Purdue Pharma Third Party Releases: A Bitter Pill to Swallow

By David H Conaway

The Supreme Court of the United States (SCOTUS) is having difficulty swallowing the third-party releases in the Purdue Pharma opioid settlement. SCOTUS has accepted the U.S. Department of Justice's appeal of Purdue Pharma's plan of reorganization containing non-consensual releases of the Sackler family, which will resolve a split in U.S. Circuit Courts of Appeals on third-party releases in Chapter 11 plans of reorganization.

Purdue Pharma (Oxycontin) 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 order accepting the U.S. Trustee's petition directs the parties to address one question:

"Whether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by non-debtors against non-debtor third parties, without the claimants' consent."

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 U.S. Congress codified the Johns-Manville strategy in the Bankruptcy Code as Section 524(g). But the channeling injunction was limited to asbestos-related claims.

Since Johns-Manville, many companies with mass tort claims (silicone breast implants (Dow Corning), defective airbags (Takata), sex abuse (Boy Scouts, USA Gymnastics), talc baby powder (Johnson & Johnson), and opioids (Purdue Pharma)) have sought Chapter 11 protection to effect the strategy of a funded trust as the sole source of recovery for claimants, releasing all other parties who may have liability, including officers, directors and shareholders of the debtor. Since the 524(g) channeling injunction applied only to asbestos claims, plan proponents used, and Bankruptcy Courts relied on,

Chapter 11's catch-all provision... Section 105(a) which provides:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

If it furthers a reorganization, the court can do it.

The Chapter 11 channeling injunction as a strategy to resolve mass tort claims indeed makes sense. When Purdue Pharma filed Chapter 11, it was a defendant in 3,400 lawsuits seeking an estimated $40 trillion in damages. Potential defendants included officers, directors and shareholders.

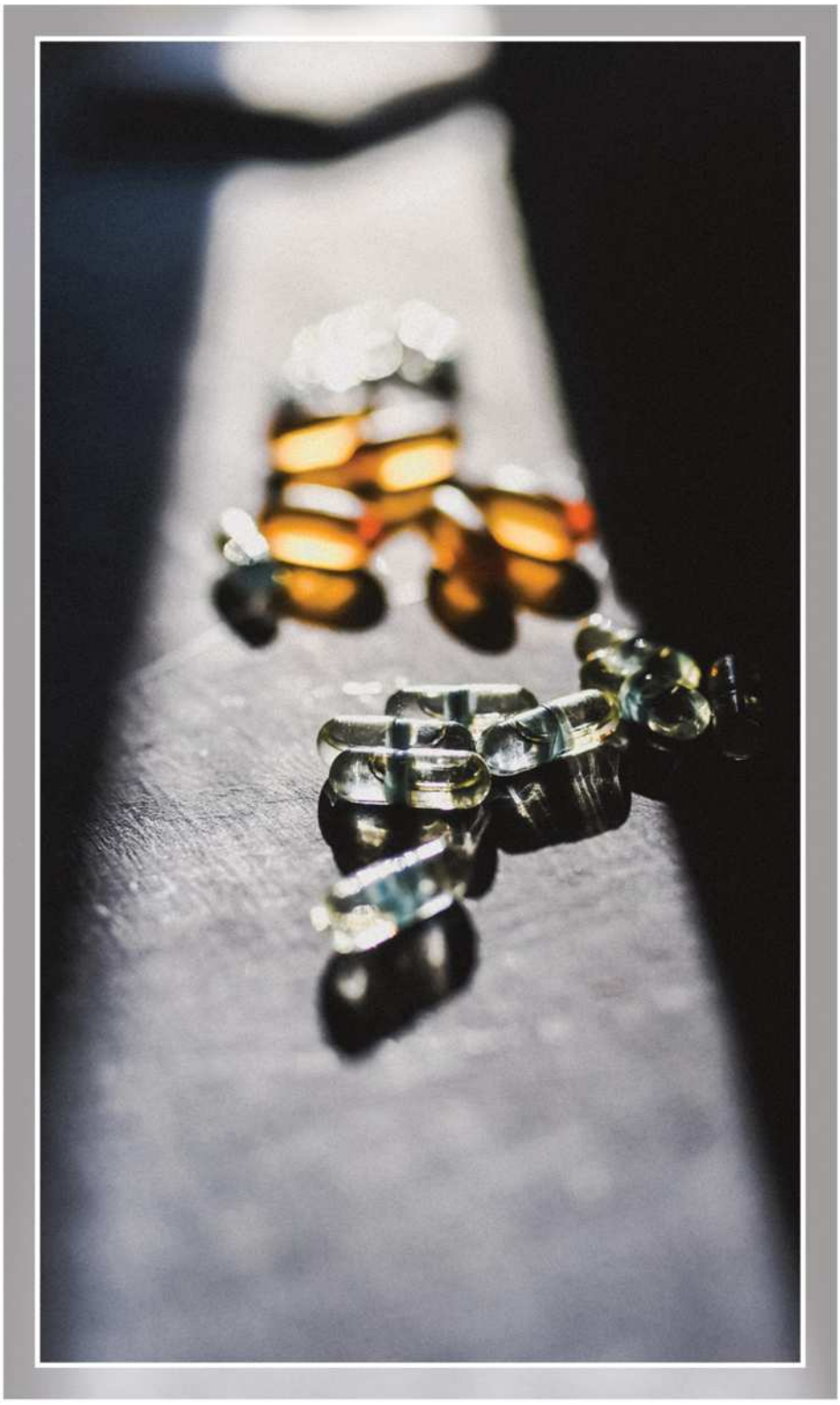
Purdue Pharma's estimated value was $1.8 billion. Thus, third parties would have to contribute to the resolution of the claims to preserve the enterprise value.

The U.S. mass tort litigation system is not pristine. Most mass tort litigation involves "class action" litigation under the U.S. Federal Rules of Civil Procedure. The class actions are usually engineered by plaintiffs' lawyers, who earn contingency fees based on the settlement amounts. Defending mass litigation is incredibly expensive. Prior to Chapter 11, Purdue Pharma spent a reported $635 million in legal fees defending opioid litigation.

Clearly, the U.S. mass tort litigation system is not a tenable solution.

So, what is wrong with the Chapter 11 solution? Perhaps companies have become too aggressive and clever. Regarding the baby powder claims, Johnson & Johnson highlights the "Texas two-step" maneuver to isolate liabilities in a newly created affiliate with no assets to shield Johnson & Johnson from any liability, other than what it deemed appropriate to contribute to the affiliate's tort claim trust.

Perhaps Purdue Pharma shocked the U.S. collective conscious as too good of a deal for the Sackler family, who earned massive profits



for many years selling Oxycontin at the expense of a massive human toll. With the approval of third-party releases, the Sacklers would escape all liability, and their opioid victims will be denied their "day in court" to assert their personal injury claims against the Sacklers. This is contrary to fundamental U.S. constitutional principles of due process of law.

To add insult to injury, another opioid maker, Mallinckrodt, filed Chapter 11 and channeled claimants into a trust, with a promise to pay claimants $1.7 billion, pursuant to a plan of reorganization approved by the Bankruptcy Court on March 2, 2022. To date, Mallinckrodt has paid $450 million. On August 23, 2023, Mallinckrodt filed a 2nd Chapter 11 proceeding (the so-called "Chapter 22") where it will pay claimants another $250 million and cancel the remaining $1 billion owed. All other potential defendants were released in the 1st Mallinckrodt Chapter 11 case, pursuant to third-party releases contained in the plan of reorganization approved in the 1st Chapter 11 case.

Needless to say, the Chapter 11 mass tort solution, that worked well for 40 years since Johns-Manville, is now under close scrutiny and subject to numerous challenges.

What is the answer? How to save otherwise viable and responsible companies, and balance the interests of legitimate tort claimants to have their "day in court" to receive fair compensation for their personal injuries? The Chapter 11 solution is clearly most efficient and likely to deliver compensation to victims faster. It is also likely that more of the settlement funds are paid to the actual claimants rather than legal fees paid to contingency fee attorneys.

However, there is a problem with the Chapter 11 solution. Debtors and their lenders control the Chapter 11 process. This means that debtors have leverage to set the settlement price. In Purdue Pharma, the proposed plan of reorganization included a settlement to fund the opioid victim trust with $4.3 billion, in exchange for broad third-party releases including the Sackler family.

Though the plan was confirmed by the Southern District of New York Bankruptcy Court, on appeal, the U.S. District Court rejected the plan. The Sacklers agreed to sweeten the deal with another $1.7 billion for a total of $6 billion settlement, to get their plan approved. The U.S. 2nd Circuit Court of Appeals approved the $6 billion settlement over the objection of the United States Trustee's office (the U.S. Department of Justice). However, on August 10, 2023, SCOTUS stayed the settlement and granted certiorari to consider the appeal by the U.S. Trustee. Reportedly, SCOTUS has fast-tracked the appeal to allow for oral arguments in December, 2023.

SCOTUS's affirmation of the Purdue Pharma plan of reorganization containing the non-consensual third-party releases would be a major blow to the U.S. mass tort claims system. If SCOTUS rules that non-consensual third-party releases are not permissible, the Chapter 11 solution for mass tort claims would be significantly diminished, bolstering the U.S. mass tort claims system. Arguably, due process in U.S. mass tort claims litigation is more theoretical than real.

The best answer may be to embrace the flexibility and creativity of Chapter 11, with changes. The Bankruptcy Code should be amended to provide for a robust claims process involving a neutral third party to ensure a fair settlement of personal injury claims.

SCOTUS' ruling in Purdue Pharma has cross-border insolvency impact. U.S.-based energy sector engineering and construction giant McDermott International recently announced that it had entered into a transaction support agreement (TSA) for a financial restructuring, which it plans to implement via Dutch Wet Homologatie Onderhands Akkoord (WHOA) proceedings and a UK restructuring plan (RP) under Part 26A of the UK Companies Act 2006 (CA 2006). McDermott further announced it will file an ancillary Chapter 15 proceeding in the U.S., primarily for the purpose of U.S. approval of the Dutch and English restructuring plans in the U.S. In the event the WHOA or Part 26A restructuring plans contain third-party releases, SCOTUS' ruling could be pivotal. ■

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