Southwest Bankruptcy Conference

General

The Fix for Third-Party Releases in Chapter 11 Cases

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2022

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FOUR SEASONS LAS VEGAS
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SEPTEMBER 8-10, 2022

AMERICAN BANKRUPTCY INSTITUTE

The "Fix" for Third-Party Releases in Chapter 11 Cases: *Alternatives for Courts or Congress to Resolve the Never-ending Third Party Release Debate*

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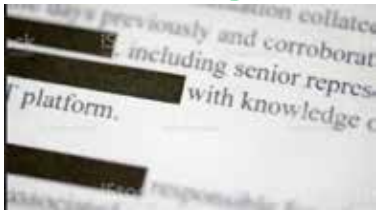
PROPOSED LEGISLATIVE FIX ONE:

Amend/Redesignate Bankruptcy Code §524(g)



Oh what a difference fourteen little words can make….

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Section 524(g) of the Bankruptcy Code

- Created by Congress to enable debtors in ***asbestos*** bankruptcy cases to bind future ***asbestos*** claimants, who have not yet manifested an injury and therefore cannot participate in the bankruptcy proceeding.
- Results in the creation of a trust governed by distribution procedures with the goal of treating current and future asbestos claims similarly.
- Under Section 524(g), current and future asbestos claims against the debtor may be channeled to a trust to resolve and pay pursuant to court approved trust distribution procedures.

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Unique Provisions of Section 524(g)

* A future claimants' representative must be appointed by the court to protect the rights of persons that might subsequently assert asbestos claims. § 524(g)(4)(B)(i).

* At least 75% of current asbestos claimants who vote on the plan must vote in favor of the plan. § 524(g)(2)(B)(ii)(IV)(bb).

* The debtor must be subject to "substantial future demands for payment arising out of the same or similar conduct or events" and the actual amount and timing of such demands "cannot be determined." §§ 524(g)(2)(B)(ii)(I) and (II).

* Trust will "operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices or periodic review of estimates of the numbers and values of present and future demands, or comparable mechanisms, that provide reasonable assurance that the trust will value, and be in a position to pay, present claims and future claims that involve similar claims in substantially the same manner." § 524(g)(2)(B)(ii)(V).

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"Benefits" of Section 524(g)

- A plan confirmed pursuant to Section 524(g) binds current and future claimants.
- Under certain circumstances, the plan can release and/or enjoin claims against affiliates of the debtor.
- The 524(g) trust protects future claimants whose injuries may not manifest for several years; the trust ensures that funds remain available to pay future claimants equitably.
- Courts approved distribution procedures can allow trusts to make payments to claimants much more quickly, efficiently and equitably than the tort system.

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11 U.S. Code § 524 - Effect of Discharge

(g)(1)(A) After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.

*** * ***

(g)(2)(B) The requirements of this subparagraph are that—(i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—(I) is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages ~~*allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products*~~;

And while we're at it, let's redesignate Section 524(g) to make it a new Section 1123(e)—it's where it really belongs to begin with….

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PROPOSED LEGISLATIVE FIX TWO:

Amend Section 1123 to Add Mandatory Opt Out for Plan Release Requirements (Or Maybe Mandatory Opt In Provisions?)

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PROPOSED LEGISLATIVE FIX THREE:

Amend 28 USC §157 To Make All Third Party Plan Release Approvals Subject to *De Novo* District Court Review

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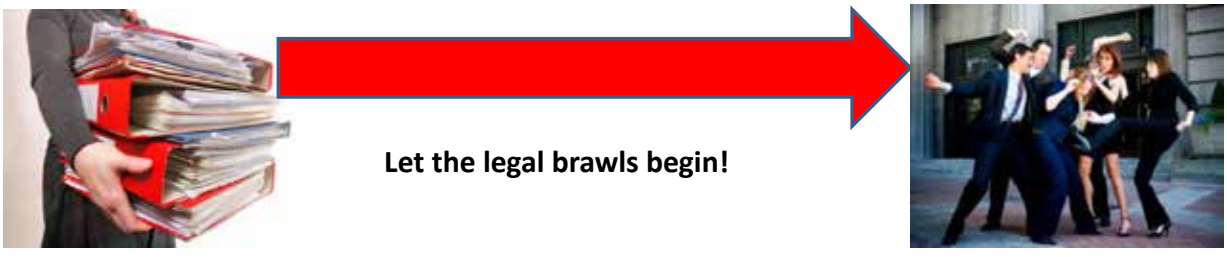
PROPOSED LEGISLATIVE FIX FOUR:

Impose A Statutory Fulsome Financial Disclosure Requirement For Any Recipient of a Third Party Release In a Chapter 11 Plan



Let the legal brawls begin!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THANK YOU!

Feature

By Thomas J. Salerno and Clarissa C. Brady

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Clarissa C. Brady
Stinson, LLP; Phoenix

In Defense Of Third Party Releases In Chapter 11 Cases (PART ONE): Let's Define The Battlefield![1]

"Nicht das Kind mit dem Bade ausschütten!"

Thomas Murner
NARRENBESCHÖRUNG (1512)[2]

The negotiation and confirmation of financial restructuring deals, even in cases of modest size, are very much like sausage making. With apologies to our vegetarian colleagues, most people can agree they want a good bratwurst, but watching one being made is neither pretty nor recommended. Chapter 11 is judicially supervised negotiation at its core. Financial restructurings

[1] This article is a compilation of a three-part series of articles by the authors which were published as: (a) "In Defense Of Third Party Releases In Chapter 11 Cases (PART ONE): Let's Define The Battlefield!", *ABI Journal* at 32 (March 2022); (b) "In Defense Of Third Party Releases In Chapter 11 Cases (PART TWO): Show Me The Money, And What's Wrong With the "God Clause"?", *ABI Journal* at 30 (April 2022); and (c) "In Defense of Third-Party Releases in Chapter 11 Cases (PART THREE): Four Proposed Legislative Fixes For The Third Party Release Mess!", *ABI Journal* at 5 (May 2022). Footnotes have been renumbered to be sequential for purposes of the consolidation of the three articles, and content has been updated to reflect developments since the original articles were published.

[2] "Don't throw the baby out with the bathwater!" *Appeal To Fools* (1512).

involve the creation of sometimes tenuous alliances, then trying to keep them together while recalcitrant constituencies snipe for tactical purposes as the case slogs its way through the arduous process that is chapter 11. Not surprisingly, the odds are not with the troubled business trying to navigate the rocky shores of chapter 11.[3] The path from the filing (oftentimes under emergency circumstances) to the closing dinner and exchange of the Lucite deal cubes belie the sometimes tense and contentious events leading up to the confirmation of a plan that memorializes the numerous deals made to get there. That is, at least in the authors' humble opinions, what also makes chapter 11 so exciting. In the immortal words of John "Hannibal" Smith, "I love it when a plan comes together!"[4]

Which brings us to the topic of this article. Reminiscent of a scene from a Mary Shelley novel, villagers wielding torches and pitchforks lay siege to the castle of a miscreant and call for the death of "the monster." The metaphorical death sought in this case is the definitive end (once and for all) of the use of third party releases in restructuring cases. The "monster" in this analogy is played by the Sackler family, controlling interest holders in *Purdue Pharma,* who undeniably made billions in profits from the opioid scourge.[5] Purdue sought chapter 11 protection based on primarily over 3000 personal injury/product liability lawsuits filed against it and its various subsidiaries and affiliates. To avoid this "veritable tsunami of litigation"[6] Purdue sought to trade a release of civil liability against the Sackler family for a payment by the Sacklers (and their various entities) of about $4.3 billion into a trust fund to pay victims of the opioid scourge that ravaged the U.S.[7] starting in the early 1990s, as part of its proposed chapter 11 plan of reorganization.

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[3] The "success rate," always a somewhat murky concept when applied to a process as diverse as chapter 11 given the myriad of potential outcomes being sought, is somewhere between 10-33%, depending on whose statistical analysis you use. *Cf*. "Chapter 11 Bankruptcy," Financial Management (September 7, 2020), available at: https://efinancemanagement.com/financial-leverage/chapter-11-bankruptcy (estimating an "abysmally low" success rate of "around 10% or so"), *with* Warren & Westbrook, "The Success Of Chapter 11: A Challenge To The Critics," 107 MICH. L.REV. 603 (2009) (using statistical analysis gauging success in chapter 11 cases of between 17-33%). Part of the difficulty is caused by one's definition of "success" in chapter 11. A sale of all assets within the first thirty days of the case, even with very little return to general unsecured creditors, with a plan confirmed distributing proceeds might be a "successful" chapter 11 in one sense, even if not economically.

[4] George Peppard as J. "Hannibal" Smith in *The A Team* (1983-87). Of course, that same show gave us "I pity the fool!" which might be applied to those about to embark on the financial restructuring process. But we digress.

[5] *In re Purdue Pharma, LP* and subsidiaries and affiliates, Case No. 7:19-bk-23649 (US Bankruptcy court, SD NY) ("**Purdue Pharma**") and *In re Purdue Pharma, L.P.,* 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021) ("**SDNY Opinion**"). Purdue Pharma sought chapter 11 protection based on primarily over 3000 personal injury/product liability lawsuits filed against it and its various subsidiaries and affiliates (characterized by the SDNY Opinion as "a veritable tsunami of litigation.").

[6] SDNY Opinion at 2.

[7] The opioid scourge has been called a "uniquely American problem" because the abundance of private health insurance in the U.S. favors prescribing drugs for pain management over alternative, more expensive therapies. *See* Shipton EA, Shipton EE, Shipton AJ, "A Review of the Opioid Epidemic: What Do We Do About It?" *Pain and Therapy* at 7 (1): 23–36 (June 2018), available at: https://link.springer.com/article/10.1007/s40122-018-0096-7. Pills are less expensive and a quick fix for what ails you . . . until the "cure" creates other problems, of course.

The bankruptcy court confirmed the plan with its proposed release over the objection of nine attorneys general [8] (the "**Objecting States**") and about 2,700 individual plaintiffs in personal injury lawsuits against *Purdue Pharma*, which confirmation order was reversed by Judge Colleen McMahon of the Southern District of New York on December 16, 2021.[9] The district court granted the motion seeking leave to appeal to the Second Circuit (over the Objecting States' objection).[10] Meanwhile, Bankruptcy Judge Drain extended the temporary litigation stay for the Sacklers until February 1, 2022, and then again through March 23, 2022.[11] and ordered the case to mediation. Upon the request of Purdue, the Second Circuit granted leave to file the appeal and also put the appeal on a very fast track with oral arguments scheduled for April 25, 2022.[12] As a result of a

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[8] Attorneys general for California, Connecticut, District of Columbia, Delaware, Maryland, New Hampshire, Oregon, Rhode Island and Washington objected to plan confirmation, and ultimately appealed the confirmation order. The US Trustee also objected and joined in the appeal.

[9] *See* SDNY Opinion; Paul R. Hage, "'The Great Unsettled Question': Nonconsensual Third-Party Releases Deemed Impermissible in *Purdue*," XLI *ABI Journal* 2, 12-13, 43-45, February 2022, *available at* abi.org/abi-journal (a thorough overview of the SDNY Opinion).

[10] *See Order Conditionally Granting Debtors' And Allied Parties' Motion For A Certificate Of Appealability* dated January 7, 2022 (Docket 117) ("**Appeal Certification Order**"). The "condition" is that the appealing parties seek expedited consideration of the appeal (which seems superfluous as an expeditious resolution of this issue seems to certainly be in the debtors' best interest in these cases). California, Maryland and the District of Columbia filed oppositions to the request for leave to file the interlocutory appeal. *See* "States Oppose Purdue's 2nd Circuit Appeal Try In Ch. 11 Case," *Law360* (January 7, 2022).

[11] Bankruptcy Judge Drain extended the injunction protections for the Sacklers through February 1, and then again through February 17, 2022 to allow the parties to continue negotiations notwithstanding the pendency of an appeal to see if a deal can be reached. *See* Chutchian, "Purdue Bankruptcy Judge Extends Temporary Litigation Shield For Sacklers," *Reuters* (December 28, 2021); "Purdue Pharma Judge Extends Sacklers' U.S. Litigation Shield To Feb 17", *Reuters* (February 1, 2022). *See also* note 3, *infra*.

[12] *See* "Purdue's Appeal On Ch. 11 Releases Fast-Tracked By 2nd Circ.", *Law360* (January 28, 2022). Indeed, this has been put on the "rocket docket", with opening briefs due February 11, 2022, and responsive briefs due March 11, 2022.

mediator-brokered settlement, and regardless of how the Second Circuit disposes of this pending appeal[13], it is a possibility that there is still a review by the Supreme Court.[14]

The SDNY Opinion, with its unequivocal rationale that there is no subject matter jurisdictional authority under any circumstances for non-debtor releases in bankruptcy cases, has been characterized as a "seismic shift" in the development of the law.[15] To put this into context, the plan (with the releases for the Sackler families) had the support of approximately 120,000 opioid-related claim creditors (representing approximately 95% of that group) as well as 97% of nearly 4800 local and state governments (including tribal authorities) in addition to forty state attorneys general.[16] The plan, however controversial, was undeniably a highly negotiated resolution of very thorny mass tort issues which garnered overwhelming support among creditor constituencies. In most other chapter 11 cases, the accepting votes would have been a crowning success story.

But of course, *Purdue Pharma* is not a typical chapter 11 case. The opioid scourge has rightfully been declared a "public health emergency" in the United States.[17] It is estimated that

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[13] On March 10, 2022, the bankruptcy court approved a mediator-brokered settlement which resulted in at least another $1 billion being contributed by the Sacklers with the possibility of another half billion from future sales of Sackler related assets (bringing the total to about $6 billion). *See* Sullivan, "Purdue Gets Approval For New $5.5 Billion Ch. 11 Sackler Deal", Law360 (March 10, 2022); *see also* Sullivan, "Purdue Reaches Final Terms On New $5.5 Billion Ch. 11 Settlement", *Law360* (March 3, 2022) ("**Sullivan**"). The non-monetary terms of the settlement are also noteworthy. They include public expressions of "regret" by the Sacklers, renaming Purdue Pharma as Knoa Pharma, and switching to manufacture of medications to treat addictions by 2024, the disassociation and removal of the Sackler family name from buildings, programs facilities and scholarships (as long as any announcement does not "disparage" the Sacklers), and the immunity does not shield the Sacklers from future criminal prosecution. *See* Hoffman, "Sacklers Strike New Deal To Settle Opioid Suits", *New York Times*, page A1 (March 4, 2022). This settlement is the equivalent of burning the Purdue Pharma house (with the Sackler name inside it) to the ground, and then salting the earth on which it stood so nothing can grow there in the future.

[14] The Objecting States have agreed not to file their opposition briefs in the pending Second Circuit appeal. That notwithstanding, the US Trustee's office has taken the position it will continue the appeal in the Second Circuit challenging the legality of the releases (resulting in the eye-opening criticism by Judge Drain on the record that the US Trustee's position was "reprehensible" and "just not right".) *See* "Justice Department Appeal Threatens $6 Billion Sackler Opioid Settlement", *ABI News* (March 22, 2022). Presumably it is hoped that the Second Circuit will consider this one of the "narrow circumstances" in which third party releases are permissible consistent with its prior precedent. *See* note 44, *infra*. Even then, the US Trustee may seek Supreme Court review as this is clearly a policy level issue for that office.

[15] *See* Vince Sullivan, "Seismic Purdue Ruling May Finally Get High Court's Attention," *Law360* (December 17, 2021).

[16] *See* Paul Scott, "Purdue Pharma Settlement Plan Approved By 95% Of Creditors, But CT Still Opposed," *Stamford Advocate* (July 27, 2021), available at: https://www.stamfordadvocate.com/business/article/Purdue-Pharma-settlement-plan-approved-by-95-of-16343595.php. In addition to the foregoing, creditor support from non-opioid related claimants in other classes ranged from 88% to 100% depending on the class.

[17] *See 2016 National Survey on Drug Use and Health*, available at: https://www.samhsa.gov/data/sites/default/files/NSDUH-DetTabs-2016/NSDUH-DetTabs-2016.pdf.

in the U.S. between 1990 and 2020, there were over 841,000 deaths by drug overdose, with prescription and illicit opioids accounting for over 500,000 of those through 2019.[18] In just the twelve month period ending April 2021, this was an average of 275 drug overdose deaths a day.[19] Beyond the tragic deaths, there are the ripple effects on society resulting from addiction such as torn families, increased crime and strains on social and medical services that follow in the wake of opioid addiction.

The "pushers" behind the opioid crisis are not unkempt characters dealing heroin in dimly lit back alleys. Far from it! The current opioid scourge in the U.S. was facilitated in high rise board rooms by professionals in designer clothes with dazzling PowerPoint presentations on how to "turbocharge" the sales of brand name opioids[20] with a distribution network of highly paid consultants,[21] pharmaceutical company sales reps and doctor's offices throughout the country as some of the most prevalent and addictive of the opioids were (and are) medications prescribed by doctors for pain management. Simply put, doctors had a "pill for what ails you." Purdue Pharma's actions were not "allegedly" improper—there were numerous criminal and civil settlements related to its conduct in continuing to aggressively market these drugs even in the face of internal evidence that highlighted the powerfully addictive nature of these pharmaceuticals.[22]

Which brings us back to the *Purdue Pharma* plan and proposed Sackler family release. With the frenzy surrounding the ultimate legality of third party releases in the form of the Sackler family, they have become the unlikely poster children for an important and (used appropriately) essential tool in the restructuring toolbox. The Sacklers are undeniably unsympathetic characters, with evidence showing that between 2008 and 2017 (when it was apparent there would be liability from damages resulting from the manufacture and sale of its opioid products), *Purdue Pharma* managed to "upstream" north of $10.4 billion of wealth (for the benefit of other Sackler controlled entities, including offshore entities), much of it from the enormous profits

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[18] *See* CDC, "Understanding the Epidemic" (March 19, 2020), available at: https://www.cdc.gov/opioids/basics/epidemic.html.

[19] Refer to the "Data Table for Figure 1a. 12 Month-ending Provisional Counts of Drug Overdose Deaths." CDC, "Vital Statistics Rapid Release Provisional Drug Overdose Death Counts" (last reviewed December 15, 2021), available at: https://www.cdc.gov/nchs/nvss/vsrr/drug-overdose-data.htm.

[20] Familiar names such as OxyContin, Percocet, Vicodin and Norco, all drugs related to opioids.

[21] Such as, for example, consulting powerhouse McKinsey & Company. *See* "McKinsey Settles For Nearly $600 Million Over Role in Opioid Crisis," *New York Times* (February 3, 2021) (McKinsey settled with attorneys general in 47 states for its role in "turbocharging" opioid sales in those states).

[22] *See* SDNY Opinion at p. 2 regarding pre-bankruptcy criminal plea agreements on various federal criminal charges.

from Purdue Pharma and its premier product OxyContin.[23] This differentiates *Purdue Pharma* from other product liability type cases (such as *Johns-Manville*, *.A.H Robins* and *Dow Corning*, for example) that put out products that turned out to be very harmful, but the extent of the harm may not have been known at the time the product was put into the marketplace. This puts *Purdue Pharma* in its own hybrid category. It is conceptually both a product liability case and an abuse case (like the Catholic dioceses, *USA Gymnastics* and *Boy Scouts of America* cases) rolled into one. Bad folks intentionally pushing a bad product to make money. The beneficiaries of the releases are not only insurance companies but also individuals who profited handsomely from the misdeeds. Not a good category to be in without a doubt. That notwithstanding, there is a real risk that the proverbial baby (in the form of useful third party releases) is tossed aside with the bathwater in the battle for the unequivocal rejection of third party releases in chapter 11 cases.

While in no way coming to the defense of the Sackler family for what they perpetrated upon the country (all while reaping enormous profits from the resulting carnage), we undertake a spirited defense of the legality and propriety of the use of third party releases in chapter 11 restructurings. Finally, the authors propose some straightforward legislative fixes to this issue based on amendments to existing Bankruptcy and Judicial Code provisions. Although the consensus is that the *Perdue Pharma* case presents egregious facts, including the fact that the Sacklers are responsible for creating the opioid epidemic, the "bad facts" do not justify the creation of bad law.

Let the games begin!

DEFINING THE BATTLEFIELD

"Precision of communication is important, more important than ever, in our area of hair trigger balances, when a false or misunderstood word may create as much disaster as a sudden thoughtless act."

James Thurber
Lanterns and Lances (1961)

To avoid confusing different concepts because of imprecise language, it is important to define terms and concepts as they are often conflated in the heat of the debate. There should be at least four (4) things that all parties should be able to agree on:

(a) A "***discharge***" in the sense of 11 U.S.C. §§ 524 and 1141(d) only applies to a debtor in bankruptcy. The Bankruptcy Code is clear in this respect.

[23] *See* SDNY Opinion at 4; *see also* "Moral Bankruptcy Doesn't Count In Sackler Family Protection Deal," *St. Louis Post-Dispatch* (December 22, 2021).

(b) The concept of ***non-debtor releases and exculpations***, backed by plan injunctions, for actions related to the bankruptcy proceeding are acceptable in most courts (call these "**Post-Bankruptcy Conduct Releases**"). These usually cover officers, directors, estate counsels, Committee members and other professionals in the case, and always exclude from the scope of such a release fraud and other bad acts. [24] The rationale for allowance of Post-Bankruptcy Conduct Releases is straightforward—barring fraud by the participants in the proceeding, any material actions taken in relation to the proceeding itself (such as negotiations, asset sales, and all the other myriad activities that make up a bankruptcy proceeding) are done after notice and court approval. Hence, to allow parties to sue outside of the bankruptcy process, for example, the directors of a now-reorganized debtor for negotiating, proposing and obtaining confirmation of a plan would subject parties to all sorts of collateral attacks on actions the bankruptcy court already approved (again, excepting out fraud by the participants). If a recalcitrant party has an issue with a course of action in a bankruptcy proceeding, they must avail themselves of the bankruptcy process (objections, appeals from orders and the like). It is a necessary "speak now or forever hold your peace" rationale. To permit otherwise would create chaos in the lack of finality.

(c) In ***asbestos related mass tort liability circumstances***, injunctions protecting non-debtors (usually insurance companies, but applies to others as well) are permitted assuming the legal requirements of 11 U.S.C. § 524(g)(2)(B) are met. Congress added 11 U.S.C. § 524(g) to the Code as part of the Bankruptcy Amendments Act of 1994 (S.540) to provide explicit statutory authority for a bankruptcy court to order the channeling of asbestos related claims against a debtor's insurers (or indeed, any other third party liable with a debtor), and an injunction protecting those third parties from claims if the mechanism was part of a confirmed chapter 11 plan. This enabled debtors facing immense liability due to asbestos claims to have a means to obtain contributions from such third parties (who would in turn be protected by an injunction) and thereby deal with both their past and future liabilities to asbestos claimants. In effect, Congress codified the process and ultimate ruling in the *Johns-Manville* case filed in 1982. In that case, Johns-Manville confirmed its plan in 1986 that created a trust, funded in part by over $850 million from numerous insurance companies (all of whom were given a release backed up by an injunction) to deal with billions in asbestos related personal injury claims. Claims were "channeled" to the trust for allowance and ultimate payment. That plan release and injunction was ultimately upheld by the Second Circuit. [25]

(d) Finally, if releases are given in a plan to which all creditors vote to accept, that release (presumably backed up by an injunction for enforcement) would be permissible, much like a

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[24] *See, e.g. Blixseth v. Credit Suisse*, 961 F.3d 1074 (9th Cir. 2020). *But see Memorandum Decision, Patterson v. Mahwah Bergen Retail Group, Inc.,* Case No. 3:21cv167 (DJN), United States District Court, Eastern District of Virginia (January 13, 2022) (finding even Post-Bankruptcy Conduct Releases impermissible.).

[25] *See MacArthur Co. v. Johns-Manville Corp.,* 837 F2d 89 (2nd Cir. 1988) ("***Johns-Manville***"). Hence, Section 524(g) (which applies only to asbestos related claims) has often been called the "Johns-Manville provision." This was a very innovative solution to a very difficult problem and is discussed in more detail in Part II of this article.

creditor can agree to modification of its rights as part of plan treatment. We will call this the "**Fully Consensual Release.**" Similarly, the failure of a claimant with adequate notice of a proposed claim that will be precluded from objecting to the approval of a plan containing the release if the objection is not timely raised.[26] In smaller cases, however, that is frequently how such objections are dealt with. There are both Supreme Court and Circuit Court decisions , however, that hold that failure to object to a plan with release provisions, providing there was adequate and proper notice of the provisions effectuating the release, may not be collaterally attacked on appeal by a creditor who did not object.[27] Of course, the authors recognize that legal purists would take issue with the Fully Consensual Release insofar as there are other, non-traditional creditors (such as the EPA, or SEC, and of course the US Trustee) which would have standing to object on legal grounds under 11 U.S.C. § 1109. The basic premise of any such objection would be that if the ability of a bankruptcy court to approve any third party release (other than the *Johns-Manville* provision releases for asbestos related claims under Section 524(g)) is one of subject matter jurisdiction, parties may not confer upon a court subject matter jurisdiction which it does not have. Courts have an independent obligation to determine whether subject-matter jurisdiction exists, even in the absence of a challenge from any party.[28]

The contentious releases (such as being advocated for in *Purdue Pharma* and the subject of scores of chapter 11 cases over the last nearly 40 years) is of course the non-consensual release for pre-bankruptcy conduct benefiting third parties. That is where the rubber truly meets the road in this debate, and that is the subject of Part II, coming in a future issue of the *ABI Journal*.

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[26] *See infra* note 26. Notwithstanding case law prohibiting these types of releases (discussed *infra*), pragmatic bankruptcy judges such as the Hon. James Marlar (Bankruptcy Judge, District of Arizona, retired) had their own methods of dealing with one or two recalcitrant creditors who were objecting to releases that otherwise had widespread support. Judge Marlar would rule that the releases would "carve out" the objecting creditor(s) only, and then confirm the plan. The Judge recognized that the objections were often interposed for tactical reasons and not because the objector really intended to spend the resources to pursue the claims. By so ruling the legal standing of the objector was removed (as they would not be injured economically). Of course that would not have been a solution in *Purdue Pharma* (and other more complex cases) given the numerous state and other agencies objecting (the carving out of which claims would present an economic hurdle and willingness, presumably, of the beneficiary of the release to do the deal).

[27] *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 145–46 (2009) (notwithstanding issue of jurisdiction to issue third party releases, failure to object if given notice precludes appeal under *res judicata* principles); *In re Le Centre On Fourth, LLC*, 17 F.4th 1326 (11th Cir. 2021).

[28] *Ruhrgas AG v. Marathon Oil Co.*, 526 U.S. 574, 583 (1999); *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 514 (2006).

In Defense Of Third Party Releases In Chapter 11 Cases (PART TWO): Show Me The Money, And What's Wrong With the "God Clause"?

WHERE THE RUBBER MEETS THE ROAD….

"Desperate times offered a certain flexibility in the rules of absolution."

Dan Brown
Origin (2017)

In Part I of this series the authors discussed the *Purdue Pharma* case as it relates to the non-consensual[29] releases of the Sackler family for payment of approximately $4.3 billion in contributions to be earmarked for payment of opioid addiction and its aftermath.[30] The order confirming the Purdue Pharma plan was reversed by the District Court for the Southern District of New York. The SDNY Opinion, with its unequivocal rationale that there is no subject matter jurisdictional authority under any circumstances for non-debtor releases in bankruptcy cases, has been characterized as a "seismic shift" in the development of the law.[31] Despite a settlement, [32] the pending "rocket docket" appeal to the Second Circuit[33] will ensure a decision sometime this summer, with a possible appeal to the U.S. Supreme Court following in its wake. Even if the Second Circuit dismissed the pending appeal in light of the settlement (unlikely given the US Trustee's continued desire to pursue the appeal)[34] , one is left to wonder what is to be done with

[29] Or at least fully non-consensual as there was widespread creditor and state regulatory support for the {Purdue Pharma plan and releases. *See* In Defense of Third Party Releases (Part I): Let's Define the Battlefield*, ABI Journal* at 32. ("**Part I Article**")

[30] *Id.* The bankruptcy court confirmed the plan with its proposed release over the objection of nine attorneys general[30] (the "**Objecting States**") and about 2,700 individual plaintiffs in personal injury lawsuits against Purdue Pharma, which confirmation order was reversed by Judge Colleen McMahon of the Southern District of New York on December 16, 2021 (the "**SDNY Opinion**"), which reversal is on appeal to the Second Circuit Court of Appeals.

[31] *See* Vince Sullivan, "Seismic Purdue Ruling May Finally Get High Court's Attention," *Law360* (December 17, 2021).

[32] *See supra* note 13.

[33] The Second Circuit not only granted leave to file the appeal, but set briefing deadlines that will occur by March, with oral argument set for mid-April, 2022. *See* Part I Article at 33.

[34] The Objecting States have agreed not to file their opposition briefs in the pending Second Circuit appeal, But the US Trustee will still continue to argue the legal impropriety of the releases before the Second Circuit. *See* note 14 *supra*. Presumably it is hoped that the Second Circuit will consider this one of the "narrow circumstances" in which third party releases are permissible consistent with its prior precedent. *See* note 44, *infra*.

the SDNY Opinion, which unequivocally holds there is no subject matter jurisdiction to grant third party releases. How, precisely, do the parties "unring that bell"? Perhaps by asking the District Court to vacate its prior decision (void it *ab initio*, as it were)? With the SDNY Opinion on the record (and no longer the subject of the pending appeal should the parties drop it), party consent or not, how does the bankruptcy court approve a plan with third party releases that the District Court said it legally cannot do based on a jurisdictional limitation?[35] Perhaps entertain a motion for reconsideration where the parties, hand in hand, can ask the District court to allow the third party releases under the "unique" facts and circumstances of that particular case? It also should be noted that even this "grand bargain" is not without its critics.[36]

This article explores the specifics of the oft-maligned (but frequently attempted, with varying degrees of success) the most controversial of the third party releases--where a plan attempts (as it did in *Purdue Pharma* and scores of other plans across the land) to give a release, backed up by an injunction, for pre-bankruptcy acts by a non-debtor third party ("**Third Party**") for not only presently existing claims, but also future claims to the extent they are directly tied to the pre-bankruptcy conduct.[37] We call this the "**Pre-Bankruptcy Conduct Release**."

Depending upon which side of the issue you find yourself on, there is no doubt this issue has created more debate than almost any other issue in the Bankruptcy Code. It is one which academia loves to wax philosophical espousing their righteous indignation in scholarly writings bemoaning the demise of civilization as we know it.[38] Like moths to a flame, politicians are never

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[35] Put another way, can parties create subject matter jurisdiction by agreement? Not likely. Perhaps the idea is for all parties to urge the Second Circuit to find authority exists under the specific facts and circumstances of this case. It would be consistent with existing Second Circuit precedent. *See* note 43, *infra.*

[36] *See, e.g.* Sullivan (Florida, who voted to accept the initial plan, has concerns that the earmarking of the increased Sackler contribution should go to all states pursuant to existing sharing agreements, not just to the settling objectors as contemplated); Schreiber, "OxyContin Victims Fight for Their Share In Purdue Bankruptcy Case", (February 27, 2022) (with victims' advocates complaining that the portion of the deal that is attributable to actual victims equates to about $5,000 per victim, with t the rest allocated to states for rehabilitative and other purposes.)

[37] Pre-bankruptcy conduct can and often does involve claims that may manifest themselves post-bankruptcy based on conduct which occurred pre-bankruptcy. Environmental contamination and product liability mass tort claims frequently may not be fully manifested at the time of a bankruptcy filing—indeed, some injured people are not even aware they have been injured because physical symptoms do not appear until a date after the filing or there is still an open statute of limitations for filing claims.

[38] *See, e.g.*, Prof. Lindsey Simon, "Bankruptcy Grifters", *Yale L. J.* (Winter 2022) (Likening beneficiaries of third party releases to "grifters" who " take advantage of situations, latching on to others for benefits they do not deserve." No judgments there…); Prof. LoPucki's forthcoming article "Chapter 11's Descent Into Lawlessness," 96 *American Bankruptcy L.J.* (June 2022). Not one to feign neutrality, Prof. LoPucki decries "lawlessness" in, *inter alia*, "illegal or abusive practices" such as venue choices, examiners to avoid trustees, the concept of the debtor in possession (over what he would suggest, which is creditor chosen management to run bankruptcy cases), sales outside of the plan process, any sort of retention bonuses for management, rejection of contracts, critical vendor orders, and of course third party releases. *See also* Adam J. Levitin, "The Boy Scouts Are Abusing The Bankruptcy System" (November 17, 2021), available at: https://news.bloomberglaw.com/bankruptcy-law/the-boy-scouts-are-

far behind to advocate their own solutions.[39] Those solutions, perhaps not surprisingly, are to simply prohibit all Pre-Bankruptcy Conduct Releases for Third Parties. Problem solved. While making for good sound bites, the law of unintended consequences certainly is in play here in that companies that might otherwise survive based on funding from third parties die on the vine. The beauty of academia and politics is that these issues are always someone else's problems later on. On to the next election/news cycle/semester!

Again, in an effort to limit the battlefield, there are at least three (3) things we hope can be agreed on: (a) First, there can never be, nor should there ever be, any attempt to release anyone (debtor or Third Party) from potential criminal liability. Even the authors acknowledge that is the proverbial "bridge too far"[40]; (b) Second, there should never be releases for future acts (hence, releases can never be a "get out of jail free" card for acts that may be committed in the future); and (c) Finally, there must be adequate and clear notice of any proposed Pre-Bankruptcy Conduct Releases to those to be effected by such releases. Due process demands are paramount and clearly must be adhered to.

So, given the caveats above, let's look at Pre-Bankruptcy Conduct Releases. The concept (like so-called "critical vendor" payment motions) was the brainchild of innovative professionals in an effort to create and preserve going concern values in real time in a mass tort context. Mass tort liability cases create their own challenges—from identifying and providing notice to potential victims/claimants, to trying to ensure some process whereby assets (such as insurance policies and other Third Party funding sources) are preserved for ratable distribution to what is often a huge and disparate class of creditors, all of whom are deserving of timely compensation for their injuries.

The first major use of this concept was the *Johns-Manville* case in 1986 (actually filed in 1982, while the ink on the Bankruptcy Code was still drying). Since then, it has been used in one form or another in scores of large mass tort liability cases, from product liability (as in *Dow Corning* in 1995, *A.H. Robins* in 1988, with *Johnson & Johnson* trying to accomplish this same thing in its 2021 filing), to personal injury from abuse cases (essentially every Catholic diocese case

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abusing-the-bankruptcy-system (despite a plan that provides over $2.3 billion in third party funding plus profits from the Boy Scouts of America, and about 73% approval by abuse claimants, Prof. Levitin breathlessly asserts that "the bankruptcy system runs roughshod over victims' rights in alleged sexual abuse cases. . .).

[39] *See Nondebtor Release Prohibition Act of 2021* ("**NRPA**") introduced by Senators Elizabeth Warren (D-Mass.), Dick Durbin (D-Ill.) and Richard Blumenthal (D-Conn.), and Representatives Jerrold Nadler (D-N.Y.) and Carolyn B. Maloney (D-N.Y.), aimed at limiting, if not prohibiting entirely, the use of third-party releases in such cases. While the legislative process for the NRPA remains in its early stage, investors and practitioners must be focused on the extent to which the NRPA proceeds through Congress in its present form.. *See also* Garner Vance, "Sackler Immunity: Problems Surrounding Nondebtor Releases in Chapter 11 Bankruptcy" *SSRN* (December 17, 2021), available at: https://ssrn.com/abstract=4002743 or http://dx.doi.org/10.2139/ssrn.4002743.

[40] Even the landmark pending Sackler settlement did not try to cross that bridge. *See* note 31, *supra*.

filed and *USA Gymnastics*), and including the pending *Boy Scouts of America* case (for which the *Purdue Pharma* case, albeit in a different jurisdiction, will have potentially devastating impact).[41]

The case law on this issue gets messy. As the SDNY Opinion recognized, "This issue has hovered over bankruptcy law for thirty-five years – ever since Congress added Section 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now. . . . the lower courts desperately need a clear answer."[42] The Circuits are split in both the ultimate allowance of, and rationale for and against allowance of, Pre-Bankruptcy Conduct Releases for Third Parties.

The cases can be divided into three (3) broad categories:[43]

(a) Not Legally Permissible: The Fifth, Ninth, and Tenth Circuits have concluded that the bankruptcy court may not authorize Pre-Bankruptcy Conduct Releases for Third Parties (which they conflate with "discharges") outside of the asbestos context under Section 524(g).[44]

(b) Permissible With Restrictions: The Second,[45] Sixth and Seventh Circuits have concluded that Section 105(a) and 1123(b)(6) provide bankruptcy judges with some "residual authority" to allow for third party releases under certain circumstances (separating the concepts of discharge and third party releases).[46]

(c) Legally Permissible: The Third, Fourth and Eleventh Circuits have concluded that either Section 105(a) authorizes Pre-Bankruptcy conduct Releases for Third Parties or that there

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41 *See* "Boy Scouts Bankruptcy Plan Hinges On Releases Deemed Illegal In Purdue Case" *ABI Rochelle Daily Wire* (December 22, 2021).

42 SDNY Opinion at *4 (discussing the lack of uniformity for third-party releases and the need for clarity).

43 These are categorized for ease of reference, but the authors acknowledge that reasonable minds could create more nuanced categories. Moreover, even within a Circuit there may be differing categories. *See, e.g.* note 16, *infra.* The SDNY Opinion did a masterful job of assembling the cases on this complex issue.

44 *See, e.g. Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020), *cert. denied,* 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021); *Bank of New York Tr. Co., NA v. Off. Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *In re W. Real Estate Fund*, 922 F.2d 592, 600 (10th Cir. 1990).

45 Obviously the Second Circuit may redefine what it finds appropriate or not should the SDNY Opinion go through the appellate process. The Second Circuit had previously held that non-consensual third party-releases against non-debtors could be approved in narrow circumstances. *Deutsche Bank A.G. v. Metromedia Fiber Network, Inc., (In re Metromedia Fiber Network, Inc.)*, 416 F. 3d 136, 141 (2d Cir. 2005).

46 *See, e.g In re Airadigm Communications, Inc.*, 519 F. 3d 640, 657 (7th Cir. 2008); *In re Dow Corning Corp.*, 280 F.3d 648, 663 (6th Cir. 2002).

are factors to evaluate in deciding when it is appropriate to impose such a release.[47] In at least Delaware, non-consensual Third Party Pre-Bankruptcy Conduct Releases specifically concerning opioid claimants have been upheld as recently as February 3, 2022. *See In re Mallinckrodt, PLC,* Case No. 20-12522-JTD (Bankr. D. Del., February 3, 2022) (Docket No. 6347) (approved releases for Third Parties with opt out rights in plan, but also approved non-consensual Third Party Pre-Bankruptcy Conduct Releases as to opioid claimants based on necessity.).[48]

ECONOMIC ANALYSIS: SHOW ME THE MONEY!

"It has been more profitable for us to bind together in the wrong direction than to be alone in the right direction."

Nassim N. Taleb
The Black Swan (2010)

Bankruptcy, chapter 11 in particular, has as its hallmark the preservation and maximization of finite resources for the benefit of constituencies (be they creditors in an insolvent estate, or creditors and equity in a solvent estate).[49] While lawyers can (and often do) argue incessantly over legal principles, the timely economic returns to constituents should be paramount.[50] Moreover, the time value of money cannot be disregarded—hence present value concepts abound in the Bankruptcy Code. Those opposed to Pre-Bankruptcy Conduct Releases in bankruptcy cases to facilitate the collection of money as part of plan confirmation have often posited that despite optimistic projections, the actual claimants themselves rarely see any meaningful recovery. The money is absorbed (like water to a dry sponge) by administrative costs and related expenses. But in the final analysis, the economic return to the claimants (those with "skin in the game") is where the focus should be.

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47 *See, e.g In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078–81 (11th Cir. 2015); *Behrmann v. Nat'l Heritage Found., Inc.*, 663 F.3d 704, 712 (4th Cir. 2011); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 212–213 (3d Cir.2000).

48 *See* "*In re Mallinckrodt PLC*: Delaware Bankruptcy Court Approves Non-Consensual Third Party Releases In Contrast To *Purdue* and *Ascena*", *V&E Restructuring & Reorganization Update* (February 14, 2022). Interestingly, another bankruptcy judge in Delaware denied confirmation of a plan with Third Party Pre-Bankruptcy Conduct Releases on the basis there was no showing the releases were necessary or there was any contribution by the Third Parties getting the releases. *See* Archer, "Judge Rejects 3rd-Party Releases In Cannabis Co. Ch. 11 Plan", *Law360* (February 15, 2022). The authors speculate that while the Third Parties were disappointed in not getting their releases, they were just too mellow to care all that much.

49 Put another way, bankruptcy is a "zero sum game" in that once the asset pool is defined, what you give to one comes from another's share of the pot.

50 Hence a common criticism of chapter 11 is that it is too lengthy and expensive. While perhaps true, in complex dynamics such as those brought by mass tort issues, it is also perhaps an imperfect but necessary evil.

A Pre-Bankruptcy Conduct Release, when applied to actors that have done bad acts (as compared to, for example, insurers who simply insured bad acts), is the bankruptcy equivalent of prosecutors cutting an immunity deal for one bad actor to catch another (ostensibly worse) bad actor. It is not condoning what the immunized actor did, but rather is a real world recognzition that sometimes you let one bad actor off the hook to acheive an imperfect but greater purpose (in the criminal analogy, catching an even worse criminal). In the bankruptcy world, a timely economic return with certainty of sources of funds to pay claims to creditors is the greater purpose to be achieved. "Punishing" a bad actor oftentimes delays or can reduce that ultimate economic recovery.[51]

Looking at the returns to creditors in bankruptcy cases could conceptually be compared to those in other mass claim types of circumstances outside of bankruptcy. Consumer related class actions are firmly entrenched in the legal landscape and, while not without its critics, recognized as a mechanism to provide legal redress to large consumer groups. Hence, conceptually the concept of Pre-Bankruptcy Conduct Releases is not all that dissimilar from settlements of class actions in other contexts (with the concept of opt out rights dealt with below). In this context, what is the recovery to claimants in class action cases?

There exist some admittedly limited empirical studies in such matters endorsed by such groups as the U.S. Chamber of Commerce (usually supported by positon papers by various law firms and others).[52] As the settlements reached in class actions are usually not public, gathering empirical data can be challenging—hence, these studies are not without controversy.[53] The foregoing notwithstanding, the US Chamber Study concluded that in the class action settlements examined, the average class member's recovery was between 0.000006-12% of the claims, or an average of a mere $32.35 per claimant.[54] The lawyers for the class, by contrast, recovered nearly $424,500 in fees.[55] The US Chamber Study further concluded that the vast majority of cases produced no benefit to most members of the putative class, and indeed approximately 35% of the class actions were dismissed voluntarilly by the plaintiffs after the plaintiff reached a private

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[51] In releases of insurance companies, even if the insurance company is not contributing 100% of policy limits, the timeliness of the economic return from the contribution, plus the recognition that there may be diminution in the policy from costs of defense of the bad actors, would still be a greater good.

[52] *See, e.g.,* "Do Class Actions Benefit Class Members?" *U.S. Chamber Of Commerce* (September 2013), which is based on a position paper by the law firm of Mayer Brown LLP entitled "Do Class Actions Benefit Class Members?: An Empirical Analysis of Class Actions" (September 2013) ("**US Chamber Study**").

[53] *See* Corporate Counsel, "Do Class Actions Benefit Class Members?" US Chamber Report (December 13, 2013) ("In an effort to sway the opinion of federal regulators about the value of arbitration over class action law suits, the U.S. Chamber Institute for Legal Reform (ILR) this week released the results of a study showing that the vast majority of class action cases produce no benefits for most members of the class.").

[54] *Id. See also* "FTC Study: Class Action Settlement Notices Have Room To Improve," *Ballard Spahr Legal Alert* (October 2, 2019).

[55] *Id.* at 2.

(*i.e.* non-class) settlement with the defendant.[56] The foregoing notwithstanding, class actions (and class action settlements) are here to stay.

It may be instructive to compare that return with the recovery to one well-known example of Pre-Bankruptcy Conduct Release cases—the seminal case of *Johns-Manville*.[57] In the 33 years since its creation, the Manville Trust has processed about one million claims seeking in excess of $5 billion in total claims.[58] The Manville Trust contains assets currently in excess of $2 billion, and is currently still paying claimants approximately 5.1% of requested claim amounts to maintain liquidity.[59] So by comparison to a traditional class action settlement, this is one tangible example where a a Pre-Bankruptcy Conduct Release for the benefit of Third Parties has returned a larger percenatge to claimants than any traditional class action settlement. To put it another way, it certainly is not worse than the recoveries to class action settlement claimants and (unlike private class action settlements that can involve dismissals after side deals are cut) has the added benefit that the entire claims distribution process is transparent.

WHAT'S WRONG WITH THE "GOD CLAUSE"?

"E pur si muove."

Galileo Galilei
(1633)[60]

Opponents of the Pre-Bankruptcy Conduct Releases are quick to point out that there is no express statutory authorization in the Code for these releases (asbestos claims excepted), and that bankruptcy courts are left to rely on the equitable powers granted to bankruptcy courts under the amorphous provisions of Section 105. In the words of one commentator, "Section 105(a), [is] sometimes referred to as the 'God clause', which allows judges to exercise their equitable powers to issue any orders necessary or appropriate to carry out a bankruptcy plan."[61]

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[56] *Id.* at 3-4.

[57] At the time the *Johns Manville* plan (with its Pre-Bankruptcy Conduct Releases) was confirmed, Bankruptcy Code §524(g) was not in the Code.

[58] *See* Matt Mauney, "Johns Manville" (August 23, 2021) available at: https://www.asbestos.com/companies/johns-manville/.

[59] *See CRMC Announcements* (February 18, 2021), available at: https://www.claimsres.com/2021/02/18/manville-mv-trust-pro-rata-increase/ (*Pro rata* Trust distributions are adjusted periodically).

[60] "Albeit it does move." Galileo purportedly muttered this phrase after Inquisition torturers forced him to recant his theory—deemed heresy by the church—that the earth orbits the sun.

[61] Sullivan, *supra* note 37, at 2.

Of course, there is also no express prohibition in the Code or jurisdictional statutes either. To paraphrase the immortal words of John F. Kennedy, ask not what the Bankruptcy Code allows, but rather what it does not specifically prohibit. The only express prohibition posited by some is the prohibition found in Bankruptcy Code §524(e) which conflates a discharge with a release and injunction. They are distinct legal issues and not tied together. The Pre-Bankruptcy Conduct Release is not a "discharge" of a Third Party (which is expressly prohibited), nor does the Pre-Bankruptcy Conduct Release flow from the discharge of the debtor. It may have the same ultimate preclusive legal effect, but it is an injunction prohibiting actions against the Third Party based on that parties own liability.

The complexities of financial restructurings are such that having some leeway in implementing creative solutions should be encouraged, not discouraged. In the words of one experienced and respected bankruptcy judge, chapter 11 is unique in the law in that it deals with what can be, not exclusively on what happened in the past (like traditional litigation).[62] So while admittedly amorphous in its scope and language, rather than attempt to make the Code another version of the Internal Revenue Code with its patchwork of stopgaps and other byzantine provisions which were inserted to deal with specific problems (always in hindsight and making the law unfathomable to most mortals), keeping flexibility for bankruptcy courts allows those courts to deal with real time, real world exigencies is critically important to the ultimate success of the chapter 11 process.

Case in point—so-called "critical vendor" motions which are, for the most part, standard in operating company chapter 11 cases. These motions provide for the post-bankruptcy payment of pre-bankruptcy unsecured claims based on the need to maintain trade credit and otherwise avoid irreparable harm to the debtor's nascent restructuring proceedings. The problem is, payment of pre-bankruptcy unsecured claims in a chapter 11 is authorized in the Code itself to be done only pursuant to a confirmed chapter 11 plan (with its attendant classification and other protections). The legal basis for "critical vendor" motions? The "doctrine of necessity" under the Railroad Reorganization Act of 1933[63] and—wait for it—Section 105.

In the *K Mart* chapter 11, a scorned non-critical vendor objected to a first day procedure to pay critical vendors taking the appeal all the way to the Seventh Circuit in 2004.[64] The Circuit Court affirmed the district court's reversal of the bankruptcy court approval of the critical vendor

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62 Hon. Redfield T. Baum (Bankruptcy Court, District of Arizona).

63 *See* Max Lowenthal, "The Railroad Reorganization Act," 47 HARV. L. REV. 18 (November 1933).

64 *See In re K Mart Corp.,* 359 F.3d 866 (7th Cir. 2004) ("A "doctrine of necessity" is just a fancy name for a power to depart from the Code. . . every circuit that has considered the question has held that this statute does not allow a bankruptcy judge to authorize full payment of any unsecured debt, unless all unsecured creditors in the class are paid in full. . . . The fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be.") (citations omitted).

motion on the basis of, *inter alia*, lack of statutory authority.[65] True enough, yet critical vendor motions are still commonplace in most jurisdictions (including within the Seventh Circuit).[66] Another case in point—the so-called "new cash exception/corollary" to the absolute priority rule. Like the "doctrine of necessity" for critical vendor motions, there is no statutory support in the Code at all under Section 1129(b)(2)B)(ii) (indeed, it is violative of the express provisions of the Bankruptcy Code) and is the product of *dicta* in a pre-Code case from the 1930s.[67] The Supreme Court has had two opportunities to rule on this very issue, and managed to simply punt on it both times[68]. And yet it is commonly used in chapter 11 cases all the time. The statutory basis? None whatsoever, rather the Supreme Court determined that there was an "ambiguity" in the Code provision to suggest it might have survived.[69]

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[65] *Id.* (finding no specified basis in the record regarding the critical need to pay the critical vendors, and lack of statutory authority); *See also* Thomas Salerno, "The Mouse That Roared: Or, Hell Hath No Fury Like a Critical Vendor Scorned," ABI Journal 28 (June 2003).

[66] Albeit with perhaps more evidentiary backup than was used in K Mart! *See e.g. In re Concepts Am., Inc.*, 625 B.R. 881, 893 (Bankr. N.D. Ill. 2021) (noting that statutory authority still exists for chapter 11 debtors to pay their critical vendors despite noting the "overhaul of 'critical vendor' payments in the Seventh Circuit" prior to *Kmart*). Seventh Circuit precedent notwithstanding, the 2015 mega-case of Caesars Entertainment Corporation (initially filed in Delaware as an involuntary bankruptcy but then moved to Chicago) had critical vendor and other first day types of motions granted allowing it to pay pre-bankruptcy unsecured claims. *See, e.g*. *In re Caesars Entertainment Operating Company, Inc. et al*., No. 15-01145 (ABG) (numerous first day motions, including critical vendors and honoring prepetition chip liabilities, all approved). *See* Docket No. 36, 49, 54, 55, 57, 58, 91, 618, 620, 621 and 622.

[67] *See Case v. Los Angeles Lumber*, 308 U.S. 106 (1939); *Cf. In re Ambanc La Mesa Ltd. Partnership*, 115 F.3d 650 (9th Cir. 1997) and *In re Bonner Mall Partnership,* 2 F.3d 899 (9th Cir. 1993) (recognizing continued viability of new cash exception) with *In re Coltex Loop Central 3 Partners, LP,* 138 F.3d 39 (2nd Cir. 1998) and *In re Bryson Properties, XVIII,* 961 F.2d 496 (4th Cir. 1992) (holding the new cash exception did not survive the enactment of the Bankruptcy Code).

[68] *See Bank of America v. 203 North LaSalle Partnership*, 526 US 434 (1999) ("**203 North LaSalle**") and *Norwest Bank Worthington v Ahlers*, 45 U.S. 197 (1988); Salerno & Kroop, "Urgent Message To The Supreme Court: 'Just Do It!'", 34 *B.C.D.* 1 1999).

[69] 203 North LaSalle at 435 ("The drafting history is equivocal, but does nothing to disparage the possibility apparent in the statutory text, that §1129(b)(2)(B)(ii) may carry such a corollary. Although there is no literal reference to "new value" in the phrase "on account of such junior claim," the phrase could arguably carry such an implication in modifying the prohibition against receipt by junior claimants of any interest under a plan while a senior class of unconsenting creditors goes less than fully paid.")

WHY ARE SOME PRE-BANKRUPTCY CONDUCT RELEASES LESS OBJECTIONABLE THAN OTHERS?

"All animals are equal, but some animals are more equal than others."
George Orwell
Animal Farm (1945)

Are those Third Parties who may have liability for asbestos related injuries along with the debtor (and legally able to obtain a Pre-Bankruptcy Conduct Release) somehow more deserving of relief than those related to mass tort damages that are not asbestos related? Was Section 524(g) just the result of a powerful asbestos-related insurance industry lobbying effort? Is there anything unique about mass tort situations in asbestos cases as compared with other product liability or mass tort cases? It is unclear, but also undeniable that the Code as currently existing creates two distinct groups of third party beneficiaries when it comes to the availability of Pre-Bankruptcy Conduct Release availability.

Put another way, let's look at this from the perspective of the victims of mass tort cases. It must be presumed that Congress believed in 1994 that there was societal and economic benefit in amending Section 524(g) to provide for a specific and detailed mechanism to get Pre-Bankruptcy Conduct Releases in the asbestos context to non-debtor Third Parties in exchange for contribution to funding trusts for payment of these claims.[70] Presumably such amendment to the law was based on anticipated quicker, ratable payments to a deserving group of victims, and incentivized third parties to "fund" trusts to administer such funds (the "carrot" being the Pre-Bankruptcy Conduct Release). It is hard to argue against this change in the law.

Real time case in point--Johnson & Johnson is currently facing about 38,000 personal injury lawsuits, with new "ovarian cancer and mesothelioma lawsuits being filed at the rate of one per hour all day, very day in 2020."[71] In another opioid producer's case defense costs were

[70] *Id.* Congress amended the Bankruptcy Code to add Section 524(g) in 1994 to "provide a restructuring model for asbestos-related bankruptcies Susan Power Johnston & Katherine Porter, "Extension of Section 524(g) of the Bankruptcy Code to Nondebtor Parents, Affiliates, and Transaction Parties," American Bar Association, The Business Lawyer, Vol. 59, No. 2, pp. 510-511 (February 2004), available at: https://www.jstor.org/stable/40688207. Section 524(g) provides for a specific and detailed procedure for the issuance of an injunction pursuant to a plan of reorganization to cover, among others, a Third Party (such as an insurance company or any other party who is alleged to be "directly or indirectly liable" with the debtor on asbestos related claims.

[71] Johnson & Johnson's subsidiary recently defeated a motion to dismiss its chapter 11 filing on bad faith grounds, with the bankruptcy court finding that chapter 11 is uniquely positioned to create a forum for the ratable distribution of assets for victims. *See* Sullivan, "J&J Talc Unit's Ch. 11 Case Allowed To Go Forward", *Law360* (February 25, 2022).

estimated at as much as $1 million per week.[72] The tort adjudication system in the U.S. has been characterized as "lottery-like" by Johnson & Johnson.[73] While J&J was characterizing this system from the perspective of astronomical jury verdicts in favor of plaintiffs (and against the company) taking years to come to judgment[74], the flip side is also true. Those claimants that get judgments first ("lottery-like" or not) stand a better chance of getting paid, but also ultimately reduce the "pot" available for later victims. Avoiding a rush to the courthouse may in practical effect benefit not just the company, but also the later victims (some of whom may not even know they have injury). Bottom line—chapter 11 should be about equitable and ratable return and not just about payment to the first that get judgments. ***The authors respectfully submit that the debate and litigation should center not on the legal issue about whether the Third Party Pre-Bankruptcy Conduct Release is legally permissible, but rather the economic issue of how much it should cost the Third Party. That is what is critical to those with "skin in the game"—certainty, timing and sources of payment and efficiency of the process.*** This is certainly where *Johnson & Johnson* is attempting to steer the debate in its pending proceedings.[75] It is also clearly the focus of the ongoing *Purdue Pharma* settlement discussions.

So why precisely are victims of personal injury (mental and/or physical) resulting from sexual abuse, or victims of product liability for faulty medical devices or talcum powder, or victims of environmental contamination, or any other mass tort less worthy of the same avenue for a more expeditious resolution of their claims and a source of payment for those claims in one forum?[76] The only difference between a personal injury claim resulting from exposure to

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[72] In opioid producer Mallinckrodt PLC's chapter 11 in Delaware, the litigation costs were estimated at $1 million per week. *See* Rochelle, "Horizontal 'Gifting' Approved in Mallinkrodt's Confirmed Chapter 11 Plan", *Rochelle's Daily Wire* (February 9, 2022).

[73] *Id.* (discussing how Johnson & Johnson was "already subject to 38,000 talc suits, with more accumulating every hour," and the numbers clearly evidenced the company "could not bear the costs—let alone the lottery-like verdicts—of adjudicating the pending and expected claims.").

[74] *See* "Talc Claimants Argue Bad Faith In J&J Ch. 11 Trial", *Law360* (February 14, 2022) (49 talc claims had been tried at the time Johnson & Johnson set up its new "Texas two-step" company to ring fence liabilities, which cases took 8 years to adjudicate with one jury verdict of $4.7 billion, reduced to $2 billion on appeal, in favor of 22 plaintiffs).

[75] *See* "J&J Could Increase $2 Billion Talc Settlement Offer, Lawyer Says", *ABI Headlines* (February 17, 2022)(quoting from testimony in the dismissal proceedings wherein Johnson & Johnson's bankrupt subsidiary stated the $2 billion being contemplated for settlement of the claims is only "a start", subject to further negotiations.)

[76] The mirror side of this proposition, of course, is why are asbestos manufacturers more worthy of chapter 11 protection than, for example, makers of talcum powder? Based on the perceived abuses of the so-called "Texas Two Step" divisive merger mechanism as a precursor to chapter 11, there is no shortage of outcry over whether Johnson & Johnson should even be allowed to be in chapter 11, much less be able to use what unquestionably will be the fulcrum of its restructuring efforts (the claims estimation process, bar date for filing of claims, creation of a trust for payment of those claims, and of course a Third Party Pre-Bankruptcy Conduct Release). *See, e.g.* Chappell, Friedman & Parr, "J&J Can't Be Allowed To Dodge Civil Justice With Bankruptcy", *Law360* (February 10, 2022). Indeed, there are currently ongoing congressional hearings on this issue. *See, e.g.* Written Testimony Of Hon. Judith Klaswick Fitzgerald (Ret.) before the Senate Committee On The Judiciary, Subcommittee On Federal Courts,

asbestos and one resulting from physical or sexual abuse or one from the use of a faulty contraceptive device or baby powder is the root cause of the injury. The injury is real in all cases. The disparity in the law has never been satisfactorily explained.[77] *See* "ABI Panelists, US Chamber Support Ch. 11 3rd Party Releases", *Law360* (February 25, 2022). The focus of the naysayers have been on the perceived benefit to the Third Parties of the Pre-Bankruptcy Conduct Release when the real focus should be on the potential benefits to the victims of the mass tort.[78] Presumably this is where congress' focus was when it enacted Bankruptcy Code §524(g) in 1994. The allowance of Pre-Bankruptcy Conduct Third Party Releases resulting from *Johns-Manville* (who pioneered the concept before the Code expressly allowed it) was viewed as visionary enough that Congress formally adopted it for asbestos cases. The same concept is now being characterized as abusive.

It is time for Congress to address this disparity decisively. To that end, the authors humbly suggest four (4) potential amendments to the Bankruptcy Code (Title 11) and Judicial Code (Title 28) that would create certainty in this uncertain jurisprudential morass.

Stay tuned for ***Part III: Four Proposed Legislative Fixes For The Third Party Release Mess!***

Oversight, Agency Action and Federal Rights, entitled "Abusing Chapter 11: Corporate Efforts To Side-Step Accountability Through Bankruptcy" (February 8, 2022).

[77] The authors recognize the lobbying efforts of the personal injury bar and insurance industries in the passage of Section 514(g). That perhaps is the only difference in the circumstances, albeit a distinction that is neither fair nor equitable from an overall policy perspective.

[78] The historic uses of chapter 11 to attempt to ring-fence liabilities (using a divisive merger or otherwise), obtain discharges for debtors and Third Party Pre-Bankruptcy Conduct Releases have been the "abuses" of bankruptcy laws decried by numerous critics discussed above. While making for expedient sound bites, it is also (in the authors' opinions) somewhat myopic. One can argue about changing the law, but at a minimum the full economic repercussions should be analyzed. If you increase taxes to companies and they move operations offshore, these same critics will complain about the loss of American jobs. In economics, as in physics, every action has a reaction. It can be good, or not so good.

In Defense Of Third Party Releases In Chapter 11 Cases (PART THREE): Four Proposed Legislative Fixes For The Third Party Release Mess!"

"We need to encourage habits of flexibility, of continuous learning, and of acceptance of change as normal. . ."

Peter F. Drucker
Innovation and Entrepreneurship: Practice and Principles
(1985)

This is the final installment of three articles on the conundrum of third party releases in chapter 11 cases. In the prior two installments, the authors defined the battlefield[79] and briefly explored the legal, policy and economic parameters of pre-bankruptcy conduct releases ("**Pre-Bankruptcy Conduct Releases**") to benefit non-debtor third parties ("**Third Party**").[80] Having sufficiently muddied the jurisprudential waters, the authors now humbly suggest four potential legislative fixes to this Pre-Bankruptcy Conduct Release for Third Parties. Notwithstanding the proposed settlement of the *Purdue Pharma* dispute,[81] it is very likely this issue will raise its head many times in the future as the issue is receiving renewed scrutiny in cases nationwide.[82] While the bankruptcy world can wait for the patchwork of judicial decisions putting the differing gloss on the issue, it is apparent Congress should fix this problem legislatively.

While sometimes in error but never in doubt,[83] the authors would propose that bankruptcy law (in the form of a Bankruptcy Code and Judicial Code amendments and otherwise in jurisprudence) to deal with this issue in one of four ways:

1. Remove The "Asbestos" Limitation From 11 U.S.C. § 524(g)(2)(B)(1): Section 524(g) takes up a full three pages in the Code! It is an extensive and detailed blueprint for how a non-debtor can obtain the protection of an injunction under a bankruptcy proceeding (which must be done through a confirmation of a chapter 11 plan) for asbestos related claims.[84] In other words,

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79 *See* Part I Article.

80 *See* Part II Article.

81 *See* notes 13 and 14, *supra.*

82 Such as in the Boy Scouts of America and essentially every Catholic dioceses cases.

83 With attribution to John J. Dawson, Esq. (1947-2009).

84 *See* Part II Article at 58.

how to legally give Pre-Bankruptcy Conduct Releases for a non-debtor Third Party. It even has classification requirments and separate voting requirements.[85]

The complex and detailed structure set out in the Code has one material jurisdictional limitation—it is only applicable to deal with asbestos or asbestos related damage claims. Section 524 currently provides in pertinent part as follows:

> **524 (g)(1)(A):** After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.
>
> * * *
>
> **(B)** The requirements of this subparagraph are that—
>
> **(i)** the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—
>
> **(I)** is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery ***for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products***;

11 U.S.C. § 524(g)(1)(A), (B)(i)(I) (emphasis added). The rest of Section 524(g) goes into intricate detail about what the trust must contain, other requirements for court approval, some limitations, etc.

So why not simply take out fourteen words in Section 524(g), and keep all the other bells and whistles in it? Hence, the section as reworded would provide as follows:

> **(B)** The requirements of this subparagraph are that—
>
> **(i)** the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—
>
> **(I)** is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages

[85] *See* 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(aa) and (bb). For example, it has a voting acceptance threshold of 75% of those voting to be approved (compared with the normal voting of 51% in number and 66 2/3rds % in amounts of claims for usual cram down purposes). Hence, it is like a super majority acceptance requirement.

[***striking: allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products***];

If the Code were to be amended as proposed above, it would provide the blueprint (with all the attendant protections and legal requirements) for Pre-Bankruptcy Conduct Releases for essentially any mass tort type of claim group, not just asbestos related claims. If it meets the due process and societal benfit hurdles for asbestos victims, why wouldn't it work for any mass tort type of situation?[86]

While Congreess is at it, it should clean up another mess it created. Congress should redesignate Section 524(g) as a new Section 1123(c) (dealing with permissive plan provisions). Including these Third Party injunction provisions in Section 524 only facilitated the conflating of the concepts of a Pre-Bankruptcy Conduct Release as a "discharge" of a non-debtor.[87] In legal reality, Section 524(g)'s extensive provisons are not about "discharge" for non-debtors, but rather a blueprint for an injunction benefitting Third Parties in the resolution of asbestos liability claims in a chapter 11 plan context. It belongs conceptually and logically in Section 1123.

2. <u>Impose A Mandatory Opt Out Option</u>: Alternatively, an amended Section 1123 could be further amended to expressly provide for mandatory provisions allowing creditors to opt out of the Pre-Bankruptcy Conduct Release provisions in any plan. If reference to non-bankruptcy class action experiemnce is any indication, there are empirical studies that show that opt outs are statistically rare. In one study, for the time period between 2014 and 2018, there was an average of about 9% opt outs in nearly 400 cases studied.[88] While an imprecise metric, it does provide some measure of statistical guidance as to how many claims will opt out of a settlement that provides more immeiate return than traditional litoigation.

Moreover, a plan that would have a mandatory opt out could have a self-effectuating "poison pill" provision along with it. For example, unless XX% in amounts of filed claims did not opt out, the contribution related to the Pre-Bankruptcy Conduct Release would not be made, and all parties would reserve their rights. This would allow for plan confirmation to move forward even if the class that would be most impacted by the Pre-Bankruptcy Conduct Release opted out

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[86] In practice non-asbestos mass tort cases are already doing this. In the *Boy Scouts of America* case, even the judge suggested that the 75% vote requirement from Section 524(g) provides a helpful benchmark in what is clearly not an asbestos related mass tort case. *See, e.g*. "Courts Are Trying To Vet Boy Scout Sex Abuse Claims", *Axios* (January 12, 2021) ("Last week the preliminary tallies of a vote by alleged victims on whether to accept the most recent $2.7 billion settlement came just short of the 75% threshold the judge suggested to move forward".). Available at //www.axios.com/local/dallas/2022/01/12/courts-vet-boy-scout-sex-abuse-claims.

[87] This anomaly in placement in the Code was specifically remarked upon by both the Sixth and Seventh Circuit court decisions. *See* Part II Article at 31.

[88] *See* "Opt Out Cases In Securities Class Action Settlements," *Cornerstone Research: 2014-2018 Update*.

or the opt outs were so large that it advsersly affected the economics of the deal.[89] It also presents the voting claimants with a real economic decision—the recovery tied to the Third Party Pre-Bankruptcy Conduct Release today, or wait another 2-3 years while the lawsuits play out and insurance policies are depleted by costs of defense. The choice should belong to those with "skin in the game" in all events. Finally, such a provision puts the focus on where it really should be in these cases—negotiations and "horse trading" between those seeking the Third Party Release and those for whose benefit the contribution will be disbursed.[90]

3. <u>Amend 28 U.S.C. §157 To Make Any Third Party Pre-Bankruptcy Conduct Release A Matter For District Court Final Adjudication:</u> The issue of legal propriety of Third Party Pre-Bankruptcy Conduct Releases is distilled (by the time it reaches appellate courts) to a distinct legal issue—is there subject matter jurisdiction for a bankruptcy court to grant these? While beyond the scope of this article, seasoned (*i.e.* older) bankruptcy practitioners will recall where they were in June of 1982 when the bankruptcy courts went out of business because of the Supreme Court's *Marathon Pipeline* jurisdictional ruling that was handed down that summer.[91] So the issue becomes whether a bankruptcy court (with its limited subject matter jurisdictional grant of authority) is arguably exceeding that jurisdictional authority in approving Third Party Pre-Bankruptcy Conduct Releases.

It is important that this discussion be put into some brief context. Faced with an unconstitutional jurisdictional regime, in 1984 Congress enacted a new jurisdictional scheme in Title 28 creating the legal fiction that bankruptcy cases were technically filed in district courts, and then automatically referred to their "units" (the bankruptcy courts).[92] District courts are

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[89] This mandatory opt out is in some respects the flip side of the 75% consent requirement found in Section 524(g)(2)(B)iii)(IV)(bb) in asbestos cases.

[90] The authors acknowledge that critics of this proposal will say that but for the appeal by the Objecting States and those dissenters from the victim class, the Sacklers would have been able to get away with the initial $4.3 billion proposed contribution, and the additional contribution totaling up to $6 billion was only because of the serious legal impediment of the appeal. Perhaps so, but ultimately it was a negotiated resolution, which is the very core of chapter 11.

[91] See generally *Northern. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The Supreme Court ruled that the jurisdictional grant to the bankruptcy court under the then existing 28 U.S.C. § 1471(c) was unconstitutional in that it gave general federal jurisdiction (reserved to Article III courts) to bankruptcy courts (Art. I courts). One of the authors graduated law school in May of 1982, and arrived to the practice of bankruptcy law just as the bankruptcy courts were conducting "going out of business sales."

[92] *See* Salerno, Papas & Kugler, Chapter 3: Commercial Bankruptcy Litigation, 2d., *Thomson Reuter's* (2021). The Bankruptcy Amendments and Federal Judgeship Act of 1984 (**BAFJA**) took effect in July 1984. Pursuant to 28 U.S.C. § 1334(a) BAFJA conferred ***original, but not exclusive***, jurisdiction upon the district courts of all civil proceedings arising under title 11 or ***arising in or related to*** cases under title 11. Under the BAFJA, all cases "related to" bankruptcy are automatically referred to the bankruptcy court. 28 U.S.C. § 157(a). The bankruptcy judge is empowered to determine whether a controversy is a "core proceeding" or is "otherwise related to" a bankruptcy case. This created the present "division of labor" between bankruptcy courts and their related district courts. Bankruptcy courts are deemed a "unit" of the district court.

undeniably Article III courts with general federal jurisdiction. With bankruptcy matters technically filed in district court (albeit automatically referred to the bankruptcy court), the constitutional quandary of subject matter jurisdiction was solved. Bankruptcy matters are clearly matters of federal question jurisdiction under 28 U.S.C. § 1331, so district courts have subject matter jurisdiction. Based on the referral by the district court, it's the bankruptcy court (as the "unit" of the district court) which exercises the jurisdiction subject to a detailed district court review regime discussed below.[93] Within the bankruptcy proceeding, Title 28 further distinguishes between "core" (those matters expressly arising under the Bankruptcy Code) and "non-core" (those matters "related to" but not expressly arising under the matters in a bankruptcy proceeding). 28 U.S.C. § 157(b). Both core and non-core matters are automatically referred by the district court to the bankruptcy court for adjudication.[94]

Even as an Article I court of limited jurisdiction, with respect to "core" matters, the bankruptcy court issues final and dispositive rulings with respect to those matters. Those are squarely in the bankruptcy court's grant of jurisdiction. So stay relief, and other expressly Bankruptcy Code matters are dealt with by the Article I specialized court (the bankruptcy court). It is a limited grant of jurisdiction. Conversely, "non-core" matters to which parties have not consented to jurisdiction (a whole new area of confusion),[95] the bankruptcy court must propose *findings of fact and conclusions of law*[96] for *de novo* review by the district court. 28 U.S.C. § 157(c). The district court (upon request of a party) must review the proposed findings of fact and conclusions of law *de novo,* adopt or reject (or some combination thereof) those proposed findings and enter final judgment. The *de novo* review means no deference is afforded the bankruptcy court's factual findings unlike a traditional appeal (in which deference is afforded in an appeal in a core proceeding). An Article III judge has looked at the factual determinations and law with "fresh" Article III eyes. Constitutional problem solved.

So, how about amending 28 U.S.C. § 157 by adding a new subsection that provides, in effect, that any plan that contains a Third Party Pre-Bankruptcy Conduct Release (which will always be in a specific and distinct section or sections of the plan), the approval of those specific sections

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[93] The statutory scheme has spawned no less than three further Supreme Court cases as its limits were explored. *See, e.g., Stern v. Marshall*, 564 U.S. 462 (2011) (even a "core" matter under Section 157(b) is recognized as such, the bankruptcy court is still only able to issue proposed findings of fact and conclusions of law); *Executive Benefits Insurance Agency v. Arkison (In re Bellingham),* 573 U.S. 25 (2014) (absent consent in a non-core matter, bankruptcy court may not finally adjudicate that matter); *Wellness Int'l Network, Ltd. v. Sharif,* 575 U.S. 665 (2015) (bankruptcy court can finally adjudicate non-core matters with consent of the parties).

[94] 28 U.S.C. § 157(a) is discretionary in wording (providing that district courts "may" refer matters to the bankruptcy court). This is academic as every district court (already facing full dockets and shortages of judges) has done so by rule.

[95] *See supra* note 90.

[96] In many jurisdictions the bankruptcy court will issue a *Report and Recommendation* with respect to these issues. This happens regularly in avoidance litigation where defendants have not submitted or consented to bankruptcy court jurisdiction in cases in which they have not filed claims (and thereby submitted to bankruptcy court jurisdiction).

will be deemed a "non-core," but related matter, and as such a party will have the right to seek a *de novo* review of that specific provision to the district court? The evidentiary record will be made at the bankruptcy court level (just like in any non-core, related matter) and with respect to the approval of that specific provision, the bankruptcy court will submit a proposed finding of fact and conclusion of law to the district court for *de novo* review. This legal standard will ensure that an Article III court with undeniable federal question jurisdiction (the district court) makes the determination as to the appropriateness of the issuance of the injunction that enforces the Pre-Bankruptcy Conduct Release.

The authors submit that this process will not take any more time than the current appeal process where there is objection to the approval of the Pre-Bankruptcy Conduct Release, and in fact will ultimately expedite the process since this process will do away with the major legal issue in the cases to date—the question of subject matter jurisdiction to approve the releases. While the prospect of a *de novo* review theoretically involves the ability to present new factual evidence, in practice what it really means is that the district court will look at the existing evidentiary record, and make its own findings without deference to the bankruptcy court's findings.[97] While it is theoretically possible an objecting party seeks a new or additional evidentiary hearing before the district court as part of the *de novo* review process, it is simply unlikely such a request would be granted absent extraordinary circumstances. What evidence would the objecting party present to the district court that it could not have presented to the bankruptcy court? And if there is such evidence, why exactly wasn't it presented to the bankruptcy court? Uncomfortable questions for counsel indeed, especially as the statute does not specify what a *de novo* review must entail. This is left to the sound discretion of the district court. A busy district court judge dealing with a full docket asked to review specialized matters of some complexity will be unlikely to reopen evidence absent very compelling circumstances. Moreover, given that the relief is essentially equitable in nature, jury trial rights are not implicated.[98]

It is the authors' opinions that making the approval of a Third Party Pre-Bankruptcy Conduct Release a non-core matter subject to *de novo* review would serve to expedite a review process, not delay it. The authors recognize that such a proposal, if adopted, could take away a powerful weapon in the plan proponent's arsenal—that of equitable mootness of plan confirmation order appeals. Absent a stay pending appeal, commencing plan distributions (and certainly substantially consummating plans) may equitably moot the appeal. While a possibility, in cases like *Purdue Pharma*, there was little to no chance such a tactic would have worked (and especially as against any federal objecting governmental entities, to whom bonding requirements for stays are not

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[97] Conclusions of law are always reviewed *de novo* in all respects.

[98] As the issuance of an injunction is inherently a matter in equity, jury trial rights are not afforded parties as a matter of right. *See, e.g.*, *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 719 (1999). A Third Party Pre-Bankruptcy Conduct release is at its core the issuance of an injunction (with the issues of need, irreparable harm, no adequate remedy at law and public policy determinations). In short, the evidentiary case made for approval of the Pre-Bankruptcy Conduct Release is realty the same evidentiary showing that would be made as part of an injunction proceeding for all practical purposes.

applicable).[99] The foregoing notwithstanding, this continued uncertainty about the subject matter jurisdiction to approve the Third Party Pre-Bankruptcy Conduct Releases that screams for a legislative fix does not come without a cost for plan proponents.

4. <u>Impose A Fulsome Financial Disclosure For All Recipents Of Pre-Bankruptcy Conduct Releases</u>: Finally, and the least preferred from the authors' perspective, would be to statutorilly impose on those Third Parties seeking a release to essentialy submit to rigorous financial scrutiny with mandatory disclosures of financial information.[100] This requirement would be akin to a "best interests of creditors test" for the Third Party beneficiary of the Pre-Bankruptcy Conduct Release, and would require a showing that such beneficiaries are providing more than claimants would get if the Third Party getting the release were itself in liquidation. [101]

This is the least preferred alternative since it is the most fraught with ancillary litigation possibilities, and inherent delays. Clearly this would create a whole other set of litigation dynamics! If the Third Party recipient of the release is an insurance company, this becomes somewhat more straightforward (particularly if the insurance company is tendering all or substantially all policy limits in exchgange for the releases). Application in a situation like *Purdue Pharma* would undeniably be a materially more convoluted and litigious process.

In any event, it is certainly better than an outright prohibition on such releases. In reality, it is somewhat similar to what bankruptcy courts are being asked to do when evaluating such releases currently (albeit with perhaps less precision). Equally unattractive would be to have the issue continue to percolate in the judicial system like the ongoing uncertainties revolving around the so called "new cash" exception (or corollary) to the absolute priority rule,[102] similar to the "doctrine of necessity" for critical vendor motions.[103] Both of these are commonly used in chapter 11 cases all the time. There really is no specific statutory basis for these. It seems to the authors that a reluctant Supreme Court looking to duck this issue on legality of third party releases could find sufficient wiggle room in the Bankruptcy Code between Sections 105(a), 1123(a)(5) (requiring that a plan must provide for "adequate means of implementation") and 1123(b)(6) (stating that a plan may provide other provisions not expressly inconsistent with the Code). Leaving this impactful decision to the vagaries of the Supreme Court solves little ultimately.

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99 *See, e.g,* FRBP 8007(d) (regarding no requirement for federal governmental agencies to post a bond for a stay pending appeal).

100 Of course, this aspect could also be added as a requirement in the other alternatives suggested in this article as well.

101 Admittedly one might counter then why not have the beneficiary simply file their own bankruptcy. The specter of additional administrative expenses and delay in such a situation would, in the authors' opinion, militate against this.

102 *See supra* notes 66-68.

103 *See* Part II Article at 58.

LAST WORD: WAS THE SACKLER DEAL SIMPLY NOT RICH ENOUGH?

"Pigs get fat, hogs get slaughtered."
Rubbery Figures
Australian TV Show
(1980s)

Bankruptcy Judge Charles G. Case's characterization of the overarching purpose of chapter 11 speaks volumes: "The intent of the Bankruptcy Code is to encourage consensual resolution of claims through the plan negotiation process. . . The Bankruptcy Court is a court of equity with a primary focus upon facilitating the reorganization process. . . ."[104] The "deal" that was memorialized in the *Purdue Pharma* plan garnered overwhelming creditor support. The subsequent deal that resulted in the objecting states' withdrawal of their objections sweetened the pot and added another $1.5 billion to the contribution being proposed. The process, as lengthy, expensive and contentious as it was, would undeniably fit within the intent of the Bankruptcy Code. Judge Drain confirmed the plan (and approved the subsequent settlement) finding, *inter alia*, they were in good faith.

It is interesting that the creative professionals that conceived of and implemented the *Johns-Manville* plan (using a Code that had no express provisions for such a process) are hailed as pioneering visionaries in the asbestos mass tort world, yet attempts to use the same basic protocol for non-asbestos injuries are decried as perverting and abusing the Bankruptcy Code and process. Perhaps one generation's visionary is the next generation's heretic. But let's be candid here—even the most neutral judge will have a challenge in ignoring the context in which this issue arises. The opioid scourge is a true human tragedy with serious societal ripple effects all fueled by greed. Given the starkly ugly history here, if the poster children for Pre-Bankruptcy Conduct Releases were people other than the Sackler family, and this issue arose in funding some class action securities strike suits, one is left to wonder whether such vitriol and litigation would have accompanied the plan confirmation. Pre-Bankruptcy Conduct Releases are found in many plans of reorganization (despite the law ostensibly prohibiting them)[105], and while there is almost always grumbling, it is less commonplace for multi-billion dollar plan proposals to be stopped dead in their tracks because of appellate litigation.

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[104] *In re Rhead*, 179 B.R. 169, 176 (Bankr. D. Ariz. 1995) (Case, BJ) (citations omitted). This is in no way intended to suggest that Judge Case (now retired) would agree with the use of his words in this specific context. The foregoing notwithstanding, it is undeniably an accurate and eloquent statement of the overarching public policy of chapter 11.

[105] *See, e.g. Memorandum Decision, Patterson v. Mahwah Bergen Retail Group, Inc.,* Case No. 3:21cv167 (DJN), United States District Court, Eastern District of Virginia (January 13, 2022). District Judge Novak, in a scathing opinion, decries the regular approval of third party releases in bankruptcy cases, and those approved by one bankruptcy judge in particular, which drives venue shopping. Not only was the plan release provision vacated and "voided" (along with other aspects), but on remand the district court ordered reassignment to a different bankruptcy judge because of the practices of the reversed judge in liberally granting such releases. A stark bench slap directed at the lower court judge for sure.

Given the beneficiaries of the *Purdue Pharma* releases and the political heat the issue caused, the positions of the various Objecting States was certainly foreseeable. As the Sackler family releases as originally proposed would result in essentially a retention of about 60% of the wealth up streamed from *Purdue Pharma*, was the issue exacerbated by the dynamic that the deal was simply not rich enough (despite the widespread and overwhelming creditor support)? As Judge McMahon candidly observed: "[Bankruptcy] Judge Drain was certainly right about one thing: where the Objecting States are concerned, it really is all about the money, specifically how much money the Sacklers are prepared to pay to 'buy peace.'"[106]

Jurisdictional and philosophical objections aside, the true issue was undeniably that the Sacklers were simply not paying enough for the releases. It was an economic impasse wrapped in a legal flag. In the end it was about how much more the Objecting States needed earmarked for them[107] and their efforts in dealing with the aftermath related to opioid addiction?[108] Indeed, perhaps the process worked precisely as intended—the Objecting States extracted more money from the Sacklers as the "price of peace". In the sausage making that is chapter 11 plan negotiations, in the authors' opinions the real litmus test should be time and expenses (legal fees and costs) saved, and measure those against the potential chapter 7 of the person/entity seeking the release. Of course, this is easier said than done, but spending enormous resources on the battles surrounding the legality of Pre-Bankruptcy Conduct Releases can also lead to a Pyrrhic victory for the winner of that fight.

Undeniably a "best interests" analysis assumes full and complete disclosures and creates its own set of litigation skirmishes. That notwithstanding, by effectively delaying (and in other cases depriving) creditors of up to $6 billion pool of recovery in real time, who has really won? While as part of the ongoing negotiations the Sacklers sweetened the pot, the possibility certainly existed that had they not, there would have been a meltdown of a highly negotiated plan with widespread creditor support. If the Second Circuit affirms the SDNY Opinion, will it be too late then for a deal that would be approved by the bankruptcy court? After all, if the bankruptcy court has no subject matter jurisdiction to issue a Third Party Pre-Bankruptcy Conduct Release, it has no subject matter jurisdiction. Whether that is done as part of a settlement agreement or a plan, subject matter jurisdiction is subject matter jurisdiction. Would the bankruptcy court then maker a report and recommendation to the district court for its consideration? Yet more delay and uncertainty.

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[106] Appeal Certification Order at 2, note 1.

[107] Indeed, after the subsequent deal was struck, some creditors complained that the structure of the sweetened deal (with its allocation of additional money to just the objecting states) amounted to "hush money" for those objectors. *See* Hailey Konnath, "NY, NJ Towns Fight $277M 'Hush Money' In Purdue Deal", *Law360* (March 7, 2022).

[108] Again, it is noteworthy that at least forty state attorneys general found the deal acceptable. *See* Part I Article at 33. Prior to the subsequent settlement, at least some groups had taken the position that the Connecticut Attorney General is "ignoring" the opioid victims and their wishes in pursuit of the appeal. *See* Paul Schott, "CT Attorney General Denies 'Ignoring' Opioid Victims' Families In Purdue Pharma Appeal," *CT Insider* (January 12, 2021).

In all events, the *Purdue Pharma* morality play and SDNY Opinion was an imperfect solution to a very messy problem. While maybe critics can all get some moral satisfaction over making the beneficiary of the releases in *Purdue Pharma* go through the exercise of personal bankruptcies, no one should be surprised when the litigation involved in that process further delays (and possibly dilutes) recoveries to those victims who so desperately need the help.

The ball is most likely at this point in the legislative court so to speak. Let's get this mess fixed. Indeed, one amendment to Section 524(g) and/or to 28 U.S.C. § 157 could accomplish that. Let's finish this already!

Faculty

Hon. Stacey G. C. Jernigan is Chief U.S. Bankruptcy Judge for the Northern District of Texas in Dallas, initially appointed on May 12, 2006. Prior to her appointment, she practiced for 17 years in the Business Reorganization and Bankruptcy Practice Group of Haynes and Boone LLP in Dallas, where she represented debtors, committees and purchasers in large, complex chapter 11 cases and out-of-court workouts, particularly with regard to energy companies, regulated entities, real estate businesses and public companies. She was also an advisor to the California Legislature in Sacramento in connection with the California utility financial crisis in 2001. Judge Jernigan is Board Certified in Business Bankruptcy Law by the American Board of Certification, a Fellow of the American College of Bankruptcy and a Fellow of the Texas and Dallas Bar Foundations. She is a frequent author and has been recognized by *Chambers USA*, *D. Magazine* and *Texas Monthly Law & Politics*. Judge Jernigan received her B.B.A. *magna cum laude* from Southern Methodist University in 1986 and her J.D. from the University of Texas Law School in 1989.

Kimberly A. Posin is a restructuring partner with Latham & Watkins in Los Angeles and has two decades of experience advising debtors and creditors on high-profile matters and on a range of restructuring related transactions. She regularly represents corporate debtors, secured lenders, creditors and other interested parties in all aspects of distressed situations, including chapter 11 bankruptcy proceedings, out-of-court restructurings, foreclosures, assignments for the benefit of creditors, and related disputes and litigation. Ms. Posin's clients range from name-brand global companies to Silicon Valley startups in a diverse range of industries. She frequently handles matters in all of the major U.S. jurisdictions, including Delaware, New York and Texas. Ms. Posin received her B.S. in 1999 from the University of Southern California and her J.D. in 2002 from the University of California, Berkeley School of Law (Boalt Hall).

Thomas J. Salerno is a partner in the Bankruptcy and Creditors' Rights practice at Stinson LLP in Phoenix, where he represents distressed companies, acquirers and creditors in financial restructurings and bankruptcy proceedings, pre- and post-bankruptcy workouts, and corporate recapitalizations. He works with clients from an array of industries, including casinos, resort hotels, sports teams, real estate, high-tech manufacturing, electricity generation, agribusiness, construction, health care, airlines and franchised fast-food operations. Mr. Salerno has represented parties in insolvency proceedings in 30 states and five countries. He has been involved in restructurings in the U.S., U.K., Germany, France, Switzerland, and the Czech and Slovak Republics. In addition, Mr. Salerno taught comparative international insolvency at the University of Salzburg and Gray's Inn School of Law in London, and is an adjunct professor at the Sandra Day O'Connor School of Law at Arizona State University, teaching bankruptcy litigation and advanced chapter 11 bankruptcy. He is also a regular guest lecturer at the Eller MBA Program for the University of Arizona. Mr. Salerno has served as an expert witness on U.S. insolvency law in litigation in Germany, and represented Coyote Hockey LLC, the owners of the Phoenix Coyotes of the National Hockey League (NHL), in historic bankruptcy proceedings that resulted in an unprecedented solution: the NHL purchasing one of its own teams for the first time in the league's 90-year history. He headed the U.S. delegation to the Czech Republic in advising the Czech Government in the historic revamping of its bankruptcy law, which took effect in January 2008, and he has also advised on revamping insolvency laws in the Domini-

can Republic and Costa Rica. Mr. Salerno is a member of the UNCITRAL working group on its Insolvency Law Reform Project, completed in early 2007. He is a former ABI Board and Executive Committee member, a past director of the American Board of Certification, a Fellow of the American College of Bankruptcy, and a member of the Plan Issues Advisory Subcommittee for ABI's landmark Bankruptcy Review Commission. Mr. Salerno received his B.A. *summa cum laude* from Rutgers University and his J.D. *cum laude* from Notre Dame Law School, where he served as an editor of the *Notre Dame Law Review*.

Lydia R. Webb is a partner with Gray Reed & McGraw LLP in Dallas, where she focuses her practice on representing and advising debtors, creditors, committees and post-confirmation trustees in bankruptcy cases and other insolvency or restructuring scenarios. She has guided clients to successful results in complex cases before courts throughout Texas and many other states, including Oklahoma, Delaware and New York. Ms. Webb's cases span the oil and gas, health care, retail, manufacturing and restaurant businesses. She has been listed in *The Best Lawyers in America* in the fields of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law since 2021 and in Bankruptcy Litigation for 2022-23, was selected to participate in the National Conference of Bankruptcy Judges Next Generation program in 2019, and has been named a "Rising Star" by *Texas Super Lawyers* since 2018. Ms. Webb is an ABI member and is social chair of the DFW Association of Young Bankruptcy Lawyers. She is also a member of the Dallas Bar Association's Bankruptcy Section, The Hon. John C. Ford American Inn of Court and the International Women's Insolvency & Restructuring Confederation. Ms. Webb was honored in 2021 as one of ABI's "40 Under 40." She received her B.B.A. *cum laude* in finance and economics from Baylor University in 2009 and her J.D. *cum laude* from Baylor University School of Law in 2012.