Should I Care About the Purdue Pharma Decision?

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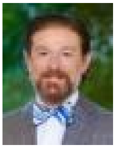

On June 27, 2024, the United States Supreme Court decided the Purdue Pharma appeal.

In a five-to-four decision, the Supreme Court held that a bankruptcy court may not extend to non-debtors the benefits of a Chapter 11 discharge usually reserved for debtors. Put another way, the Supreme Court held that "the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a non-debtor without the consent of affected claimants.”

The immediate effect of the decision was to reverse the court-approved plan to settle the opioid litigation against Purdue Pharma and the Sackler family. But some commentators have suggested this is one of the most consequential bankruptcy cases of the last 40 years, and it will have broad implications for Chapter 11 beyond this case.

In Chapter 11, a debtor attempts to reorganize its affairs through a plan of reorganization. If the bankruptcy court confirms the plan, the debtor often has its debts discharged. Plan solicitation, voting, horse-trading, and confirmation – by consent or at a contested hearing – come at the end of the process. Beforehand, the debtor has disclosed its assets, liabilities, and projected future revenue and expenses.

That is fine for the Chapter 11 debtor. The controversy arises when non-debtors – who have not laid bare their financial situation -- seek a discharge as part of a plan of reorganization. In Purdue Pharma, it was the Sackler family. But billions of dollars and a national public-health crisis need not be at stake for this issue to arise.

Consider a local mid-market company that files for bankruptcy protection. The owners of the company can, and often do, try to seek a personal discharge as part of the company's bankruptcy. The company may also have affiliates or subsidiary companies with potential exposure. Lenders and other claimants may want to bring claims against ownership and the affiliates for voidable transfers, breach of fiduciary duty to the company, or other improper conduct.

Here are things to remember. First, a non-debtor third-party discharge usually involves a *quid pro quo*. The non-debtors rarely seek a discharge for nothing. Asking the bankruptcy judge for a "buy one get one free" special will not work.   Usually, non-debtors provide cash to the plan in exchange for their discharge. The Sacklers, for example, were going to pay $6 billion under the Purdue Pharma plan. Sometimes, however, an owner will argue that he is the brains of the operation and the debtor can't operate effectively if he is saddled

with litigation and, therefore, should be discharged.

Second, bankruptcy is a group process. If all you have is a two-party dispute, then you will not be in bankruptcy (or not for long). Chapter 11 involves different classes of creditors and numerous claimants in each class. A debtor need not get 100% acceptance to confirm a plan. The problem arises when some creditors will grant a discharge to a non-debtor and others refuse.

In Purdue Pharma, almost all the creditors were willing to pinch their noses and take the deal, even though everyone knew the Sacklers had taken $11 billion from the company but were only paying $6 billion under the plan. For these claimants, the bird in the hand beat the one in the bush. The objecting creditors felt otherwise. Sure, they would have to litigate for many more years, but they believed that when the dust settled, they would recover more than what the plan provided.

It’s no surprise that the Circuit Courts were divided on the issue, and the Supreme Court's decision was five to four. Putting aside the text of the Bankruptcy Code, which rivals only the Internal Revenue Code for opaque and confusing provisions, this issue has valid public policy and fairness arguments on both sides. But policy considerations aside, the Supreme Court has now told bankruptcy courts they can't confirm a plan with non-debtor third-party releases over the objection of creditors, even if it's just a vocal minority and even if confirmation would be "good" public policy.

Where does that leave us? First, the bankruptcy court can still confirm a plan with non-debtor third-party releases if everyone consents. Perhaps the decision will change the negotiation dynamics and provide creditors with more leverage against third parties seeking releases. This could cause third parties to pay more to pass a consensual plan. Or it may have the opposite effect. If third parties realize they can't get the consent of all claimants and they will have future litigation exposure, they may be reluctant to contribute to the debtor's plan.

The decision could spawn more creative Chapter 11 plan provisions. Debtor may propose plans that will pay creditors "in full" over time, but seek injunctions prohibiting litigation against non-debtor third parties during the life of the plan. Technically, this would not be a non-debtor discharge, but it would delay creditors' ability to pursue claims. Debtors may also propose plans conditioned on settlement of pending or potential lawsuits against the non-debtor third parties.

The path forward will be interesting, and we will monitor how the bankruptcy courts and lawyers respond to this momentous decision.

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