Expert Analysis - Opinion

Despite Its Plan Objections, UST Also Won In Purdue Ch. 11

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Law360 (June 12, 2023, 5:22 PM EDT) -- In litigation, there is typically a clear winner and a clear loser.

Upon an initial review of the U.S. Court of Appeals for the Second Circuit's May 30 decision affirming Purdue Pharma LP's Chapter 11 plan, the win would be attributed to the debtors, the victims, and all of the other public and private creditor constituencies who overwhelmingly supported the plan.

The loss would be attributed to the Office of the U.S. Trustee, or UST, and the U.S. Department of Justice, who opposed the nonconsensual third-party releases.

However, once one parses through the dense, 97-page decision that took more than a year to produce, it is clear that this decision is, in actuality, a win for all parties involved, including the UST.

How is it a win for the UST?

Prior to the Purdue Pharma decision, there was little guidance from and in the Second Circuit on when nonconsensual third-party releases were appropriate.

The UST regularly opposed such releases, but typically, the releases were granted and some, including the UST, saw the broad releases as an abuse of the bankruptcy system.

In the Purdue Pharma decision, the Second Circuit made abundantly clear what is expected to obtain approval of nonconsensual third-party releases, and the analysis is extensive.

Going forward, nonconsensual third-party releases will only be approved in extremely rare circumstances and there is no room for abuse. The court stated:

> We now clarify any ambiguity and identify the factors that should be considered in order for a bankruptcy court to approve of nonconsensual third-party releases. In doing so, we remain conscious of the "heightened" "potential for abuse" posed by such releases ... We wholeheartedly endorse the view that "third-party releases are not a merit badge that somebody gets in return for making a positive contribution to a restructuring," nor are they "a participation trophy" or "gold star for doing a good job."[1]

The court then established a framework to evaluate such releases, which extremely limits the ability of debtors to include such releases in future plans. The factors articulated by the court are as follows:[2]

- Whether there is an identity of interests between the debtors and the released third parties "such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate";
- Whether claims against the debtor and nondebtor are factually and legally intertwined;
- Whether the scope of the releases is appropriate;
- Whether the releases are essential to the reorganization, and whether without the releases, "there is little likelihood of [a plan's] success";
- Whether the nondebtor contributed substantial assets to the reorganization;
- Whether the affected class of creditors overwhelmingly voted in support of the plan; and
- Whether the plan provides for the fair payment of enjoined claims.

Notably, the Second Circuit stated that each of the factors must go through an evidentiary wringer, far greater than what had previously sufficed. The court stated:

> Although consideration of each factor is required, it is not necessarily sufficient – there may even be cases in which all factors are present, but the inclusion of third-party releases in a plan of reorganization should not be approved. [T]he bankruptcy court is required to support each of these factors with specific and detailed finding. For the bankruptcy court to make such findings, extensive discovery into the facts surrounding the claims against the released parties will most often be required. [3]

Finally, the court held that even if all of the seven factors supported the releases, the granting of the releases must be evaluated "against a backdrop of equity," and the court cautioned, "given the potential for abuse, courts should exercise particular care when evaluating these types of releases."[4]

As a result, it will be nearly impossible for debtors to justify nonconsensual third-party releases, even in the most complex of mass tort cases.

It happens that the facts and circumstances that gave rise to the court's decision in Purdue Pharma are unique and extremely rare. Such facts and circumstances are highly unlikely to arise ever again.

Recent U.S. Centers for Disease Control and Prevention data shows that more than 100,000 people died from overdose in 2022 alone.

Should the Purdue plan take effect, the states will receive billions of dollars that will be used exclusively for abatement of the opioid crisis, and individual victims will receive up to $750 million on account of their injuries due to addiction or the loss of a loved one.

Simply put, the plan will save thousands of lives. Not in the distant future, but as soon as the first dollars are distributed. Such funds will be put to use providing, among other things:

- Communities with life-saving drugs, such as Narcan, to treat overdoses; and
- Treatment and rehabilitation services for those currently suffering from addiction, so they may get their lives back on track.

President Joe Biden recently promised states $1.5 billion to abate the opioid crisis, which to this day is still raging. The Purdue Pharma plan will deliver four times that amount, and it will not come with the bureaucratic red tape typically associated with federal programs.

The court emphasized how the releases in Purdue Pharma's case were equitable and appropriate under the specific factual circumstances of the case, clearly indicating that nonconsensual third-party release provisions in bankruptcy cases will likely not be approved unless the equities are comparable to those present in the Purdue case.

The likelihood of that happening is close to zero. So, yes, the Purdue Pharma decision is a win for all, including the UST.

The Purdue Pharma debtors win because they get to emerge from bankruptcy, after four years, delivering billions of dollars of value to be used for victim compensation, abatement of the opioid crisis and overdose rescue medicines.

The states and municipalities win because they will recover nearly $6 billion to enable them to fund programs specifically for abatement of the opioid crisis.

The victims win because they will recover up to $750 million on account of the deliberate, cruel and devastating harms inflicted upon them or their loved ones.

And the UST wins because it achieved the best result possible regarding its objection to Purdue Pharma's plan — an answer as to whether the U.S. Bankruptcy Code authorizes such releases, clear guidelines that set an extremely high bar for such releases in the future, and public confidence in the UST, who performed its function by protecting the integrity of the bankruptcy system.

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Disclosure: The firm represents the ad hoc group of individual victims in the Purdue Pharma bankruptcy cases.

[1] In re Purdue Pharma L.P., 2023 WL 3700458 at *27 (2nd Cir. May 30, 2023).

[2] Id. at *27-28.

[3] Id. at *28.

[4] Id.