Davis Polk

Landmark Second Circuit decision affirms Purdue Plan, legality of nonconsensual third-party releases

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The Plan—the result of years-long efforts by the Debtors (represented by Davis Polk) and other key stakeholders to resolve opioid clams against Purdue and recover from its owners—will provide billions of dollars and other critical benefits for opioid abatement and victim compensation, among other important benefits. The Plan was accepted by over 95% of the over 120,000 voting creditors.

On May 30, 2023, the United States Court of Appeals for the Second Circuit (Second Circuit) reversed an order of the District Court that vacated the Bankruptcy Court's confirmation order and held nonconsensual third-party releases were not permitted under the Bankruptcy Code.[1]

The Second Circuit set forth seven factors to evaluate nonconsensual third-party releases, and, applying those factors to the facts, concluded that each supported approving the releases.

The Plan will provide billions of dollars for efforts to abate the opioid crisis and victim compensation and enables, among other critical benefits, the creation of an extensive document depository accessible to the public that will contain documents related to the development, production, and sale of opioids. Fewer than 10 out of over 615,000 claimants (under one five-hundredth of one percent) remained in opposition on appeal, and all 50 states either support or no longer oppose the Plan.

Purdue's bankruptcy, plan, and confirmation

Before bankruptcy, Purdue Pharma L.P. and certain of its affiliates (Debtors) faced over 2,600 lawsuits alleging that they acted improperly in the marketing and sale of opioids and seeking damages based on public nuisance, consumer protection laws, unjust enrichment, false claims acts, and similar theories. Purdue had long been privately owned by members of the Sackler family, and certain Sacklers previously served as officers and directors of Purdue. Many lawsuits against the Debtors also named members of the Sackler family as defendants and asserted claims substantially similar—and often identical—to the claims asserted against the Debtors. As the District Court observed, "[plaintiffs] would rely on the same facts to establish the liability of both [Purdue and the Sacklers]" and there would be "no way for [plaintiffs] to pursue the allegations against [the Sacklers] without implicating Purdue, and vice versa."[2]

By mid-2019, it had become apparent that the "veritable tsunami of litigation" faced by the Debtors would result in their financial and operational ruin.[3] Bankruptcy provided the only viable solution to halt the immense destruction of value associated with defending against thousands of lawsuits and to facilitate a value-maximizing and equitable resolution for and among victims. To that end, before the Debtors filed for chapter 11 relief, a number of plaintiff constituencies including 23 states, the Sackler family, and Purdue reached an agreement in principle on the structure of a global resolution of opioid litigation related to the Debtors. The cornerstone of this settlement required the Sackler family to, among other things, relinquish all of their equity in the Debtors and make additional cash payments totaling at least $3 billion (Settlement Framework).

With the Settlement Framework in hand, Purdue then commenced chapter 11 proceedings. Over the course of the next several years, the Debtors, the Official Committee of Unsecured Creditors (UCC), and additional key stakeholders, including ad hoc groups of governmental creditors and individual victims worked to improve upon the Settlement Framework's terms and build upon its initial support. Critical developments included:

- a mediated settlement among Purdue's governmental creditors, pursuant to which (i) the non-federal public claimants made an historic commitment to dedicate all value received by them to abate the opioid crisis; (ii) the non-federal public claimants resolved critical issues as to the allocation of value among themselves; and (iii) public and non-public claimants reached agreements addressing the allocation of estate value to each group;

- consensual resolution of the United States' civil and criminal claims against the Debtors in an abatement-centric settlement; and

- a series of mediated settlements of creditors' claims against the Sackler family, pursuant to which the minimum amount the Sacklers were required to pay increased by over 40% to $4.325 billion, as well as a host of other historic concessions to creditors, including restricting the Sacklers' ability to obtain naming rights for charitable contributions.

The Plan ultimately filed by the Debtors embodied the terms of each of these interlocking settlements. In addition, the Plan (1) delivers on a critical commitment made by the Debtors at the outset of the chapter 11 cases: the creation of a public document repository of more than 100 million pages of documents produced during the chapter 11 cases and tens of millions more; (2) requires Purdue's operating assets to be transferred to a new entity structured as a public benefit company dedicated to mitigating the opioid crisis (also a requirement to earn the $1.775 billion DOJ forfeiture judgment credit); and (3) subjects the Sackler family to restrictions on participation in any opioid business worldwide.

To facilitate its global, abatement-centric resolution of claims, the Plan channels civil liability with respect to opioid claims related to Purdue, including claims that might be asserted against certain non-debtor third parties, such as the Sacklers, to creditor trusts and releases the Debtors, the Sacklers, and certain related parties from such claims (Shareholder Releases). The Shareholder Releases do not apply to conduct occurring after the Plan's effective date and —notably—do not impact the ability of any governmental entity to prosecute released parties for criminal or tax liability.

The Plan garnered overwhelming support among Purdue's victims. Over 97% of governmental creditors and 95% of voting personal injury claimants voted to accept the Plan.

A tiny group of objectors objected to the Plan and the Shareholder Releases in particular. Over the course of six days, the Bankruptcy Court (Hon. Robert Drain) heard testimony from 41 witnesses and accepted into evidence "a courtroom full of exhibits."[4] After holding two full days of oral argument, the Bankruptcy Court issued an extensive 159-page opinion that carefully considered the objections to the Plan, the evidence, and the law and confirmed the Plan (Confirmation Order).

The Bankruptcy Court found, among other things, that "[w]ithout the $4.325 billion being paid by the Sacklers under the plan and the other elements of the Sackler settlements," the "other elements of the plan would not happen. The record is clear on that."[5] Moreover, as the Bankruptcy Court determined, the "most likely" alternative to settlement was a liquidation of the Debtors, in which "unsecured creditors" such as those injured by Purdue's opioid products "would probably recover nothing from the Debtors' estates."[6]

With respect to the Shareholder Releases, in particular, the Bankruptcy Court concluded that they were authorized by the Bankruptcy Code and Second Circuit case law, finding, among other things, that the settlement payments from the Sacklers were "substantial" and materially exceed the value of the Debtors' businesses; those payments were integral to the Plan, which would "unravel" without them; the Plan was overwhelmingly accepted; the releases, as narrowed by the Court, were "narrowly tailored" to ensure the success of the Plan; the settlement was fair to the nonconsenting claimants; and, without the settlements, opioid claimants "would probably recover nothing from the Debtor's estates."[7]

The District Court decision and settlement with the Nine

Eight states and the District of Columbia (collectively, the Nine), five Canadian municipalities and indigenous nations (Canadian Creditors), the United States Trustee (U.S. Trustee), and three *pro se* individuals appealed the Confirmation Order.

What is notable about the small number of appeals is that none contested the detailed evidence and factual findings at trial that: (1) there is no better alternative to the Plan and (2) if the Plan is not effectuated, there will be (a) massive loss of value at the Debtors, (b) years of intercreditor litigation that would have required victims to compete with one another for recoveries, (c) years of uncoordinated litigation by victims attempting to recover from the Sacklers, (d) material recovery and collectability issues against the more than 55 Sacklers, particularly given that many of them are not U.S. citizens and live overseas, have their assets in over 200 trusts in six jurisdictions, and/or never served as officers or directors of Purdue, and (e) a high probability that victims receive nothing.

On December 16, 2021, the District Court vacated the Confirmation Order, principally holding that the Bankruptcy Code does not authorize nonconsensual third-party releases outside of the asbestos context.[8]

The Debtors, the UCC, and multiple other supporting governmental and private victim creditor groups appealed this ruling to the Second Circuit.

While these appeals were pending, yet another round of mediation was conducted resulting in a settlement among the Debtors, the Nine, and the Sacklers. Under that settlement, the Sacklers agreed to commit an additional $1.175 to $1.675 billion to opioid abatement efforts, resulting in an aggregate $5.5 to $6 billion contribution to the Plan (or approximately 97% of the total amount of all non-tax cash distributions Purdue made to the Sacklers since January 1, 2008). In exchange, the Nine agreed to withdraw their opposition to the appeals of the District Court's decision vacating the Confirmation Order.

As a result of this additional settlement, fewer than 10 claimants out of over 615,000 (under one five-hundredth of one percent) remained in opposition to the Plan on appeal before the Second Circuit. No States, territories, counties, cities, towns, districts, tribes, or represented U.S. party opposed the Plan.

In contrast, the Plan is supported by every organized creditor group that participated in the chapter 11 cases, including the (1) UCC, (2) Ad Hoc Group of Individual Victims, (3) Ad Hoc Group of Neonatal Abstinence Syndrome Children, (4) Ad Hoc Group of Governmental and Other Contingent Litigation Claimants, (5) Multi-State Governmental Entities Group, (6) Native American Tribe Group, (7) Ad Hoc Group of Hospitals, (8) Third-Party Payor Group, (9) group of ratepayer mediation participants, and (10) a majority of states that formerly constituted the Ad Hoc Group of Non-Consenting States. And the Nine no longer oppose it.

The Second Circuit decision

On May 30, 2023, the Second Circuit, endorsing virtually every one of the Debtors' arguments, reversed the District Court's decision and affirmed the Plan. It held that the Bankruptcy Court properly approved the Plan and made the requisite detailed factual findings to approve the Shareholder Releases.

First, the Second Circuit held that the Bankruptcy Court had "broad" subject-matter jurisdiction to confirm the Plan, including the Shareholder Releases, because, under the Bankruptcy Court's "related to" jurisdiction direct claims against the Sacklers "pose[] the specter of direct impact on the *res* of the bankrupt estate" and "may just as surely impair the bankruptcy court's ability to make a fair distribution of the bankrupt's assets as a third-party suit alleging derivative liability."[9]

Second, the Second Circuit affirmed the Bankruptcy Court's conclusion that two sections of the Bankruptcy Code—11 U.S.C. § 105(a) and §1123(b)(6)—"jointly" provide the statutory basis for approving a plan that includes nonconsensual releases of third-party claims against non-debtors.[10]

Section 1123(b)(6), the Court recognized, permits the inclusion of "any other appropriate provision" in a plan so long as it is "not inconsistent" with other sections of the Bankruptcy Code.[11] In tandem with § 105(a)'s grant of "broad equitable power to the bankruptcy courts to carry out the provisions of the Bankruptcy Code," § 1123(b)(6), therefore, confers upon "bankruptcy courts a *residual authority* consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships."[12] Although acknowledging that its previous case law approving nonconsensual third-party releases had not cited § 1123(b)(6) in particular, the Court joined other Courts of Appeals to have reached the issue in holding that § 1123(b)(6) and § 105(a) permit bankruptcy courts' to impose of third-party releases under appropriate circumstances.[13]

Third, the Second Circuit looked to its prior cases (most notably *Metromedia, Drexel* and *Manville*) and concluded that each supported approval of a plan containing nonconsensual third-party releases. It also found that these cases had addressed—and rejected—many of the arguments advanced by the Appellees.

Taking stock of the considerations discussed in these prior cases and the case law of other circuits, the Second Circuit identified seven factors "that should be considered in order for a bankruptcy court to approve of nonconsensual third-party releases."[14] The Court noted that "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."[15] In this case, however, applying these seven factors to the Plan, the Second Circuit determined that each supported reversal. It held:

- Factor 1. Identity of Interests Between Debtors and Released Parties: There was a sufficient identity of interests between Purdue and the Sacklers such that a suit against the Sacklers is, "in essence, a suit against [Purdue] or will deplete the assets of the estate" through indemnity, contribution, or otherwise.[16]
- Factor 2. Factual and Legal Overlap Between Claims Against Debtors and Settled Third-Party Claims: Especially as narrowed by the Bankruptcy Court, the third-party releases in the Plan covered only claims against the Sacklers that are factually and legally intertwined with claims against Purdue.
- Factors 3 and 4. The Releases are Essential to the Reorganization & Proper in Scope: The third-party releases, as narrowed by Judge Drain, were necessary and essential to the reorganization. Without the settlement of which the third-party releases are a critical part, the *res* of the estate would be completely depleted. The third-party releases "are both needed for the distribution of the res and to ensure the fair distribution of any recovery for claimants."[17]
- Factor 5. Substantial Contribution to the Reorganization: The Sacklers have agreed to contribute a "significant sum"—$5.5 to $6.0 billion, possibly "the largest contribution in history for [third-party] releases"—toward the reorganization.[18]
- Factor 6. Overwhelming Approval by Creditors: "The claimants voted overwhelmingly to approve" the Plan, with "[o]ver 95% of the personal injury classes vot[ing] to accept" it. Indeed, "the main challenge . . . is not by creditors,

but by the Trustee—a government entity without a financial stake in the litigation."[19]

- Factor 7. Fair Payment of Enjoined Claims: The value of all claims is approximately $40 trillion, making full payment impossible. The Plan provides for a "fair allocation" of proceeds, and "no party" has given any reason to doubt that the Plan is "fair and equitable."[20]

Finally, the Second Circuit rejected arguments that the third-party releases in the Plan violated the Due Process Clause of the United States Constitution, and held that ample and sufficient notice was given to all parties.

As the Second Circuit explained, "[w]ithout the Plan, … many victims of the opioid crisis would go without any assistance and face an uphill battle of litigation[.]"[21] In addition to the $5.5 to $6.0 billion to be paid by the Sacklers, the Second Circuit also emphasized that "the additional concessions made by the Sacklers—including governance requirements, abatements trusts, the public document archive, and divestment of the Sacklers from the opioid business worldwide[]—contributed to the Plan's equity."[22]

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] *In re Purdue Pharma L.P.*, No. 22-110-bk(L) (2d Cir. May 30, 2023).

[2] *In re Purdue Pharma L.P.*, 635 B.R. 26, 86-87 (S.D.N.Y. 2021) (McMahon, J.) (quoting *Dunaway v. Purdue Pharma. L.P.*, 619 B.R. 38, 51 (S.D.N.Y. 2020)).

[3] *Id.* at 35.

[4] *In re Purdue Pharma L.P.*, 633 B.R. 53, 59 (Bankr. S.D.N.Y. 2021) (Drain, J.).

[5] *Id.* at 84.

[6] *Id.* at 109.

[7] *Id.* at 94, 107, 109.

[8] The District Court agreed with the Bankruptcy Court that the Canadian Creditors' claims were properly classified differently than those domestic claimants, who have access to abatement trusts. The Canadian Creditors cross-appealed this issue. The Second Circuit, however, affirmed, holding that the Canadian Creditors' classification was proper and that the Canadian Creditors had another source of recovery, Purdue Canada. The Second Circuit also rejected the Canadian Creditors' argument under the Foreign Sovereign Immunities Act.

[9] *In re Purdue Pharma L.P.*, No. 22-110-bk(L) (2d Cir. May 30, 2023) (slip op. at 47-48) (quotation omitted). The Second Circuit also ruled that that the Bankruptcy Court lacked constitutional authority to finally approve the Shareholder Releases, and, thus, that District Court correctly construed the Bankruptcy Court's decision as setting forth its proposed findings of fact and conclusions of law for the district court's de novo review, pursuant to *Stern v. Marshall*, 564 U.S. 462. But it further concluded "that the practical import of the *Stern* issue is nonexistent given that only conclusions of law [were] at issue" in the appeal. *Id.* at 41.

[10] *Id.* at 62.

[11] *Id.* at 51 (quotation omitted).

[12] *Id.* at 52 (quotation omitted).

[13] Judge Wesley filed a separate opinion concurring in the judgment, concluding that clear Second Circuit precedent authorized nonconsensual third-party releases, but disagreeing that the Bankruptcy Code authorized them.

[14] *Id.* at 63.

[15] *Id.* at 67.

[16] *Id.* at 64, 68-89.

[17] *Id.* at 72.

[18] *Id.* at 74.

[19] *Id.*

[20] *Id.* at 75.

[21] *Id.* at 70-71.

[22] *Id.*