How Purdue Pharma High Court Case May Change Bankruptcy

By **Brian Shaw and David Doyle** (April 2, 2024)

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In September 2021, Purdue Pharma LP's Chapter 11 plan had been confirmed by the U.S. Bankruptcy Court for the Southern District of New York and was just beginning to wind its way up the appellate ladder.[1]

Even then, two and a half years before it reached argument before the U.S. Supreme Court, it was apparent that the case could have far-reaching ramifications to the bankruptcy system beyond just eliminating most third-party releases.[2]

Specifically, some worried that the combination of often-controversial third-party releases with the terrible facts surrounding Purdue Pharma and its business practices could result in the U.S. Congress or the Supreme Court deciding to reign in the bankruptcy court's use of its equitable tools.[3]

Now, in April, bankruptcy practitioners and the system are sitting on that predicted precipice.

Sometime soon, likely before its summer break, the Supreme Court will render an opinion in the case of Purdue Pharma[4] that may be the death of most third-party releases in Chapter 11 bankruptcy cases. If that happens, the decision, at a minimum, will have its immediate effect on certain types of Chapter 11 cases, especially those involving mass torts or insider-directed allegations of wrongdoing.

However, depending on both the decision's breadth and the Supreme Court's ability to understand the issue's context within the broader Chapter 11 practice, the opinion could have much more far-reaching effects on the entire bankruptcy system.

For example, a simple ruling holding that as a matter of law, third-party releases are not provided for under the U.S. Bankruptcy Code, and therefore are unlawful, would become the new poster child for those who believe the bankruptcy court's equitable discretion should be limited to that which is expressly set forth in the Bankruptcy Code.[5]

Not coincidentally, many of those same critics also believe that such a restriction will curb abuses of the Bankruptcy Code enabled by the expansive use of equitable discretion.[6]

So, what exactly are those perceived abuses? The 800 — or multibillion — pound gorilla in the room is, unfortunately, a case with terrible, far-reaching facts.[7]

It is those terrible facts that made the bankruptcy case national front-page news.[8] It is also those terrible facts that garnered a strong populist view that the terrible people who owned the debtors should only be able to keep those possessions that they would be able to keep with them in — hypothetical — prison.[9]

And while that view ignores the practical considerations that led the bankruptcy court and most victims and their families to believe that the confirmed Purdue Pharma plan

represented the best possible outcome under those terrible circumstances, it is not hard to understand the populist reaction.

And why does the populist reaction matter? Because it would be very naive to believe populism will have no effect on the individual minds of a historically unpopular Supreme Court,[10] or for that matter, Congress, which but for its ongoing dysfunction, may have made a serious attempt to address this issue statutorily because of such populism.[11]

Several other equitable concepts saddled with accusations of abuse and on the radar of lawmakers are also at risk in the shadow of the upcoming Purdue Pharma decision, including:

- The use of equitable mootness to proactively neuter parties' appeal rights;[12]
- The use of derivative standing to pursue bankruptcy cause of actions as litigation leverage;
- Shotgun prepackaged bankruptcy cases that rely on discretion to shorten the period from filing to confirmation to less than 28 days;[13] or
- Looking past a debtor that manufactures venue — as compared to choosing between venues — on the eve of bankruptcy to take advantage of a particular law or a particular court to which the putative debtors would otherwise not have access.[14]

All of these issues have two important characteristics in common: They are derived from what is often called the implicit authority of the Bankruptcy Code,[15] and at times, have been at the heart of accusations of abuse.[16]

For example, in 2021, the U.S. Court of Appeals for the Eighth Circuit, in FishDish LLP v. VeroBlue Farms USA Inc.,[17] sharply curtailed the use of equitable mootness — or what it referred to as equitable dismissal — in the Eighth Circuit.[18]

The Eighth Circuit held that equitable mootness could only be used in rare circumstances because otherwise, the appellate court would not only be precluding a party from obtaining Article III judicial review, but it would be abdicating its jurisdiction instead of exercising it.[19]

The principal reasons behind the Eighth Circuit's criticism? The perception that once a confirmed plan was substantially consummated, equitable mootness required dismissal of confirmation-related appeals as well as the predatory use of equitable mootness to cut off the appellate rights of others — as opposed to the defensive use, which protects parties relying on the confirmed plan's consummation from the harm caused by dilatory appellants.[20]

A high-profile example of a shotgun bankruptcy can be found in the case of In re: Belk Inc. in 2021 in the U.S. Bankruptcy Court for the Southern District of Texas, which was conducted from filing to confirmation in less than 24 hours.[21]

The debtors argued that it had effectively complied with all of the notice requirements pertaining to plan confirmation on its own, with the assistance of its counsel, no less than 28 days prior to the filing of their cases, and as such, confirmation of its plan in a 19-hour time frame was an appropriate exercise of the bankruptcy court's discretion.[22]

The bankruptcy court confirmed the plan over the objection of the U.S. trustee,[23] but the 19-hour window within which any objection could be filed and presented would not have provided most creditors with the practical ability to challenge confirmation.

Many critics of the decision argued that the aggressive timeline was not allowed under the Bankruptcy Code and rules.[24] Moreover, as a tactic, it knowingly excluded all but the largest, most active constituents from participating in the debtors' bankruptcy cases and restructuring.

And of course, there is much angst around the issue of third-party releases. As discussed, Purdue Pharma and its pending Supreme Court decision is the big show.

Opponents of third-party releases resolutely argue that, other than in the context of Title 11 of the U.S. Code, Section 524(g), and its specific carveout for asbestos cases, the bankruptcy court has neither the power nor the jurisdiction to force the release of third party claims that are not property of, or claims against, the applicable debtor or its estate.[25]

Opponents similarly reject the current practice in some circuits[26] that allows narrowly tailored third-party releases under certain circumstances because it is necessary for an effective reorganization and in the best interests of the bankruptcy estate.[27]

They do so, not because they want creditors harmed, but because the law provides a bankruptcy court with its statutorily derived powers, and it cannot simply exercise powers it does not statutorily have.[28]

It is this last concept, taken at its most simplistic and basic meaning, if accepted by the Supreme Court, that will push the use of equitable tools off the precipice.

So why are we here? Because these equitable concepts do not arise from any express provisions of the Bankruptcy Code — or in the case of equitable mootness, the U.S. Constitution.

Rather, they are implicit equitable powers that were often utilized under the Bankruptcy Code's predecessor, the Bankruptcy Act, and in the opinion of many, retained as an equitable power under the Bankruptcy Code.[29] Each purports to fill in some gap left in the Bankruptcy Code, and at least, their proponents argue, they further the Bankruptcy Code's purpose.

However, despite their perceived favor among practitioners and their long history of use in the bankruptcy system, they are sitting on the precipice because they are not expressly provided for under the Bankruptcy Code, and the Purdue Pharma case has presented their shortcomings, along with a side of terrible facts, to the Supreme Court on a silver platter.

As a result, their potential extinction is looming.

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[1] In re Purdue Pharma L.P. et al., Case No. 19-23649-RDD (Bankr. S.D.N.Y.).

[2] See Brian Shaw and Mark Radtke, Bankruptcy Courts Equitable Discretion May Be In Danger, LAW360, September 20, 2021.

[3] Id.

[4] William K. Harrington, United States Trustee, Region 2 v. Purdue Pharma L.P. et al. (Case Nos. 23-124).

[5] See e.g., Ralph Brubaker, Mandatory Aggregation of Mass Tort Litigation in Bankruptcy (A Response to Bankruptcy Grifters by Lindsey D. Simon), The Yale Law Journal, Volume 131 (2021-2022).

[6] See Official Committee of Talc Claimants, et al. v LTL Management, LLC (In re LTL Management, LLC), Case Nos. 22-2003, 22-2004, 22, 3005, 22-2006, 22-2007, 22-2008, 22-2009, 22-2010, 22-2011, Brief of Amici Curae Law Professors in Support of Appellants.

[7] In re Purdue Pharma L.P. et al., Case No. 19-23649-RDD (Bankr. S.D.N.Y.).

[8] See, e.g., Chris McGeal, Opioids have killed 600,000 Americans. The Sacklers just got off basically scot-free, The Guardian, Sept.5, 2021; Zachary B. Wolf, The worst drug dealers in history are getting away with billions, CNN. Sept. 3, 2021.

[9] Id.

[10] Supreme Court approval ratings at record low, new Gallup Poll show, CNN, August 2, 2023.

[11] See The Role of Purdue Pharma and the Sackler Family in the Opioid Epidemic: Hearing before the Committee on Oversight and Reform of the House of Representatives, 116th Cong., 2d Sess. (Dec. 17. 2020); Nondebtor Release Prohibition Act of 2021, H.R. 4777, 117th Cong. (2021) and Nondebtor Release Prohibition Act of 2021, S. 2497. 117th Cong. (2021).

[12] Adam J. Levitin, Written Testimony Before the H. Comm. On the Judiciary Subcomm. On Antitrust, Commercial, and Administrative Law 14 (July 28, 2021).

[13] See., e.g. Lynn M. LoPucki, The Lawlessness of Belk, 97 Am. Bankruptcy L. J., 912 (2023).

[14] Bankruptcy Venue Reform Act of 2021, H.R. 4193, 177th Cong. (2021).

[15] In re Pack Liquidating, LLC et al., 2024 WL 409830, *7 (Bankr. D. Del.).

[16] See., e.g. LoPucki, The Lawlessness of Belk.

[17] Fishdish LLP v. VeroBlue Farms USA Inc. (In re VeroBlue Farms USA Inc.), 6 F. 4th 880 (8th Cir. 2021).

[18] Id., at 888.

[19] Id., at 889.

[20] Id.

[21] In re Belk Inc., Case No. 21-30630 (Bankr S.D. Tex.).

[22] Id., at [D.I. 14]

[23] Id., at [D.I. 44]

[24] See., e.g. LoPucki, The Lawlessness of Belk.

[25] See, e.g., Brubaker, Mandatory Aggregation of Mass Tort Litigation in Bankruptcy.

[26] See, e.g., Airadigm Communications, Inc. v. Federal Communications Comm'n (In re Airadigm Communications, Inc.) 519 F.3d 640 (7th Cir. 2008).

[27] Id.

[28] See, e.g., Brubaker, Mandatory Aggregation of Mass Tort Litigation in Bankruptcy.

[29] Pack Liquidating, 2024 WL 409830 at * 7 (Bankr. D. Del.).