST]—a government entity with no financial stake in this litigation."

Seventh, "whether the plan provides for the fair payment of enjoined claims." The court found that the UST had not alleged any unequal treatment of claimants, and no party gave them a reason to disturb the Bankruptcy Court's findings that the settlements and allocations were "fair and equitable."

The court also found that there was no due process violation with respect to the releases. The question for the court was whether claimants lacked adequate notice or a meaningful opportunity to be heard regarding the releases. The court found that the bankruptcy court made detailed findings that notice of the confirmation hearing was widespread, that the releases were written clearly and in plain and simple English, and that parties had a meaningful opportunity to be heard at the confirmation hearing, which lasted six days.

Finally, the court held that a provision imposing nonconsensual releases must be evaluated "against a backdrop of equity." In the case of *Purdue,* the court reviewed the Bankruptcy Court's factual findings in detail, highlighted the overwhelming support for the plan and the additional concessions made by the Sacklers, including their agreement to governance requirements, abatement trusts, a document depository, and the Sacklers' divestment from the opioid business.

Thus, the court concluded the Bankruptcy Court correctly confirmed Purdue's plan.

The Second Circuit's decision is an important step forward, particularly for the personal injury victims, who have not received a single penny from the over $50 billion in opioid-related settlements to date. It remains to be seen whether the UST will let the matter rest in light of the Second Circuit's unambiguous affirmation of nonconsensual third-party releases in nonasbestos cases or whether they will appeal the decision to the Supreme Court or seek an en banc review.