

Bankruptcy Law

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# Mallinckrodt's Second Bankruptcy 'Flagrant' Case of Bad Plan

By Evan Ochsner

Deep Dive

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- Mallinckrodt fell behind projections from first bankruptcy
- New plan to slash opioid settlement funds by \$1 billion

Drugmaker Mallinckrodt Plc's return to bankruptcy, where it will substantially reduce payments to opioid claimants, comes after it fell short of overly optimistic projections from its first Chapter 11.

Opioid claimants will now see their \$1.7 billion settlement fund established through Mallinckrodt's first bankruptcy slashed to \$700 million as a result of the flawed financial forecasts embedded in the company's prior restructuring plan, which faced little formal pushback in court.

The proposed reduction in settlement funds will be "devastating" to opioid claimants, said Joseph Steinfeld, an opioid victim lawyer with ASK LLP.

The company's Chapter 11 filing on Monday comes slightly more than a year after it emerged from its first bankruptcy with a deal resolving litigation from individuals and state and local governments that accused it of contributing to the national opioid crisis.

The first bankruptcy was supposed to be final. All corporate debtors are required to show a judge they can meet the obligations of their restructuring plans and are unlikely to restructure again, a standard known as "feasibility." The bankruptcy code says a plan can be confirmed if it is "not likely" to be followed by further restructuring or liquidation.

Still, Chapter 11 refilings are common enough that they are unofficially referred to as Chapter 22s.

"This is supposed to be rare," Anthony Casey, a bankruptcy professor at the University of Chicago, said in an email. "The feasibility requirement means that a Chapter 22 has to be unlikely at the time of the first plan confirmation."

Judge John Dorsey of the US Bankruptcy Court for the District of Delaware ruled last year that Mallinckrodt had a reasonable chance of carrying out its restructuring plan. By the time Dorsey ruled on the plan, only one formal objection to feasibility remained, even though the topic is often a contentious part of plan confirmation.

Mallinckrodt's financial troubles partly came from lagging sales of its flagship product, Acthar Gel, which treats multiple sclerosis and infant spasms, among other ailments. The company had high hopes for the drug, but sales have fallen below expectations.

Representatives for Mallinckrodt didn't respond to multiple requests for comment.

### **Overblown Projections**

Dorsey relied on Mallinckrodt's financial projections and what he called the "persuasive" testimony of Randall Eisenberg, an outside expert Mallinckrodt hired as its chief restructuring officer, to determine that the plan was feasible. This is typical for large Chapter 11 cases, where bankrupt companies often provide declarations from their top officers to assure a judge that a plan is workable.

Eisenberg, a partner at management consulting firm AlixPartners, testified that Mallinckrodt would be able to carry out the plan.

Mallinckrodt projected that between 2022 and 2025, net sales would grow to \$2.4 billion from \$2.2 billion, and earnings before interest, taxes, depreciation, and amortization would grow to \$820 million from \$791 million. A year and a half after Dorsey approved the plan, those projections have not held up.

Mallinckrodt's financial guidance for this year projects total net sales between \$1.7 billion and \$1.82 billion and adjusted earnings between \$510 million and \$560 million.

Eisenberg said Mallinckrodt could still have sufficient liquidity even if earnings dropped "more than 25% per year in each of the years included" in the analysis. But the company's 2023 guidance shows it facing a more than 30% drop from the bankruptcy projections.

During its bankruptcy, Mallinckrodt reduced its earnings projections by 5% to 7% per year. But the change didn't alarm Eisenberg, according to Dorsey's ruling.

"Mr. Eisenberg concluded that the Plan is unlikely to be followed by liquidation or a need for further reorganization," Dorsey wrote in February 2022. "Having considered the evidence in the record, I am satisfied that the Plan is feasible."

Eisenberg didn't respond to requests for comment.

### **Objections to Feasibility**

Disputes over feasibility are a common feature of plan confirmation, said Donald Workman, the head of Baker & Hostetler's Washington bankruptcy team.

"That's often an issue in confirming a Chapter 11, is that people opposing say the plan is not feasible," said Workman, who worked on US Airways' Chapter 11 in the early 2000s.

Feasibility disputes can arise over issues such as a debtor's ability to meet union contracts, obtain exit financing, or generate enough post-bankruptcy revenue to live up to the Chapter 11 plan, he said. Opponents typically hire experts to argue the plan isn't feasible, while the debtors hire experts to argue the opposite.

But that didn't happen in Mallinckrodt. The lack of objections likely means other parties agreed not to oppose the feasibility analysis as part of settlement negotiations, Melissa Jacoby, a bankruptcy law professor at the University of North Carolina, said.

Judges tend to rule that a plan is feasible unless a creditor mounts a vigorous objection, bankruptcy experts said. If no one raises an issue, the feasibility analysis is conducted by an expert hired by the debtors.

But that creates an inherent conflict of interest, said Edward Altman, a professor emeritus of finance at NYU who studies bankruptcies.

"There is a bias toward accepting plans simply because the various experts get their fees and the various companies and their experts go on to the next case," Altman said.

### **'Everyone Was Mistaken'**

Mallinckrodt's refiling is far quicker than many Chapter 22s, said Altman, whose 2014 study found that about 15% of all Chapter 11 debtors file for bankruptcy protection again.

"That is extremely short," Altman said. "That is a flagrant case of a failed plan."

The US bankruptcy system wants to allow debtors to reorganize, and courts are unlikely to block a plan backed by broad consensus, said Samir Parikh, a bankruptcy law professor at Lewis & Clark Law School. Mallinckrodt's failure isn't unique, he said. Market conditions change; projections are imperfect.

"In Mallinckrodt, it turned out really badly, but no one objected at the time," Parikh said. "Maybe the debtor was mistaken but it seems like everyone was mistaken. And that happens."

The only challenge to the plan's feasibility during court approval came from a group of creditors litigating an Acthar Gel royalty dispute with Mallinckrodt. In its objection, the creditor group accused Mallinckrodt of failing to fully disclose its bankruptcy expenses and cash on hand. Dorsey overruled the objection, citing Eisenberg's analyses.

Other feasibility concerns raised earlier in the case had been rendered moot, Dorsey ruled.

Now, Mallinckrodt joins a list of Chapter 22 debtors that include Continental Airlines, RadioShack, and Hostess. David's Bridal filed for bankruptcy in April for the second time in five years.

### **Signs of Trouble**

Another creditor group argued in an October 2021 filing that Mallinckrodt's restructuring plan had overly optimistic sales projections for Acthar Gel. But the judge didn't address that objection in his order approving the plan a few months later.

By that time, Acthar Gel sales had been struggling for years. The drug continues to underperform, and the company has told investors it expects the situation to get worse.

"Acthar Gel sales will decline between 15% and 20% for the year," Mallinckrodt said in an August earnings report.

The financial analyses cited in the bankruptcy were peppered with disclaimers, and Dorsey's opinion acknowledged success wasn't guaranteed. The judge cited the bankruptcy code and feasibility standards established in other cases that referred to a plan's "reasonable prospect of success" and a "workable scheme of organization."

Feasibility is an imperfect standard, Paul Geller, a consumer attorney at Robbins Geller Rudman & Dowd, said. Sometimes companies are too optimistic, or don't offload enough debt.

"The reality is that sometimes after a plan is confirmed and effectuated, a company can't meet its obligations," he said in an email.

But Steinfeld, the opioid claimant attorney, questioned how Mallinckrodt could make a second bankruptcy filing about 14 months after emerging from its first.

"How does a tort victim find any solace in the bankruptcy system at this point?" Steinfeld said. "I don't think they can."

James Nani in New York also contributed to this story.

To contact the reporter on this story: Evan Ochsner in Washington at [echochner@bloombergindustry.com](mailto:echochner@bloombergindustry.com)

To contact the editors responsible for this story: Maria Chutchian at [mchutchian@bloombergindustry.com](mailto:mchutchian@bloombergindustry.com); Anna Yukhananov at [ayukhananov@bloombergindustry.com](mailto:ayukhananov@bloombergindustry.com)

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