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# How Purdue High Court Case Will Shape Ch.11 Mass Injury

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## **Law360 - Expert Analysis**

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The U.S. Supreme Court closed its last session of the year on Dec. 4 by hearing oral argument in *Harrington v. Purdue Pharma LP*.

The issue to be resolved by the court is the scope of the authority of the bankruptcy court to approve nonconsensual, third-party releases as part of a Chapter 11 settlement plan. The decision portends to have significant implications.

This Purdue Pharma case could be one of the most consequential corporate bankruptcy decisions in over a decade and could resolve the split of authority that has divided courts for more than 30 years.

The court will aim to address the extent that the broad equitable powers of bankruptcy courts extend to granting nonconsensual, nondebtor releases in certain circumstances to afford relief that effectively operate to release — arguably discharge — a category of claims against those who have not filed for bankruptcy protection.

The eventual decision, no matter where the court lands, has the potential to reshape how mass injury cases get resolved in Chapter 11 filings by determining the legality of nondebtor releases and addressing claims of thousands of claimants in large cases, many of which are ongoing.

The court was very active at oral argument over a Chapter 11 case involving a nationwide settlement negotiated as part of a plan of reorganization. At stake is whether the court reverses a U.S. Court of Appeals for the Second Circuit decision upholding broad releases for the benefit of the debtor's family owners, the Sacklers, who are not in bankruptcy in exchange for a \$6 billion contribution to a plan.

The questioning by the justices reflected a clear tension between pragmatism — the effect of unwinding a settlement that was supported by stakeholders — and concerns with respect to whether the bankruptcy court had the authority to grant broad immunity.

The court was also mindful of the potential implications of its decision on other pending cases, including asbestos cases involving the so-called Texas Two-Step where nonconsensual third-party releases constitute an

integral part of restructuring efforts. The authority of the bankruptcy court, constitutional concerns and pragmatism associated with affording meaningful relief for thousands of victims are all at play in Purdue Pharma.

The U.S. Department of Justice's watchdog, the U.S. Trustee's Office, advocated for a categorical prohibition of nonconsensual, third-party releases. The Trustee's Office contended that the bankruptcy laws do not permit the issuance of a discharge for nondebtors — in this case, the Sackler family that was contributing the \$6 billion to a plan trust in exchange for a settlement and release of all claims.

Such relief would upset the basic quid pro quo of bankruptcy that affords a discharge only to a debtor bankruptcy as part of an exchange for undertaking the obligations imposed by the U.S. Bankruptcy Code. Counsel for the Trustee's Office argued that even a discharge in bankruptcy under Chapter 7 would not go as far as the contemplated releases in this case, which would discharge fraud claims.

Counsel for the Trustee's Office argued that the issue presented raised due process and perhaps other constitutional issues, such as property rights of third parties who were not part of the bankruptcy proceedings would be affected.

The government contended the settlement was inappropriate since the releases would eliminate causes of action owned by individual creditors and victims and bankruptcy does not permit the extinguishment of the property rights of third parties who have not affirmatively consented.

The supporters of the plan settlement responded by taking issue with the contention that a discharge was being granted. The supporters of the settlement contended the settlement provided a release of a defined category of claims in exchange for valuable consideration, where a discharge extinguishes liability on virtually all debts.

Supporters also contended that bankruptcy laws vest bankruptcy courts with authority to issue all orders that are necessary or appropriate to carry out the provisions of Chapter 11.

The settlement arrived at in Purdue Pharma had been carefully negotiated for years and provides a mechanism for getting billions of dollars to address those harmed in the opioid epidemic. The court was extremely mindful of the overwhelming support for the Chapter 11 plan and releases in this case.

The court questioned whether it was appropriate for the federal government, which had no economic stake in the matter, to stand in the way and blow up a negotiated settlement that compensates victims. The respondents characterized the government as an interloper to the proceeding, since it had no financial stake in the outcome.

The court questioned counsel about the impact that any ruling it would make would have on other mass tort cases, pointing to the

current Johnson & Johnson talc bankruptcy case as one example.

The parties discussed the benefit of such releases in mass injury cases and argued that there are cases where such releases are not only appropriate, but essential to provide relief — cases involving the Boy Scouts of America and the Catholic Church are examples.

The court also questioned the impact of its decision on exculpations for officers, directors and others that are often central features in Chapter 11 plans.

Counsel for the Official Committee of Unsecured Creditors emphasized that the releases were tailored in this case, and supported by the victims who are the creditors in the bankruptcy case.

Without the availability of the release afforded by the collective bankruptcy proceeding, the committee indicated that a Chapter 7 would ensue and no viable path to any victim recovery would be available. It would be the functional equivalent of the Wild West.

The debtor's counsel argued that an adverse ruling would undermine the bankruptcy regime and necessarily result in countless individual proceedings brought by plaintiffs representing thousands of victims as well as a Chapter 7 trustee who would be responsible for liquidating the bankruptcy estate.

It would be a race among the trustee and creditor victims, with those that are the fastest being able to achieve recovery from a finite pool of assets to the detriment of other legitimate victims. Such a line-jumping process harms all victims and, according to supporters, jeopardizes any recovery.

A collective proceeding with adequate safeguards and narrowly tailored releases are necessary to resolve cases like Purdue Pharma and other mass tort cases. The debtor and the committee contended that value would dissipate and could not be obtained absent a settlement and release as part of a collective, court-supervised bankruptcy proceeding.

Counsel for the U.S. trustee responded by arguing that a bankruptcy court can't simply do whatever it takes to achieve a favored recovery.

The release at issue goes beyond what the statutes authorize, according to Curtis Gannon, the DOJ attorney. An adherence to the text of the bankruptcy code and the property rights of third parties who have not consented must be respected.

The justices questioned the breadth and impact of the releases, taking off from the Trustee's Office's position, probing at the appropriateness of granting nondebtor releases that are tantamount to a bankruptcy discharge without the concomitant requirement imposed on debtors to put "all their assets on the table."

Supporters of the plan and releases responded that the goal of bankruptcy

and the plan at issue is "to maximize recovery and fairly and equitably distribute it to the victims." The contributions to be received under the currently-on-hold reorganization plan would be used to pay victims and fund efforts to combat the opioid crisis.

Bankruptcy court is the refuge for addressing the financial fallout of a failed business and economic distress. This includes mass injury cases, particularly in recent years.

The collective, participatory proceeding that the bankruptcy system affords makes bankruptcy well suited to resolve mass injury cases. There are rules and an established framework in place that allows for the appointment of representatives that include trustees and committees in appropriate circumstances.

The judicially supervised and participatory nature of bankruptcy provides an effective governor for tailoring effective relief to the circumstances and the equities of the particular case.

Courts, including bankruptcy courts, have historically approved plans with releases, and issued injunctions and bar orders as part of settlements reached in Chapter 11 plans and outside of bankruptcy. At the heart of the Purdue Pharma case and many other cases is the power of federal courts to approve settlement agreements that absolve parties outside the bankruptcy case of legal responsibility.

The fact that a settlement involves nondebtors should be of no significance. Settlements that include releases from liability as a material component are commonplace particularly where, as here, the claims against the debtor are so deeply intertwined with the claims against the nondebtors.

The overlay of an insolvency regime administered by fiduciaries, and that includes judicial supervision while safeguarding due process and other rights, should not, to say the least, be viewed with disfavor.

Settlements should be encouraged even in mass injury cases and, if narrowly tailored to the circumstances, a remedy that provides releases for the benefit of nondebtor third parties can be both necessary and appropriate uses of bankruptcy authority in circumstances that require the balancing of various relationships and competing interests, according to Title 11 of the U.S. Code, Sections 105 and 1123(b)(6).

The justices in Purdue Pharma will necessarily need to consider the boundaries of a bankruptcy court's authority, examine constitutional considerations, and determine the appropriateness of releases depriving personal injury victims in mass tort cases of their right to sue third parties not debtors in the bankruptcy proceeding.

The importance of the decision before the Supreme Court is not only on the impact the decision will have on bankruptcy law and practice in general, but to the victims in the case.

As articulated by the debtor's counsel, Pratik Shah: "If there's one thing you take away from my argument today, it is this, and let me be crystal clear: Without the release, the plan will unravel, Chapter 7 liquidation will follow, and there will be no viable path to any victim recovery."

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