No. 23-124

IN THE

Supreme Court of the United States

WILLIAM K. HARRINGTON, UNITED STATES TRUSTEE, REGION 2,

Petitioner,

v.

PURDUE PHARMA L.P., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

AMICI CURIAE BRIEF OF THE HONORABLE EUGENE WEDOFF (RET.) AND LAW PROFESSORS SARA GREEN, GEORGE KUNEY, STEPHEN LUBBEN AND LAWRENCE PONOROFF IN SUPPORT OF THE PETITIONER

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INTEREST OF THE *AMICI*[1]

Your *amici* are the Honorable Eugene Wedoff (ret.) who served as a U.S. Bankruptcy Judge in the Northern District of Illinois in Chicago from 1987–2015 and as Chief Judge from 2002–2007 and Law Professors Sara Green (Duke University), George Kuney (University of Tennessee), Stephen Lubben (Seton Hall University School of Law) and Lawrence Ponoroff (Tulane University Law School).

We are filing this *amicus* brief in support of the Petitioner. Our interest in filing this *amicus* brief is to address the impropriety of nonconsensual third-party releases. The granting of releases from liability for the Sackler family—the owners of Purdue Pharma, none of whom filed for bankruptcy relief—is well beyond the statutory reach of bankruptcy law.

While third-party releases have been the subject of persistent criticism on various grounds, including constitutional, policy and statutory grounds, our brief seeks reversal of the Second Circuit decision on statutory grounds. Nonconsensual third-party releases do not, and cannot, satisfy the statutory standard for all plans of reorganization under Chapter 11, namely, that none of the plan's provisions are "inconsistent" with the provisions of Title 11, as set forth in 11 U.S.C. §1123(b)(6).

1. Pursuant to Sup. Ct. R. 37.6 *amici* represent that no party's counsel authored the brief in whole or in part, nor contributed money that was intended to fund preparing or submitting the brief, nor that any person other than the *amici curiae*, their members, or their counsel, contributed money that was intended to fund preparing or submitting this brief.

We demonstrate in this brief the critical inconsistencies concerning the foundational aspects of plan confirmation, namely, disclosure, distribution, and discharge.

INTRODUCTORY STATEMENT

On September 1, 2021, the U.S. Bankruptcy Court for the Southern District of New York confirmed the Plan of Reorganization for Purdue Pharma, L.P.[2] The Plan contained nonconsensual third-party releases for members of the Sackler family who had not personally filed for bankruptcy. On appeal to the United States District Court, Judge Colleen McMahon observed that the validity of third-party releases was the "great unsettled question" among the courts.[3] She then reversed the decision of the Bankruptcy Court, holding that "the Bankruptcy Court lacked statutory authority to impose … [the Release]."[4] However, on further appeal, a Panel of the Second Circuit reversed and remanded the District Court decision.[5]

The District Court's ruling was correct. The impropriety of third-party releases has been recognized by the courts for at least the past thirty-eight years. *See, e.g.*, *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985) ("[The] bankruptcy court has no power to discharge the liabilities of a nondebtor pursuant to the consent of

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2. *In re Purdue Pharma, L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021).

3. *In re Purdue Pharma, L.P.,* 635 B.R. 25, 37 (S.D.N.Y. 2021).

4. *Purdue Pharma,* 635 B.R at 38.

5. *In re Purdue Pharma, L.P.*, 69 F.4th 45 (2d Cir. 2023).

creditors as part of a reorganization plan."). At least three circuits outlaw them.[6]

Respected academic writers view third-party releases as part of a trend toward lawlessness in bankruptcy jurisprudence. ("The perpetrators of lawless Chapter 11s use an array of legal devices to insulate themselves against liability for their wrongdoing [including third party releases].").[7] Professor Ralph Brubaker writes, "[n]ondebtor releases are an illegitimate and unconstitutional exercise of substantive lawmaking powers by the federal courts."[8] Commentators have written that third-party releases have led to substantial abuses within the bankruptcy system, and that they permit a distortion of bankruptcy law that is wholly outside the carefully articulated Congressional scheme found in Title 11.

Reversal of the Second Circuit decision is compelled by the correct resolution of the underlying statutory issues. The Second Circuit Panel in *Purdue Pharma* stated that the statutory issue was the "primary issue in this appeal."[9] "[T]he dispositive question is whether, *under*

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6. *Landsing Diversified Properties v. First Nat'l Bank & Trust Co of Tulsa*, (*In re W. Real Estate Fund Inc*, 922 F.2d 592, 600 (10th Cir. 1991); *Matter of Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995); *Bank of N.Y. Trust Co. v. Off. Unsecured Creditors' Comm.* (*In re Pac. Lumber Co.*), 584 F.3d 299 (5th Cir. 2009); *Underhill v. Royal*, 769 F.2d 1426.

7. *See* Lynn LoPucki, *Chapter 11's Descent into Lawlessness,* 96 Am. Bank. L. J. 247 (2022).

8. Ralph Brubaker, *Mandatory Aggregation of Mass Tort Liability in Bankruptcy*, 131 Yale L. J. F. 960, 960 (2022).

9. *Purdue Pharma,* 69 F.4th at 66.

the Bankruptcy Code, a bankruptcy court is authorized to approve the Release."[10] This brief demonstrates the lack of statutory authority for third-party releases.

The Second Circuit agreed that there was no express provision that authorizes third-party releases. Nevertheless, it found that the statutory authority could be inferred from the combination of 11 U.S.C. § 1123(b)(6) and § 105(a). Notably, it recognized that § 105(a) by itself was insufficient.[11] Thus, it looked primarily to § 1123(b)(6). This section contains the requirements for what a plan of reorganization may include, and expressly excludes provisions which are either not appropriate or are "inconsistent with the applicable provisions of this title."

The Second Circuit incorrectly held that § 1123(b)(6) *only* excludes from a plan of reorganization provisions which are expressly prohibited in the Code but that otherwise, permits a bankruptcy court unlimited authority for any other kind of plan provisions. This was legal error and by itself justifies reversal.

The correct statutory test under § 1123(b)(6) is whether third-party releases are inconsistent with the applicable provisions of the Code. This does not require that they be expressly prohibited. Third-party releases are intrinsically inconsistent with the provisions of the

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10. *Id.* at 88 (Wesley, J., concurring) (emphasis added).

11. "We reject Appellants' suggestion that § 105(a) alone supports the imposition of the releases in this action. Indeed, our case law, and that of the majority of our sister circuits, support the proposition that § 105(a) alone cannot justify the imposition of third-party releases." *Purdue Pharma*, 69 F.4th at 73.

Code. Such releases amount to a bankruptcy discharge without any compliance with the statutory requirements for such. Granting third-party releases amounts to nothing less than a "wholesale restructuring" of the entire statutory scheme that governs the entitlement to a discharge and release from claims.[12]

Discharge, distribution, and disclosure inconsistencies.

The granting of third-party releases is inconsistent with the Code's statutory scheme for disclosure, distribution, and discharge. First and foremost, the releases for the Sacklers were squarely inconsistent with the Code because there is *no provision* which authorizes third-party releases other than § 524(g), which section was not relevant here. We agree with those courts that hold that § 524(g) provides the *only* permitted statutory basis for third-party releases, and that § 524 is dispositive of the issues in this case.[13]

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12. "It has been a cardinal principle of bankruptcy law from the beginning that its effects do not normally benefit those who have not themselves 'come into' bankruptcy court with their liabilities *and* all their assets. To violate this principle … is simply to invite a wholesale restructuring of those involved in commercial transactions without any indicating from Congress that such a profound change was intended." *Venture Properties, Inc., v. Norwood Group, Inc. (In re Venture Properties, Inc.)*, 37 B.R. 175, 177 (Bankr. D.N.H. 1984).

13. "The circuits that have read § 524(e) as a bar to third-party releases have reasoned that "it is the debtor[ ] who has invoked and submitted to the bankruptcy process, that is entitled to its protections; Congress did not intend to extend such benefits to third-party bystanders." *Purdue Pharma*, 69 F.4th at 74.

Further, the Purdue Plan permitted a discharge of debt for claims which the Code expressly states *cannot be discharged* as to individual debtors. Code §§ 523(a)(2), (a)(4), (a)(6) and (a)(7) state that a debtor may not receive a discharge for fraud, defalcation, willful and malicious injury, and fines, penalties and forfeitures payable to a governmental entity. Yet the Purdue Plan was inconsistent with these provisions. The District Court correctly noted that it was unaware of any court that has granted a discharge to debtors such as the Sacklers given the nature of the third-party claims against them (for violations of state and federal law, as well as willful misconduct).[14]

The granting of third-party releases is also inconsistent with other core provisions of Title 11 dealing with disclosure, distribution and the "best interest" test. Third-party releasees are not legally obligated to schedule and disclose all their assets, nor are they legally obligated to distribute all their non-exempt assets to creditors. And third-party releasees are not legally required to ensure that objecting creditors receive the floor amount required in a lawful plan of reorganization under the best interest test.

The Second Circuit failed to consider the import of these statutory inconsistencies. Instead of looking to what

14. "The Section 10.7 Shareholder Release does not carve out or exempt claims for fraud or willful and malicious conduct, liabilities from which Purdue cannot be discharged in its own bankruptcy. . . . Second Circuit has never approved a non-consensual release of claims against non-debtors of this sort, nor has it ever explained what provision of the Bankruptcy Code authorizes a bankruptcy court to do so." *Purdue Pharma*, 635 B.R. at106.

the Code requires, the Second Circuit relied on a judicially created doctrine set forth in *Master Mortgage* to fill the missing gap of statutory authority.[15] Yet this too fails to be compliant with the Code. "[T]he judicially decreed criteria for approval of nonconsensual nondebtor releases do not replicate the Bankruptcy Code's substantive and procedural protections for the third-party claims being discharged thereby."[16]

The deviations from what the Code requires are similar in import to the Code deviations that this Court addressed in *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 471 (2017) ("courts cannot deviate from the procedures 'specified by the Code,' even when they sincerely 'believ[e] that ... creditors would be better off'"). Just as the deviations from the Code's priority system could not be justified based on certain creditor advantages, even in rare cases, neither can the Code's disclosure, distribution, and discharge provisions be altered or disregarded, even in the rare case by means of a nonconsensual third-party release.

SUMMARY OF LEGAL ARGUMENT

The Bankruptcy Court's ruling that it had the authority to approve a nonconsensual release of third-party claims was reversible error.

First, the Second Circuit held that § 1123(b)(6) in conjunction with § 105 provides statutory authority for

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15. *In re Master Mortgage Investment Fund*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994). *Purdue Pharma,* 69 F.4th at 78.

16. Brubaker, *supra* note 8, p. 981 (2022).

nonconsensual third-party releases. This was legal error. Neither statutory section authorizes nonconsensual third-party releases. Section 105(a) is limited to equitable relief which must be anchored to existing Code provisions: it cannot be the basis for inferring substantive rights.[17] The granting of a release is the functional equivalent of a discharge, which is a substantive legal right.[18] The Second Circuit agreed that § 105(a) by itself is not sufficient to authorize nonconsensual third-party releases.

Second, neither does § 1123(b)(6) authorize the approval of nonconsensual third-party releases. Section 1123(b)(6) prohibits a plan from containing any provisions which are not "appropriate" *and* which are inconsistent with the "applicable provisions of this title." The only Code provision which permits third-party releases is § 524(g) which does not pertain here. On this ground alone, reversal of the Second Circuit is appropriate.

Third, the correct statutory test for what is "inconsistent" under § 1123(b)(6) focuses on whether the releases provide rights and benefits to the Sacklers that are not permitted or are expressly excluded to individual debtors under the Code. Because the claims being released included those for fraud and willful misconduct, under no circumstances could they be included in a nonconsensual plan of reorganization.

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17. *Law v. Siegel*, 134 S. Ct. 1188 (2014).

18. *See In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d Cir. 2005); *In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) ("A discharge is in effect a special type of permanent injunction.").

Fourth, third-party releases are inconsistent with the applicable provisions of Chapter 11 because they provide a discharge from debt without requiring the third party to comply with the disclosure and distribution scheme of the Code. This foundational distribution scheme is violated (and hence inconsistent with the provisions of Title 11) when a plan grants the full legal benefits of a discharge to a party that fails to disclose its assts and declines to make all its non-exempt assets available for creditors.

Fifth, the third-party releases in the Purdue Plan were inconsistent with the provisions of § 1129(a)(7). This provision requires that a plan of reorganization cannot be confirmed over the objection of a dissenting creditor unless the plan provides a distribution to such creditor of no less than that creditor would receive in a chapter 7 liquidation. The Bankruptcy Court failed to make adequate findings concerning the value of the claims against the Sacklers, and hence did not properly apply this best interest test.

Sixth, the Second Circuit grounded much of its decision on equitable considerations. The Sacklers' conduct in this case does not satisfy any cognizable standard of what is equitable. The Sacklers, as owners and managers of Purdue Pharma, were responsible for a public health catastrophe.[19] When they perceived the risk of individual liability, they transferred to themselves over $11 billion from Purdue. They then insisted on a reorganization plan that personally granted them releases from their

19. *See Purdue Pharma,* 633 B.R. at 58 describing the "massive public health crisis," the "public health catastrophe" and noting the "extraordinary harmful effects of the Debtors' primary product, the prescription drug OxyContin."

wrongdoing in exchange for "contributing" less than one-half of what they had transferred to themselves.[20] In short, there is no equitable context in this case that would conceivably make the granting of releases compliant with equitable norms or principles.

LEGAL ARGUMENT

I. The Bankruptcy Code contains no statutory authority that permits a bankruptcy court to approve nonconsensual third-party releases.

A. Bankruptcy Code § 105(a) does not authorize nonconsensual third-party releases nor grant broad residual powers to a bankruptcy court.

It is uniformly recognized that there is no express statutory authority for the granting of third-party releases. "The Bankruptcy Code does not expressly provide for a discharge of liabilities of any party other than the debtor. Instead, aside from a special provision for asbestos bankruptcies, the discharge provisions of the Code relate only to the debtor."[21]

Lacking any expresses authority, the Second Circuit sought to fill this statutory gap by reading together §§

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20. The Sacklers "agreed to contribute up to $6 billion … but only on the condition that … they receive a release from liability . . . ." William Harrington, U.S. Trustee, Application for a Stay of the Mandate of the United States Court of Appeals, filed in these proceedings, p. 2 (hereafter, "Trustee Stay App.").

21. Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances,* 100 Tex. L. Rev. 202, (2022).

105(a) and 1123(b)(6), as providing an implied "residual power" that would justify the granting of such releases. Neither § 105(a) nor § 1123(b)(6), when read together or separately, provide any legal basis for the granting of nonconsensual third-party releases.

The Second Circuit expressly recognized that § 105(a) standing alone cannot be the legitimate basis for the granting of a third-party release.[22] This ruling was correct because (a) § 105(a) has been viewed as only permitting equitable relief and (b) the granting of a release is tantamount to a discharge and is thus substantive.

The limited scope of § 105 springs from the view that bankruptcy courts are essentially courts of equity. *Young v. United States*, 535 U.S. 43, 50 (2002) ("bankruptcy courts … are courts of equity and "appl[y] the principles and rules of equity jurisprudence."); *Pepper v. Litton*, 308 U.S. 295 (1939) ("[T]his Court has held that for many purposes 'courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity'".); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) ("The Bankruptcy Court is a court of equity").

Despite this often repeated phrase that bankruptcy courts are courts of equity, some scholars have suggested that a bankruptcy court has "no general equitable power," and that § 105 has been misread as creating such a right.[23] What is widely agreed is that "[t]he fact that a

22. *Purdue Pharma*, 69 F.4th at 73.

23. *See* Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*. 79 Am Bankr. L. J. 1. (2005).

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." *Matter of Chicago, Milwaukee, St. Paul and Pacific R. Co.*, 791 F. 2d 524, 528 (7th Cir. 1988).

The statutory development of § 105(a) demonstrates that whatever equitable powers do exist, they do not include the power to create substantive rights. "The predecessor Bankruptcy Act of 1898 contained a provision virtually identical to Code § 105(a), and the 1898 Act cases uniformly held that this provision did not authorize nonconsensual nondebtor discharge provisions".[24] Professor Klee likewise notes the restrictive reading of §105's predecessor under the Act.[25] The leading pre-Code case setting forth the limited nature of the equitable relief is said to be *Callaway v. Benton*, 336 U.S. 132 (1949) which was described as holding that bankruptcy courts' equitable injunctive powers "did not authorize a nonconsensual nondebtor release via permanent injunction."[26]

24. Brubaker, *supra* note 8 at 968 (citing Act of July 1, 1898, ch. 541, 30 Stat 544).

25. Kenneth N. Klee and Whitman L. Holt, Bankruptcy and the Supreme Court: 1810-2014 (West, 2014) at p.178, note 1288, (citing *D. Ginsberg & Sons, Inc. v. Popkin,* 285 U.S. 204, 206-08 (1932)).

26. Brubaker, *supra* note 8 at 968. *See also,* Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non–Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 992 (1997) ("*Callaway,* then seems to speak *solely* to the impropriety of a *permanent* non-debtor release and injunction.")

Since the adoption of the 1978 Code, this Court has adopted a "restrained and limited approach" to the permissible use of § 105.[27] "[M]any recent decisions of the Court have made clear that whatever equitable powers bankruptcy courts have, they 'must and can only be exercised within the confines of the Bankruptcy Code.'"[28] *See Law v. Siegel,* 134 S. Ct. 1188, 1194 (2014). ("We have long held that 'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of' the Bankruptcy Code.")

This Court's more recent decisions on bankruptcy law have repeatedly emphasized that the touchstone for its decisions is statutory compliance with the Bankruptcy Code, and that "equitable" considerations cannot substitute for compliance with the Code. [29] This limit on the use of equitable powers means that bankruptcy courts cannot invoke "inherent powers" to create substantive rights, such as a non-debtor discharge, otherwise unavailable under the Bankruptcy Code.

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27. Klee, *supra* note 25 at 172.

28. Klee, *supra* note 25 at 179 (citing *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206 (1988)).

29. Jonathan M. Seymour, *Against Bankruptcy Exceptionalism,* 89 Univ. Chi. L. Rev. 1925, 1934 (2022) challenging the notion that bankruptcy courts can rely on notions of equity to depart from standard rules of statutory construction. Professor Seymour cites *Taggart v. Lorenzen,* 139 S. Ct. 1795 (2019), *City of Chicago v. Fulton,* 141 S. Ct. 585 (2021), *Baker Botts LLP v. ASARCO, LLC,* 135 S. Ct. 2158 (2015) and *RadLAX Gateway Hotel v. Amalgamated Bank,* 566 U.S. 639 (2012) as reflecting the Court's strong inclination to rely only on "well established canon[s] of statutory interpretation."

B. Bankruptcy Code § 105(a) does not authorize the granting of nonconsensual third-party releases: a release is the functional equivalent of a discharge, is substantive in nature and is not within the ambit of any "residual powers" of a Bankruptcy Court.

The granting of a discharge is a substantive act and lies at the center of bankruptcy law. "[T]he introduction of the discharge could well be considered the most important event in bankruptcy history."[30] "[I]t ranks ahead in importance of all others in Anglo-American bankruptcy history."[31] A discharge alters the rights of parties and has the adjudicative power of a binding judgment. The power to determine when a discharge may be granted lies solely with Congress.

The Second Circuit Panel held that "the bankruptcy court's ability to release claims at all derives from its power of discharge."[32] Earlier decisions from the Second Circuit were in accord: "In form, it [a nondebtor release] is a release; in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code. The potential for abuse is heightened when releases afford blanket immunity." *Deutsche Bank AG v. Metromedia Fiber Network Inc.,(In re Metromedia Fiber Network, Inc.),* 416 F.3d 136, 142

30. Sullivan, Warren and Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (1989), in Charles J. Tabb, Bankruptcy Anthology, 2002, p. 524.

31. Tabb, *supra* at note 31, p. 525, citing John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History,* 70 Am. Bankr. L. J. 163 (1996).

32. *Purdue Pharma,* 69 F.4th at 70.

(2d Cir. 2005). As discussed below, the Panel in this case appeared to deviate from prior rulings of the Second Circuit.[33]

The notion that a release is in effect a discharge is supported both by substantial case law and leading commentators. Professor Brubaker notes, the term "release" is just a euphemism for an implementing injunction "that permanently extinguishes and bars nonconsenting creditors from pursuing direct claims of liability against non-debtor parties."[34]

Professor Brubaker aptly describes the legal consequences of a channeling injunction in terms of its discharge consequences. "[T]he 'channeling' terminology is now widely employed to describe injunctions that effectuate a discharge of personal liability (of either a debtor or a nondebtor) that leaves specified property as the only source of recovery for those whose claims have been discharged—that is their claims are 'channeled' away from the discharged person and toward and against that property (and only that property)."[35]

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33. Surprisingly, the Second Circuit seemed to contradict its prior ruling in *Metromedia*. "While the Bankruptcy Code forbids a *discharge* of a non-debtor's claim under 11 U.S.C. § 524(e), the releases at issue on appeal do not constitute a discharge of debt for the Sacklers because the releases neither offer umbrella protection against liability nor extinguish all claims." *Purdue Pharma*, 69 F.4th at 71.

34. Ralph Brubaker, *A Case Study in Federal Bankruptcy Jurisdiction: Core Jurisdiction (or not) to Approve Non-Debtor "Releases" and Permanent Injunctions in Chapter 11,* 38 Bankr. L. Ltr. No. 2, February 2018, p. 1.

35. Brubaker, *supra* note 8, at 963, n.11.

The release of a claim is an adjudication and functionally a discharge. "An NDR [nonconsensual nondebtor release] is the functional equivalent of a bankruptcy discharge—bankruptcy's 'greatest power'—'without a filing and without the safeguards of the [Bankruptcy] Code."[36]

Numerous courts agree that a release/injunction operates as a discharge. *In re PT Bakrie Telecom Tbk*, 628 B.R. 859, 880 (Bankr. S.D.N.Y. 2021). ("A third-party release can act as a complete release, waiver, and discharge of that party from a claim of any nature … arising out of or in connection with the debtor and its plan of reorganization."); *In re Mal Dunn Assocs., Inc.*, 406 B.R. 622, 629 (Bankr. S.D.N.Y. 2009) ("In form, [a release] … may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code."); *In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) ("A discharge is in effect a special type of permanent injunction."); *In re Digital Impact, Inc.*, 223 B.R. 1, 14 (Bankr. N.D. Okla. 1998. ("The Court may not use its equitable powers to create substantive rights, such as a non-debtor discharge, otherwise unavailable under the Bankruptcy Code. *See United States v. Sutton*, 786 F.2d 1305, 1307–08 (5th Cir.1986)").

In this case, the Panel attempted to distinguish prior circuit precedent, stating that the releases were not a discharge because the releases did not provide the full

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36. Jonathan C. Lipson, *'Special': Remedial Schemes in Mass Tort Bankruptcies,* 101 Tex. L. Rev. 1769, 1770 (2023) (citing *Deutsche Bank AG v. Metromedia Fiber Network, Inc.,* 416 F.3d 136, 142 (2d Cir. 2005)).

"umbrella" of protections.[37] This statement overlooks the more significant fact that the release for the Sacklers provided significantly more legal benefits than an individual debtor could obtain in a bankruptcy case. The releases given to the Sacklers were correctly described by the U.S. Solicitor General as being a "release of liability of exceptional and unprecedented breath."[38] The scope of the release covered virtually every conceivable claim related to the opioid catastrophe, including claims that are not dischargeable for individual debtors:

> The release provision "absolutely, unconditionally, irrevocably, fully, finally, forever[,] and permanently release[s]" the Sacklers from every conceivable type of opioid related civil claim—including claims based on fraud and other forms of willful misconduct that could not have been discharged had the Sacklers filed for bankruptcy in their individual capacities.[39]

The releases provided protection that was not available to the Sacklers had they filed their own bankruptcy cases. As the District Court properly noted the release provisions of the Plan directly conflicted with §§ 523(a)(2), (4) and (6), which, respectively, prohibit a discharge of claims for fraud, fiduciary defalcation or willful and malicious conduct.[40] "[T]he Second Circuit

37. *Purdue Pharma*, 69 F.4th at 70-71.

38. Trustee Stay App., p. 2.

39. Trustee Stay App., p. 2-3.

40. *Purdue Pharma,* 635 B.R. at 106-07.

has never approved a non-consensual release of claims against non-debtors of this sort [for fraud claims] nor has it ever explained what provision of the Bankruptcy Code authorizes a bankruptcy court to do so."[41] "[T]he Code] ensures that all debts arising out of fraud are excepted from discharge [] no matter what their form."[42]

The substantive nature of the release and injunction, and its essential nature as a bankruptcy discharge, preclude the use of § 105 or other inherent powers to justify permitting the granting of such releases in either a plan of reorganization or as part of a "settlement." The discharge power remains within the sole province of the legislature and may not arise by judicial fiat or inference. As the Second Circuit Panel conceded, § 105(a) by itself cannot justify the third-party releases in this case.

C. ***United States v. Energy Resources*** **does not authorize using "inherent powers" to approve nonconsensual third-party releases.**

In the absence of any statutory authority the Second Circuit looked primarily to this Court's decision in *United States v. Energy Resources Co., Inc.*, 495 U.S. 545 (1990) as somehow permitting equitable relief to reach beyond express statutory authority. This is a misreading.

Energy Resources addressed a narrow issue of how tax payments made by a debtor to the Internal Revenue Service should be allocated, as between "trust fund" obligations and non-trust fund obligations. This Court

41. *Id.* at 107.

42. *Archer v. Warner*, 538 U.S. 314, 321 (2003).

noted that the Code was silent as to which was permitted, but clearly *some designation* was required. The IRS argued that the payments should be applied to non-trust fund liabilities. This Court declined to do so, holding this was an "added protection *not specified in the Code.*"[43]

As the Fifth Circuit stated, *Energy Resources* held that the residual power under § 105 applied only to affect debtor-creditor relationships and could not be used to release non-debtor parties. "Energy Resources did not discuss a bankruptcy court's jurisdiction over non-debtor tax liabilities. Nothing in Energy Resources suggests that bankruptcy courts have jurisdiction to determine the tax liabilities of non-debtors." *In re Prescription Home Health Care, Inc.,* 316 F.3d 542, 549 (5th Cir. 2002).

Energy Resources is not to be read as signally this Court's willingness to enlarge the notion of "inherent powers." In the thirty-three years since the decision in *Energy Resources* this Court has more emphatically insisted on grounding its statutory interpretations of bankruptcy law based on traditional rules used by federal courts.[44]

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43. 495 U.S. at 550 (emphasis added).

44. *See, Against Bankruptcy Exceptionalism, supra* note 29. p. 1934 discussing this Court's decisions which reject the notion that bankruptcy courts can rely on notions of equity to depart from standard rules of statutory construction, citing various examples including *RadLAX Gateway Hotel v. Amalgamated Bank,* 566 U.S. 639 (2012) as reflecting the Court's strong inclination to rely only on "well established canon[s] of statutory interpretation."

II. Bankruptcy Code § 1123(b)(6) does not contain statutory authority for a bankruptcy court to approve nonconsensual third-party releases.

A. Section 1123(b)(6) precludes plan provisions which are inconsistent with the provisions of Title 11.

Just as § 105(a) by itself cannot be used to create a substantive right to a release, nor does the cobbling together of §§ 105 and § 1123(b)(6) create such a power. As noted, § 1123 contains part of the requirements for a lawful plan of reorganization. It states that a "plan may include any other appropriate provision not inconsistent with the applicable provisions of this title." Thus, it excludes from a plan any provision which is either not "appropriate" or not "consistent" with the provisions of Title 11.

The District Court correctly held that § 1123(b)(6) adds *nothing* to the substantive powers of a court; it is a counterpart of what is found in § 105 but transported from the general provisions to the plan provisions of Chapter 11. The District Court held that § 1123(b)(6) does not create a power to grant a release, just as § 105 does not.

> In form, Section 1123(b)(6) is substantively analogous to Section 105(a)'s authorization of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). If the latter does not confer any substantive authority on the bankruptcy court – and that proposition is well settled, at least in this Circuit – then the former can in no way be read to do so.

> That alone would be reason to conclude that Section 1123(b)(6) does not provide the statutory authorization we are seeking.[45]

There are important differences in the statutory language used in § 105(a) as opposed to §1123(b)(6). Section 105 authorizes a court to enter an order which is "necessary or appropriate." Section 1123(b)(6) permits a plan to contain "any other appropriate provisions not inconsistent with the applicable provisions of this Code."

When § 1123(b)(6) is compared to § 105(a) it is apparent that § 1123(b)(6) is *more restrictive* than § 105(a). Section 105 requires that the proposed order be "necessary." Section 1123(b)(6) states that even a "necessary" provision could be prohibited if it was not in concert with the provisions of Title 11.

This difference in statutory language reveals that § 1123(b)(6) requires a more demanding standard for inclusion in a plan than merely being "necessary." The difference in language matters. "[W]here the document [statute] has used one term in one place, and a materially different term in another, the presumption is that the different term denotes a different idea."[46]

The Second Circuit held to the contrary, stating "§ 1123(b)(6) is limited only by what the Code expressly forbids, not what the Code explicitly allows." *Purdue Pharma,* 69 F.4th at 74.

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45. *Purdue Pharma,* 635 B.R. at 106.

46. Antonin Scalia and Bryan Garner, Reading Law: The Interpretation of Legal Texts, Thompson West (2012), 170.

The Second Circuit thus gave no effect to the requirement that the plan provision not be "inconsistent" with the provisions of Title 11. This notion that virtually anything is permitted unless expressly precluded would work a radical reordering of plan confirmation. It should be plain that the Code cannot list every conceivable plan provision that is not consistent with the scope and purpose of Title 11.

The Second Circuit's interpretation of the legal standard under § 1123(b)(6) was legal error. The Panel simply noted the absence of any prohibition, giving no consideration as to whether the releases were inconsistent with other provisions in the Code. This omission, without more, justifies reversal of the decision.

B. Nonconsensual third-party releases are inconsistent with the Code's substantive provisions pertaining to discharge of claims.

The statutory requirement that a plan not contain provisions which are inconsistent with the Code is not satisfied where (a) a party seeks a "release" which is tantamount to a discharge, (b) the party complies with none of the basic obligations of a debtor, and yet (c) such party obtains the benefits in a release greater than what the Code permits a debtor under the discharge provisions. Such an outcome can hardly satisfy the notion of what is appropriate or consistent with Title 11 as required by § 1123(b)(6).

A fatal flaw with the Sackler releases was that they were "inconsistent" with the Code's discharge provisions because they greatly exceeded the scope of a discharge

that an individual debtor would receive in bankruptcy. The District Court correctly held that the releases for the Sacklers were inconsistent with the express statutory provisions that forbid an individual debtor from receiving a discharge based on fraud and willful misconduct:

> First and foremost, the Section 10.7 Shareholder Release is inconsistent with the Bankruptcy Code because it discharges a non-debtor from debts that Congress specifically said could not be discharged by a debtor in bankruptcy. The Section 10.7 Shareholder Release does not carve out or exempt claims for fraud or willful and malicious conduct, liabilities from which Purdue cannot be discharged in its own bankruptcy. *See* 11 U.S.C. §§ 523(a)(2), (4), (6). Reading the Bankruptcy Code as authorizing a bankruptcy court to discharge a non-debtor from fraud liability – something it is strictly forbidden from doing for a debtor – cannot be squared with the fact that Congress intended that the Bankruptcy Code "ensure that all debts arising out of fraud are excepted from discharge no matter what their form." *Archer v. Warner,* 538 U.S. 314, 321, 123 S. Ct. 1462, 155 L.Ed.2d 454 (2003) (internal citation omitted).[47]

In addition, the District Court correctly held that the Purdue plan was inconsistent with § 523(a)(7) because it granted the Sacklers a discharge for governmental fines or penalties, which would not have been permitted had they personally filed for bankruptcy:

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47. *Purdue Pharma,* 635 B.R. at 106.

> Second, as the State Appellants point out, a debtor's discharge cannot relieve him of "any debt ... to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty..." 11 U.S.C. § 523(a)(7). At least some of the claims asserted by the State Appellants seek relief in the nature of non-dischargeable civil penalties payable to and for the benefit of governmental units. Such claims could not be discharged if the Sacklers had filed for personal bankruptcy.[48]

In short, the Sacklers were able to obtain a release that provided greater legal benefits than a discharge under the Code, without complying with the basic obligations of a debtor in bankruptcy. The District Court's determination of this core inconsistency with the provisions of Title 11 was correct. The Purdue plan was materially inconsistent with the provisions of Title 11, and standing alone justifies reversal of the Second Circuit.

C. Nonconsensual third-party releases are inconsistent with the disclosure and distribution statutory regime under Title 11.

Third-party releases should be prohibited because they are irreconcilable with the disclosure and distribution scheme required of debtors who seek a discharge under the Code. As the U.S. Solicitor General argues in this case, the Code contains a basic "bankruptcy bargain" or

48. *Purdue Pharma,* 635 B.R. at 107

quid pro quo which requires that the debtor disclose its assets and make them available for creditor distribution in exchange for a discharge:

> To balance those relations, the Code establishes a basic *quid pro quo.* A debtor seeking bankruptcy relief must shoulder a host of obligations—such as the obligation to disclose all its creditors, its assets and liabilities, its current income and expenditures, and the nature of its financial affairs. 11 U.S.C. § 521(a). The debtor must then apply all its assets, with certain narrow exemptions, *see generally id.* § 522) to the satisfaction of its creditors' claims. In exchange, the debtor receives a discharge of its debts.[49]

The disclosure requirements are essential in order to determine if all of a debtor's non-exempt assets are made available to creditors, and that at a minimum, any plan of reorganization provides dissenting creditors as much as they would have received in a chapter 7 liquidation, as required by the best interest test.

These obligations are bypassed with respect to a third-party release. All property is *not* turned over for distribution. The third party being released, unlike a debtor, has no obligation to submit its property to the jurisdiction of the court and for its assets to become "property of the bankruptcy estate" under § 541. Nor are third-party releasees obligated to fulfill any of the

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49. U.S. Trustee's Memorandum of Law in Support of Motion to Stay Mandate, Case No. 22-110 bk, ECF Dkt. 1012, p. 12.

disclosure obligations required of a debtor to obtain the releases. This freedom from disclosure gives them bargaining leverage that a debtor does not enjoy; namely, the ability of a third party, with no duty of candor to the court, to trade partial disclosure and distribution of their assets in a way that a debtor cannot.

In the present case, the Sacklers were given a release despite unanswered issues over their assets, and the undisputed fact that they had transferred a material part of their wealth to offshore trusts in an effort to remove their assets from the reach of creditors.[50] It was undisputed that the Sacklers had moved some, or most, of the $11 billion they had transferred from Purdue to themselves to offshore accounts and to spend-thrift trust in order to place their assets beyond the reach of creditors.

The transfer of the $11 billion to the Sacklers was consequential. "The bankruptcy estate does not hold sufficient assets to fund the plan, in part because the Sacklers 'drained Purdue's total assets by 75%' and reduced Purdue's 'solvency cushion' by 82%."[51]

These transfers of $11 billion raised issues over whether they were avoidable as fraudulent conveyances.

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50. "The Sacklers' … assets are in fact widely scattered and primarily held (x) in purportedly spendthrift offshore trusts, (y) in purportedly spendthrift U.S. trusts, and/or (z) by people who themselves live outside of the territorial jurisdiction of the United States and might not have subjected themselves sufficiently to the U.S. for a U.S. court to get personal jurisdiction over them." *Purdue Pharma* 633 B.R. at 88.

51. Trustee Stay App. at 9, citing App. 19a.

Judge Drain noted the various arguments the Sacklers could use to defend against the fraudulent conveyance claims, but stated that while he was evaluating the evidence, "I am not deciding anything close to the merits of those claims."[52]

The District Court likewise noted the magnitude of the potential fraudulent conveyance claims and that there had been no "finding" on the merits:

> "[Judge Drain found that][t]he record suggest[s] that at least some of the Sacklers were very aware of the risk of opioid-related litigation claims against Purdue and sought to shield themselves from the economic effect of such claims by causing Purdue to make billions of dollars of transfers to them and to shield their own assets, as well, from collection." *While he made no finding that these distributions* qualified as fraudulent conveyances, or that they could be recouped by Purdue, Judge Drain also acknowledged *that the estate had potential claims of "over $11 billon of assertedly avoidable transfers*."[53]

The Purdue case is illustrative of the disparity between the duties and obligations of a debtor seeking a discharge, and the lack of duties on a third party seeking a nonconsensual release from third-party claimants. In the Purdue case, the unresolved questions over the amount of the Sackler wealth being secreted and the collectability

52. *Purdue Pharma,* 633 B.R. at 91.

53. *Purdue Pharma*, 635 B.R. at 57 (emphasis added).

problems appear to have been used as a bargaining tool. Unlike in the case of a debtor, the Bankruptcy Court had no means to compel the information. This certainly did not go unnoted by the Bankruptcy Court (hence Judge Drain noting that the result was "bitter").[54] Thus, the Sacklers were able to offer less than 50% of the transferred wealth that they had taken out of Purdue in exchange for a release, as opposed to making *all* non-exempt assets available to creditors.

Third-party releases are thus legally infirm under the test of "inconsistency" set forth in § 1123(b)(6) because of the absence of any obligation to disclose assets and to make all assets available for distribution to creditors. In this sense alone, the nondebtor releases "do not replicate the Bankruptcy Code's substantive and procedural protections for the third-party nondebtor claims being discharged thereby."[55]

D. Nonconsensual third-party releases are inconsistent with the best interest test of § 1129(a)(7).

Part of a debtor's burden of proof in seeking plan confirmation, is to establish that the "plan complies with the applicable provisions of this title." 11 U.S.C. § 1129(a)(1). The applicable provisions include the best interest test set forth in 11 U.S.C. § 1129(a)(7). "[I]n conjunction with a Chapter 11 debtor's discharge, each and every creditor has the right to insist that it receive at least as much under the debtor's plan of reorganization as that creditor

54. *Purdue Pharma,* 633 B.R. at 93.

55. Brubaker, *supra* note 8, p. 981.

would receive in a liquidation of the debtor's assets."[56] "The 'best interests' test applies to individual creditors holding impaired claims, even if the class as a whole votes to accept the plan." *Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 442 (1999).

Professor Brubaker writes that the best interest test requires "liquidation value for a creditor" and that this right is "inviolable."[57] Further he writes that the return in the Chapter 7 liquidation must include what creditors would receive from third-party non-debtors who are receiving a release under the plan:

> Yet, the best interests equation also properly mandates consideration of creditors' comparative recoveries on non-debtor claims, to the extent the plan is treating those non-debtor claims by release.[58]

This "inviolable" right was not satisfied. In the present case, the objecting states opposed confirmation because a "failure of proof exists here given the absence of expert testimony regarding the value of the third-party claims against the shareholder released parties."[59] Judge Drain

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56. Brubaker, *supra* note 8, p. 981.

57. Brubaker, *Bankruptcy Injunctions*, *supra* note 27, p. 992 (citing Bruce Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganization,* 44 Stan. L. Rev. 69, 87-70 (1991)).

58. Brubaker, *supra* note 8, p. 992.

59. *Purdue Pharma,* 633 B.R. at 111. The bankruptcy court stated that "the Sacklers, as a family, are worth . . . approximately $11 billion." 633 B.R. at 88.

acknowledged "there was no such expert testimony."[60] Instead of testimony on the value of the claims against the Sacklers, he focused predominantly on the "evidence regarding the strengths and weaknesses of the claims . . . the risks of collection and the dilutive effect of all of the other litigation that would be pursued . . . ."[61] Based on these mostly collection issues, he said, "I conclude no additional evidence is required." [62]

But at least two courts disagree and have held that the best interest test does require a court to value the claims against the released third parties. *In re Ditech Holding Corp.*, 606 B.R. 544, 614 (Bankr. S.D.N.Y. 2019) and *In re Quigley*, 437 B.R. 102 (Bankr. S.D.N.Y. 2010) (court must consider creditors' Chapter 7 right to seek full satisfaction from [released] non-debtors in gauging satisfaction of the best interest test).

The District Court appeared critical of Judge Drain's statements that he was not required to determine the value of the claims against the Sacklers in calculating the best interest test, noting that other courts do require this:

> Judge Drain also argued that the best interest test under section 1129(a)(7) requires that the amount that an objecting creditor stands to receive under the plan on account of its claim be at least as much it would receive if the debtor were liquidated under chapter 7. *In re*

60. *Id.*

61. *Id.*

62. *Id.*

> *Purdue Pharma L.P.*, 2021 WL 4240974, at *50. Thus, he concluded, the best interest test does not require analysis of the claimant's rights against third parties. *Id.* He acknowledged that his reading of the statute was at odds with at least two of his colleagues' reading of the same statute. [63]

Even the evidence on collectability was equivocal. There was no "decision" by Judge Drain that the Sackler wealth was either not reachable but instead only a "reasonable inference" that collection was a matter of significant concern.[64]

Despite these concerns, Judge Drain recognized that on some level (in a "vacuum") "the ultimate judgments that could be achieved on the estate claims (and the closely related third-party claims that are being settled under the plan) might well be higher than the amount that the Sacklers are contributing.[65]

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63. *Purdue Pharma,* 635 B.R. at 77.

64. "Once more, *I'm not deciding any legal issues* that would affect the collectability of judgments against Sackler family members or their entities, but, given the record before me, as well as the agreement of substantially all of the parties in these cases to a settlement of the estates' claims against the Sacklers and their related entities after the due diligence that they have undertaken, I make the reasonable inference that the issue of collection if the settlement were not approved is in fact a significant concern." *Purdue Pharma*, 633 B.R. at 89 (emphasis added).

65. *Purdue Pharma,* 633 B.R. at 93.

The best interest test required evidence that the plan would provide dissenting creditors as much as they would have received under a chapter 7 liquidation, which includes what they could have recovered against the Sacklers. This conclusion that no evidence was required concerning the claims against the Sacklers meant that there was inadequate evidence on whether the best interest test was satisfied.

III. Equitable considerations did not support the Second Circuit's approval of the third-party releases.

The Second Circuit stated that the second primary question was whether "equitable considerations supported the bankruptcy court's approval of the plan."[66]

The equitable considerations, however, did not support the approval of the releases. The Sacklers' willful misconduct made such a finding unsupportable. When Judge Drain noted that his decision left him "BITTER" he was mostly referring to the fact that the Sacklers had been able to create spend-thrift and offshore trusts that made reaching their assets a matter of "concern."[67] This deliberate secreting of assets was hardly reason to praise their equitable conduct.

The Bankruptcy Court's bitterness reflects the lack of equity in the outcome. It was a reflection that the Sacklers had utilized their bargaining leverage to obtain a result that varied substantially from what would have been required of them had they sought a "release" through

66. *Purdue Pharma,* 69 F.4th at 57 and 69.

67. *Purdue Pharma,* 633 B.R. at 93.

the lawful means of filing individual bankruptcy cases. Apparently concerned that complying with the Code could have cost them the other half of their wealth, they insisted on a release and discharge which was neither "consistent" with the Code, nor in any sense "equitable."

CONCLUSION

The District Court's ruling was correct, and the decision of the Second Circuit should be reversed.

Respectfully submitted,

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