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PURDUE PHARMA AND THE NONCONSENSUAL RELEASE OF DIRECT CLAIMS AGAINST NON-DEBTORS

By David S. Kupetz[*]

I. Introduction

In a high profile appellate decision vacating Purdue Pharma's confirmed chapter 11 bankruptcy plan of reorganization, the U.S. District Court for the Southern District of New York addressed an issue that "has hovered over bankruptcy law for thirty-five years."[1] The court identified the "great unsettled question" as whether a bankruptcy court (or any other court) has statutory authority to grant non-consensual releases of third-party claims against non-debtors. The court explained that, while one would think that this had been long ago settled, it has not been, stating "[t]here is a long-standing conflict among the Circuits that have ruled on the question, which gives rise to the anomaly that whether a bankruptcy court can bar third parties from asserting [a] nonderivative claim against a non-debtor — a matter that surely ought to be uniform throughout the country — is entirely a function of where the debtor files for bankruptcy."[2]

A plan of reorganization is generally the vehicle for achieving the goal of rehabilitation of the debtor under chapter 11 of the Bankruptcy Code.[3] Confirmation (approval) of a chapter 11 plan binds the debtor, any entity acquiring property under

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[1] *In re Purdue Pharma, L.P.*, 635 B.R. 26, 38 (S.D. N.Y. 2021), certificate of appealability granted, 2022 WL 121393 (S.D. N.Y. 2022) (Judge Colleen McMahon).

[2] 635 B.R. at 89.

[3] 11 U.S.C. § 101, et seq.

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the plan, creditors, and equity security holders of the debtor.[4] Subject to certain limited exceptions, confirmation discharges a debtor from pre-confirmation claims and such obligations are replaced by the obligations under the plan.[5] The plan is, in effect, a new court-sanctioned contract between the reorganized debtor, its creditors, and other parties to the plan. Complications and controversy have now come to the fore where the plan is used to accomplish a non-consensual release of claims held by third-parties against persons and entities who are not the debtor in the bankruptcy case and, in particular, as in *Purdue Pharma*, when those claims are not even derivative of claims against the chapter 11 debtor.

The district court, in *Purdue Pharma*, lamented the decades-long split in the federal Circuits on the question of whether a chapter 11 plan can be used to impose nonconsensual non-debtor releases. The court explained that the reasoning underlying the rulings is consistent in the Circuits that say no and that the justifications vary for those Circuits that say yes.[6] Further, rejecting the Second Circuit precedent limiting the granting of such releases to "unique" cases, the district court stated that "[t]his will no longer do. Either statutory authority exists or it does not."[7] Concluding that the bankruptcy court lacked the statutory authority to impose the releases, the district court recognized that "[t]his opinion will not be the last word on the subject, nor should it be."[8] The court declared, however, "[i]t must be put to rest sometime; at least in this Circuit, it should be put to rest now."[9]

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[4] 11 U.S.C. § 1141(a).

[5] 11 U.S.C. § 1141(d).

[6] 635 B.R. at 37.

[7] 635 B.R. at 37.

[8] 635 B.R. at *38. Less than thirty days after the issuance of the district court's decision in *Purdue Pharma*, a district court for the Eastern District of Virginia issued an opinion addressing non-consensual non-debtor releases in *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 2022 U.S. Dist. LEXIS 7431 (E.D. Va. 2022) (finding such releases to be unconstitutional in that case), and less than a month after that, a Delaware bankruptcy court approved such releases in *In re Mallinckrodt PLC*, 2022 Bankr. LEXIS 273 (Bankr. D. Del. 2022).

[9] 635 B.R. at 38.

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II. Purdue Pharma Bankruptcy Case

Purdue chose to file its bankruptcy case in the White Plains location of the bankruptcy court for the Southern District of New York, presumably largely because there was just one bankruptcy judge (Judge Robert D. Drain)[10] in that courthouse and it liked its chances with that judge. On November 22, 2021, following negative publicity flowing from the bankruptcy court's ruling on the plan in the Purdue case, the Bankruptcy Court for Southern District of New York announced that going forward large chapter 11 cases will be assigned on a random basis to the bankruptcy judges of the district irrespective of the courthouse in which the case is filed.[11]

As the district court described, "[e]ngulfed in a veritable tsunami of litigation, Purdue [commenced a] chapter 11 bankruptcy [case] in September 2019. The intent was for a '*Manville*-style' bankruptcy that would resolve both existing and future claims against the company arising from the prescription of OxyContin."[12] As a result of the bankruptcy filing,

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[10]On September 30, 2021, Judge Drain announced that he intends to retire as of June 30, 2022.

[11]General Order M-581 (Bankr. S.D.N.Y.) signed November 30, 2021 ("[E]ffective December 1, 2021, Local Bankruptcy Rule 1073-1 is amended to include new subdivision (f) providing for the random assignment of mega chapter 11 cases to the Judges irrespective of the courthouse in which the case is filed.").

[12]635 B.R. at 35. Discussing *Manville*, the district court stated:

> Section 524(g) [of the Bankruptcy Code] was passed after the United States Court of Appeals for the Second Circuit had affirmed the entry of an unprecedented injunction barring claims against certain non-debtors in connection with the bankruptcy of the nation's leading manufacturer of asbestos, the Johns Manville Corporation. MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988) ("*Manville I*"). The permanent injunction in that case extended to actions against Manville's insurers, all of whom had dedicated the entire proceeds of their policies — proceeds on which parties other than Manville were additional insureds and had a call — to a settlement fund into which the claims of asbestos victims would be channeled, valued, and resolved. The Second Circuit concluded that the bankruptcy court could permanently enjoin and channel lawsuits against a debtor's insurer relating to those insurance policies because those policies were "property of the debtor's estate." Id. at 90. The Court of Appeals did not cite to a single section of the Bankruptcy Code as authorizing entry of the injunction.

635 B.R. at 92. Further, "Despite the Second Circuit's affirmance of the *Manville I* injunction, questions continued to be raised about its legality. Congress passed Sections 524(g) and (h) of the Bankruptcy Code to remove

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an automatic stay halted all litigation against Purdue.[13] Further, the bankruptcy court entered and repeatedly extended a preliminary injunction, in effect, expanding the automatic stay to halt litigation against certain non-debtors affiliated with the company. The beneficiaries of these special injunctions were primarily members of the Sackler family, which had long owned Purdue.[14] Then, as characterized by the district court, "[f]or two years, committees of various classes of creditors — individuals, state and local governments, indigenous North American tribes, even representatives of unborn children who were destined to suffer from opioid addiction — negotiated with Purdue and the Sacklers under the watchful eye of the experienced Bankruptcy Judge, with the assistance of two of this country's finest and most experienced mediators."[15]

The negotiations eventually resulted in a plan of reorganization for Purdue that the district court said "would, if implemented, afford billions of dollars for the resolution of both private and public claims, while funding opioid relief and education programs that could provide tremendous benefit to the consuming public at large."[16] Under the plan, in return for obtaining non-consensual third-party releases, the Sacklers agreed to contribute approximately $4.3 billion. The plan was approved by a supermajority of votes cast by the members of each class of creditors. The bankruptcy judge confirmed the plan and, as described by the district court, "had invested so much of himself in the effort to find a workable solution to a seemingly intractable problem."[17] Various parties, including eight states and the District of Columbia, certain tribes, and a few individual personal injury claimants, filed formal objections to the plan and appealed its

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any doubt that those injunctions were authorized. See H.R. Rep. 103-835 at *41." 635 B.R. at 35.

[13] 11 U.S.C. § 362.

[14] 635 B.R. at 35. The district court explained that "[a]s the opioid crisis continued and worsened . . ., the Sacklers — or at least those members of the family who were actively involved in the day to day management of Purdue — were well aware that they were exposed to personal liability over OxyContin." 635 B.R. at 36 (footnote omitted).

[15] 635 B.R. at 36.

[16] 635 B.R. at 35.

[17] 635 B.R. at 35.

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confirmation.[18] In negative reaction to the bankruptcy court's confirmation of the plan, legislation known as the "Nondebtor Release Prohibition Act of 2021" has been introduced in Congress.[19]

Between 2008 and 2017, the Sacklers pulled $10.4 billion out of the company, substantially reducing Purdue's "solvency cushion."[20] Much of the money was either transferred to offshore entities controlled by the Sacklers or deposited into spendthrift trusts that could not be reached in bankruptcy. All of the appellants, according to the district court, objected to the plan's "broad releases, not just of derivative, but of particularized or direct claims — including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes — to the members of the Sackler family (none of whom is a debtor in the bankruptcy case) and to their affiliates and related entities."[21] Moreover, the district court emphasized that these claims could not even be discharged if the Sacklers were themselves debtors in bankruptcy.[22]

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[18] 635 B.R. at 35.

[19] H.R. 4777 and S. 2497 — 117th Congress (2021–2022).

[20] 635 B.R. at 36.

[21] 635 B.R. at 36. The district court summarized the appellants' arguments as follows:

> Appellants attack the legality of the Plan's non-consensual release of third-party claims against non-debtors on a number of grounds. They argue that the release (referred to in this opinion as the "Section 10.7 Shareholder Release") is both constitutionally defective and not statutorily authorized; that the Bankruptcy Court lacks constitutional authority and subject matter jurisdiction to approve the release or to carry out certain "gatekeeping" aspects of the Plan that relate to it; and that granting a release to the non-debtor Sacklers is unwarranted as a matter of fact and would constitute an abuse of the bankruptcy process.

635 B.R. at 36.

[22] 635 B.R. at 36. The district court summarized the overall scheme as follows:

> When the family fortune was secure, the Sackler family members withdrew from Purdue's Board and management. Bankruptcy discussions commenced the following year. As part of those pre-filing discussions, the Sacklers offered to contribute toward a settlement, but if — and only if — every member of the family could "achieve global peace" from all civil (not criminal) litigation, including litigation by Purdue to claw back the money that had been taken out of the corporation. The Plan confirmed by the Bankruptcy Court extinguishes all civil claims against the Sacklers that relate in any way to the operations of Purdue — including claims on which certain members of the Sackler family could be held

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III. District Court's Survey of Prior Precedent

The district court emphasized that the U.S. Supreme Court "has never specifically considered whether the non-consensual release of non-derivative claims asserted by third parties against non-debtors can be approved in the context of a debtor's bankruptcy."[23] The district court, however, took guidance from Supreme Court decisions framing the contours of the Bankruptcy Code and limiting the powers of bankruptcy courts. The district court cited *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,[24] for the principle that the Bankruptcy Code is intended to be comprehensive. It cited *Norwest Bank Worthington v. Ahlers*,[25] for the proposition that the bankruptcy court's traditional equity powers can only be exercised within the confines of the Bankruptcy Code. The district court relied on *Law v. Siegel*,[26] and *Czyzewski v. Jevic Holdings Corp.*,[27] for the precept "that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code — not even in 'rare' cases, and not even when those orders would help facilitate a particular reorganization."[28]

Next, turning to the case law in the Second Circuit where the Purdue case was pending, the court found that the issue

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personally liable to entities other than Purdue (principally the various states). These claims could not be released if the Sacklers were themselves debtors in bankruptcy.

635 B.R. at 36.

[23]635 B.R. at 94.

[24]*RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S. Ct. 2065, 182 L. Ed. 2d 967, 56 Bankr. Ct. Dec. (CRR) 144, 67 Collier Bankr. Cas. 2d (MB) 483, Bankr. L. Rep. (CCH) P 82218 (2012).

[25]*Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 99 L. Ed. 2d 169, 17 Bankr. Ct. Dec. (CRR) 201, 18 Collier Bankr. Cas. 2d (MB) 262, Bankr. L. Rep. (CCH) P 72186 (1988).

[26]*Law v. Siegel*, 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014).

[27]*Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 137 S. Ct. 973, 197 L. Ed. 2d 398, 63 Bankr. Ct. Dec. (CRR) 242, 77 Collier Bankr. Cas. 2d (MB) 596, 41 I.E.R. Cas. (BNA) 1613, Bankr. L. Rep. (CCH) P 83082 (2017).

[28]635 B.R. at 94 ("And in two recent cases, the Supreme Court has held, albeit in contexts different from the one at bar, that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code — not even in 'rare' cases, and not even when those orders would help facilitate a particular reorganization.").

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of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors, was unsettled, except in asbestos cases, where statutory authority is clear and exists under Bankruptcy Code section 524(g).[29] The district court stated:

> All parties agree that one and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C. § 524(g), which was passed by Congress in 1994. It provides for such an injunction solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos. And it sets out a host of conditions that must be satisfied before any such injunction can be entered, including all of the following:
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> (i) the injunction is to be implemented in connection with a trust the is to be funded in whole or in party by the securities of the debtor and that the debtor will make future payments, including dividends, to that trust 524(g)(2)(B)(i)(I);
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> (ii) the extent of such alleged liability of a third party arises by reason of one of four enumerated relationships between the debtor and third party (524(g)(4)(A)(ii));
>
> (iii) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind (524(g)(4)(B)(i)); and
>
> (iv) the court determines the injunction is fair and equitable to persons that might subsequently assert such demands, and, in light of the benefits provided to such trust on behalf of such third parties. § 524(g)(4)(B)(ii)).[30]

Section 524(g) injunctions barring third party claims are limited and cannot be entered in favor of just any non-debtor. They can only be used to enjoin actions against a specific set

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[29] 11 U.S.C. § 524(g). Emphasizing the clarity of the limits of section 524(g) of the Bankruptcy Code, the district court stated "[t]hat Section 524(g) applies only to asbestos cases is clear. The statute explicitly states than the trust that 'is to assume the liabilities of a debtor' be set up in connection with '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)(2)(B)(i)(I))." 635 B.R. at 93–94. The district court further underscored that "[i]f that were not clear enough, Congress passed another section to provide that injunctions that had previously been entered in asbestos cases — not in any other kind of case — would automatically be deemed statutorily compliant, even if those injunctions did not have all the features required by § 524(g). See, 11 U.S.C. § 524(h)." 635 B.R. at 93–94.

[30] 635 B.R. at 91.

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of non-debtors: those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers.[31] In *Purdue Pharma*, the district court proclaimed that "[t]he language of the statute plainly indicates that Congress believed that Section 524(g) created an exception to what would otherwise be the applicable rule of law.[32] The district court concluded that the chore of determining whether and how to extend non-debtor releases outside the context of asbestos cases was left to Congress and not the courts and that "[s]ince 1994 [when section 524(g) was enacted] Congress has been deafeningly silent on this subject."[33]

The district court turned to addressing a host of Second Circuit cases that could potentially serve as binding precedent in *Purdue Pharma*.[34] However, the district court concluded that guidance was limited and the law in the Second Circuit was unsettled, stating:

> The only fair characterization of the [Second Circuit] law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear. Because the Court of Appeals has decided every other case on non-statutory grounds, its only clear statement is that Section 105(a), standing alone, does not confer such authority on the bankruptcy court outside the asbestos context.[35]

Addressing the law of the other circuits, the district court

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[31] 11 U.S.C. § 524(g)(4)(A).

[32] 635 B.R. 91. The district court continued:

> Subsection 524(g)(4)(A)(ii) says: "Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor." 11 U.S.C. § 524(g)(4)(A)(ii). Section 524(e) provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The word "notwithstanding," suggests that the type of injunction Congress was authorizing in § 524(g) would be barred by § 524(e) in the absence of the statute.

Id. at 92.

[33] 635 B.R. at 94.

[34] See 635 B.R. at 104.

[35] 635 B.R. 104. With regard to the leading Second Circuit case of *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 44 Bankr. Ct. Dec. (CRR)

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stated that "[a]ll but three of the other Circuits have spoken directly to the issue of statutory authority. They have reached conflicting results — a most unfortunate circumstance when dealing with a supposedly uniform and comprehensive nationwide scheme to adjust debtor-creditor relations."[36] The district court discussed that (1) the Fifth, Ninth, and Tenth Circuits completely reject that a court can authorize non-debtor releases outside the asbestos context,[37] (2) the Third Circuit, while not identifying any statutory authority, has held that bankruptcy courts have constitutional authority to extinguish certain third-party claims by confirming a chapter 11 plan,[38] (3) the Fourth and Eleventh Circuits have concluded that sec-

276, 54 Collier Bankr. Cas. 2d (MB) 1033, Bankr. L. Rep. (CCH) P 80397 (2d Cir. 2005), the district court stated:

> [W]hile Metromedia said a great deal, the case did not hold much of anything. Its relevance, for present purposes, is that Judge Jacobs cautioned that statutory authority for non-consensual non-debtor releases outside of the asbestos context was at best uncertain — and then disposed of the case on other grounds, without identifying what section or sections of the Bankruptcy Code might actually authorize such relief in non-asbestos bankruptcy.
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> No subsequent Second Circuit case has filled in the blank.

635 B.R. at 104.

[36] 635 B.R. at 104.

[37] See *In re Pacific Lumber Co.*, 584 F.3d 229, 252, 52 Bankr. Ct. Dec. (CRR) 46, Bankr. L. Rep. (CCH) P 81642 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394, 1401–02, 34 Collier Bankr. Cas. 2d (MB) 544, Bankr. L. Rep. (CCH) P 76673, 33 Fed. R. Serv. 3d 249 (9th Cir. 1995); *In re Western Real Estate Fund, Inc.*, 922 F.2d 592, 600, 21 Bankr. Ct. Dec. (CRR) 320, 24 Collier Bankr. Cas. 2d (MB) 1012, Bankr. L. Rep. (CCH) P 73754 (10th Cir. 1990), opinion modified, 932 F.2d 898 (10th Cir. 1991). "Those courts read § 524(e) as barring the granting of such relief — put otherwise, they under Congress' use of the phrase "Notwithstanding the provisions of § 524(e)" in § 524(g) as creating an exception to an otherwise applicable rule." Purdue Pharma, 635 B.R. at 104. In *Blixseth v. Credit Suisse*, 961 F.3d 1074, 68 Bankr. Ct. Dec. (CRR) 224 (9th Cir. 2020), cert. denied, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021), the Ninth Circuit upheld the release of a creditor from liability for certain claims under an exculpation clause contained in a chapter 11 plan. The Ninth Circuit emphasized the narrow nature of the releases and distinguished its prior decisions rejecting non-debtor releases. Unlike "sweeping nondebtor releases from creditors' claims on the debts discharged in the bankruptcy," the more limited releases at issue involved "releases of participants in the plan development and approval process for actions taken during those processes." 961 F.3d at 1083–84.

[38] *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 133–40, Bankr. L. Rep. (CCH) P 83470 (3d Cir. 2019), cert. denied, 140 S. Ct. 2805, 207 L. Ed. 2d 142 (2020). While, according to the district court, the Third

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tion 105(a) of the Bankruptcy Code authorizes such releases,[39] (4) the Sixth and Seventh Circuits have concluded that bankruptcy courts have "residual authority" to grant the releases,[40]

Circuit has not identified any section of the Bankruptcy Code that authorizes non-debtor releases outside the asbestos context, in *Purdue Pharma*, Bankruptcy Judge Drain cited Millennium (Purdue Pharma, 635 B.R. at 104. With regard to *Millennium*, the district court in *Purdue Pharma* pointed out that statutory authority for third-party releases was not addressed, stating:

> [T]he Third Circuit does not discuss statutory authority in that case. Instead, the Millennium court concluded that the bankruptcy court had constitutional authority to extinguish certain third-party claims by confirming a chapter 11 plan. In re Millennium Lab Holdings II, LLC, 945 F.3d 139–40.
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> On those occasions when the Third Circuit did address a bankruptcy court's statutory authority to impose non-debtor releases, it overturned bankruptcy court orders granting them. For example, in In re Continental Airlines, 203 F.3d 203 (3d Cir. 2000), the Court of Appeals rejected as extra-statutory the provision in a plan of reorganization that released claims against current and former directors of Continental, and that permanently enjoined shareholder actions against them, finding that the Bankruptcy Code "does not explicitly authorize the release and permanent injunction of claims against non-debtors, except in one instance not applicable here" — that being asbestos cases. Id. at 211; 11 U.S.C. § 524(g). And in In re Combustion Engineering, Inc., 391 F.3d 190 (3d Cir. 2004), the Third Circuit, like the Second Circuit in Metromedia, held that Section 105(a) does not give the court the power to create substantive rights that would otherwise be unavailable under the Bankruptcy Code, and vacated the channeling injunction. Id. at 238. Neither Continental Airlines nor Combustion Engineering has ever been overruled by the Third Circuit.

635 B.R. at 104.

[39] *National Heritage Foundation, Inc. v. Highbourne Foundation*, 760 F.3d 344, 350, 71 Collier Bankr. Cas. 2d (MB) 1896, Bankr. L. Rep. (CCH) P 82667 (4th Cir. 2014); *In re Seaside Engineering & Surveying, Inc.*, 780 F.3d 1070, 1076–79, 60 Bankr. Ct. Dec. (CRR) 212, 73 Collier Bankr. Cas. 2d (MB) 605, Bankr. L. Rep. (CCH) P 82783 (11th Cir. 2015). With regard to these cases, the district court stated that "Fourth and Eleventh Circuit law contradict Second Circuit law, and cannot be relied on as authority for the proposition that such releases are statutorily authorized." Purdue Pharma, 635 B.R. at 105.

[40] "[T]he Sixth and Seventh Circuits . . . have concluded that Sections 105(a) and 1123(b)(6) of the Bankruptcy Code, read together, codify something that they call a bankruptcy court's 'residual authority,' and hold that a bankruptcy court can impose non-consensual releases of third-party claims against non-debtors in connection with a chapter 11 plan pursuant to that 'residual authority.' " 635 B.R. at 105. "They get the phrase 'residual authority' from *U.S. v. Energy Resources Co., Inc.*, 1990-2 C.B. 263, 495 U.S. 545, 549, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 20 Bankr. Ct. Dec. (CRR) 840, 22 Collier Bankr. Cas. 2d (MB) 1093, Bankr. L. Rep. (CCH) P 73381, 90-1 U.S. Tax Cas. (CCH) P 50281, 65 A.F.T.R.2d 90-1078 (1990)." 635 B.R.

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and (5) the First, Eighth and D.C. Circuits have yet to weigh in on the question.[41]

IV. Non-Derivative Claims at Issue

In *Purdue Pharma*, the district court addressed the question of a bankruptcy court's power to release, on a nonconsensual basis, direct/particularized claims asserted by third parties against non-debtors pursuant to the Section 10.7 Shareholder Release under the Purdue plan.[42] The district court characterized this as involving "a very narrow range of claims that might be asserted against the Sacklers."[43] The release of derivative claims was governed by Section 10.6 of the Purdue plan and was not challenged on appeal. The district court described derivative claims as "claims that would render the Sacklers liable because of Purdue's actions (which conduct may or may not have been committed because of the Sacklers). 'Derivative' claims are those seek to recover from the estate indirectly 'on the basis of [the debtor's] conduct,' as opposed to the non-debtor's own conduct."[44] The district court recognized the bankruptcy court's power to approve the release of derivative claims against non-debtors, stating that "[d]erivative claims in every sense relate to the adjustment of the debtor-creditor relationship, because they are claims that relate to injury to the corporation itself. If the creditor's claim is one that a bankruptcy trustee could bring

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at 105 n.68; see *In re Airadigm Communications, Inc.*, 519 F.3d 640, 657, 49 Bankr. Ct. Dec. (CRR) 179, Bankr. L. Rep. (CCH) P 81123 (7th Cir. 2008).

[41] 635 B.R. at 105 ("The First, Eighth, and D.C. Circuits have yet to weigh in on the question of whether statutory authority to impose non-debtor releases exists.").

[42] Consensual releases were not at issue here and should not be controversial (although issues can certainly arise regarding what constitutes consent). For example, the Seventh Circuit has noted approvingly that "courts have found releases that are consensual and non-coercive to be in accord with the strictures of the Bankruptcy Code." *Matter of Specialty Equipment Companies, Inc.*, 3 F.3d 1043, 1047, 29 Collier Bankr. Cas. 2d (MB) 1215, Bankr. L. Rep. (CCH) P 75398 (7th Cir. 1993).

[43] 635 B.R. at 90.

[44] 635 B.R. at 90, citing Manville III, 517 F.3d at 62 (quoting *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 17 Bankr. Ct. Dec. (CRR) 293, 18 Collier Bankr. Cas. 2d (MB) 316, Bankr. L. Rep. (CCH) P 72180 (2d Cir. 1988)).

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on behalf of the estate, then it is derivative."[45] Such "claims could assuredly be released by a bankruptcy court exercising *in rem* jurisdiction over the *res* of the estate."[46]

In contrast, the district court explained that "direct claims" are "claims that are not derivative of Purdue's liability, but are based on the Sacklers' own, individual liability, predicated on their own alleged misconduct and the breach of duties owed to claimants other than Purdue. 'Direct' claims are based upon a 'particularized' injury to a third party that can be directly traced to a non-debtor's conduct."[47] Under Section 10.6(b) of the *Purdue* plan, the release of claims against the Sacklers that are derivative of the estate's claims them was effected. This release was not challenged as being beyond the power of the Bankruptcy Court.

The bankruptcy court concluded that it had statutory authority to authorize the release of non-derivative — direct or particularized — claims, because the third party claims to be released in this case were "premised as a legal matter on a meaningful overlap with the debtor's conduct."[48] The bankruptcy court "did insist that the Section 10.7 Shareholder Release [of non-derivative claims] be modified so that it covered only third-party claims in which 'a Debtor's conduct, or a claim asserted against the Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party."[49]

The district court summarized the Section 10.7 Shareholder Release under attack on appeal as follows:

> It releases all members of the Sackler families, as well as a variety of trusts, partnerships and corporations associated with the family and the people who run and advise those entities from liability for claims that have been brought against them personally by third parties — claims that are not derivative,

[45] 635 B.R. at 90 (citation omitted).

[46] 635 B.R. at 75.

[47] 635 B.R. at 90.

[48] 635 B.R. at 75.

[49] 635 B.R. at 75 (citation omitted) ("In other words, he [the bankruptcy judge] insisted that there be substantial factual overlap between the released particularized claims and the derivative claims that no one disputes he had the power to release, such that the released nonderivative claims were 'sufficiently close to the claims against the debtor.' ").

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> but as to which Purdue's conduct is a legally relevant factor. Example: nearly all of the State Appellants have a law under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices. As Judge Drain recognized (see *In re Purdue Pharma L.P.*, 2021 Bankr. LEXIS 2555, 2021 WL 4240974, at *44), the liability imposed by these statutes is not derivative; the claims arise out of a separate and independent duty that is imposed by statute on individuals who, by virtue of their positions, personally participated in acts of corporate fraud, misrepresentation and/or willful misconduct. Liability under those laws is limited to persons who occupied the roles of officer, manager or director of a corporation — which means that there is considerable factual overlap, perhaps even complete congruence, between those claims and the derivative claims against the same individuals that Judge Drain had undoubted authority to release and enjoin. But it is undisputed that these laws impose liability, and even penalties, [on such persons independent of any corporate liability (or lack of same), and independent of any claim the corporation could assert against them for faithless service as a result of those same acts.[50]

The district court then noted that its decision "applies only to direct (non-derivative) claims — sometimes referred to as 'particularized' claims — that arise out of the Sacklers' own conduct . . . and that either have been or could be asserted against the non-debtor members of the Sackler family and their affiliates . . . by parties other than the Debtors' estate."[51]

V. *Constitutional Authority*

The district court claimed that it did not rule on the bankruptcy court's constitutional authority to approve nonconsensual release of direct claims against non-debtors. Rather, it explained that "[b]ecause I conclude that the Bankruptcy Court lacked statutory authority to impose the Section 10.7 Shareholder Release, I need not and do not reach the constitutional questions that have been raised by the parties. Nor do I need to decide whether this is a case in which such releases should be imposed if my statutory analysis is incorrect. Those issues may need to be addressed some day, but they do not

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[50] 635 B.R. at 86.

[51] 635 B.R. at 91.

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need to be addressed in order to dispose of this appeal."[52] Additionally, the district court expounded that "while it [the bankruptcy court] may have lacked constitutional authority to give them final approval under the rule of *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011), that matters little in the great scheme of things; it [only] changes the level of deference this court should give to Judge Drain's findings of fact, but those findings are essentially unchallenged."[53]

Nonetheless, while purporting to leave the question of Constitutional authority for another day, the district court rejected the reasoning of the bankruptcy court and opined otherwise, expounding:

> Judge Drain reasoned that the non-consensual third-party releases that he was approving were "constitutionally core" under Stern because plan confirmation is a "fundamentally central aspect of a Chapter 11 case's adjustment of the debtor/creditor relationship." . . . But nothing in Stern or any other case suggests that a party otherwise entitled to have a matter adjudicated by an Article III court forfeits that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. Were it otherwise, then parties could manufacture a bankruptcy court's Stern authority simply by

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[52] 635 B.R. at 38.

[53] 635 B.R. at 37. The district court discussed the bankruptcy court's conclusion that it had constitutional power to issue a final order confirming a plan containing the third party releases qualified as "constitutionally core" under *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011) and its progeny, Purdue Pharma, 635 B.R. at 80–81, and explained the significance with regard to the standard of review on appeal as follows:

> The standard of review of findings of act is far less deferential if a bankruptcy court is presented with something it cannot adjudicate to final judgment as a constitutional matter unless the parties consent. Stern v. Marshall, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011). In such a circumstance, a bankruptcy judge has authority only to "hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment." Exec. Benefits Ins. Agency v. Arkison, 573 U.S. 25, 34–36, 134 S. Ct. 2165, 189 L. Ed. 2d 83 (2014). In that case, the findings of fact are reviewed de novo as well. If a bankruptcy court issues a final order in the mistaken belief that it has constitutional authority to do so, the district court can treat a bankruptcy court's order as a report and recommendation, but it "must review the proceeding de novo and enter final judgment."

635 B.R. at 79.

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> inserting the resolution of some otherwise non-core matter into a plan.
>
> The learned bankruptcy judge relied on the Third Circuit's recent decision in *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 139 (3d Cir. 2019), cert. denied sub nom. *ISL Loan Tr. v. Millennium Lab Holdings II, LLC*, 140 S. Ct. 2805, 207 L. Ed. 2d 142 (2020). In *Millennium*, the court, like Judge Drain in this case, concluded that the "operative proceeding" for purposes of Stern analysis was the confirmation proceeding, not the underlying third-party claim against a non-debtor that was being released pursuant to the plan. . . . The Third Circuit read Stern to allow a bankruptcy court to confirm a plan containing such releases "because the existence of the releases and injunctions" are " 'integral to the restructuring of the debtor-creditor relationship.' " . . ..
>
> Perhaps they are, but that is beside the point. In *Stern*, the Supreme Court held that bankruptcy courts have the power to enter a final judgment only in proceedings that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 564 U.S. at 499. It did not say that a bankruptcy court could finally dispose of non-core proceedings as long as they were "integral to the restructuring of the debtor-creditor relationship."[54]

The district court discussed that "[t]he core vs. non-core distinction is critical when assessing a bankruptcy court's constitutional authority to enter a final judgment disposing of that proceeding."[55] The district court, while not ruling on the question of constitutional authority, identified and discussed overreaching by the bankruptcy court, stating that "[i]n this case, the learned Bankruptcy Judge improperly elided his authority to confirm a plan of reorganization (indubitably a core function of a bankruptcy court) with his authority to finally dispose of claims that were non-consensually extinguished pursuant to that plan over which — as he himself recognized — he has only "related to" jurisdiction over the

[54] 635 B.R. at 80 (citations omitted).

[55] 635 B.R. at 80 ("In particular, a bankruptcy court lacks the constitutional authority to enter a final judgment in a proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. Any doubt on that score was put to rest by the United States Supreme Court in *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011).").

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third-party claims against the non-debtor Sacklers."[56] The court made it clear that it viewed the bankruptcy court as having exceeded its Constitutional power, exclaiming:

> The third-party claims at issue neither stem from Purdue's bankruptcy nor can they be resolved in the claims allowance process. Yet those claims are being finally disposed of pursuant to the Plan; they are being released and extinguished, without the claimants' consent and without any payment, and the claimants are being enjoined from prosecuting them. Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority to resolve a non-core claim by the artifice of including a release of that claim in a plan of reorganization. . . .
>
> The fact that the releases are being ordered in the overall context of a plan confirmation that "settles" many disputed matters (against the Debtors, not against non-debtors) does not alter this. The Appellants in this case do not want to settle their claims against the non-debtors — at least, not on the terms set forth in the Plan. This "settlement" is non-consensual — which means that, under Stern, a bankruptcy court cannot enter the order that finally disposes of their claims against those non-debtors. . . .
>
> Nor is there any doubt that the entry of an order releasing a claim has former adjudication effects, which is a key attribute of a final judgment. The Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to res judicata claim preclusion barring any subsequent action bringing a released claim: First in *Stoll v. Gottlieb*, 305 U.S. 165, 171, 59 S. Ct. 134, 83 L. Ed. 104 (1938), and again in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 155, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009).
>
> Because the non-consensual releases and injunction are the equivalent of a final judgment for *Stern* purposes, Judge Drain did not have the power to enter an order finally approving them. To the extent of his approval of the Section 10.7 Shareholder Releases, his opinion should have been tendered as proposed findings of fact and conclusions of law, both of which this court could review de novo. 28 U.S.C. § 157(c)(1). Stern, 564 U.S. at 475. If approved by this Court, those releases would of course be incorporated into the Plan.

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[56] 635 B.R. at 80.

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> So the standard of review in this case is de novo as to both the Bankruptcy Court's factual findings and its conclusions of law.[57]

In the aftermath of the district court's decision in *Purdue Pharma*, the district court for the Eastern District of Virginia in *Patterson v. Mahwah Bergen Retail Grp., Inc.*,[58] overturned a chapter 11 plan's grant of nonconsensual non-debtor releases based on constitutional deficiencies (and did not purport to limit its ruling to the lack of statutory authorization highlighted by the *Purdue* district court). Unlike the district court in *Purdue Pharma*, the district court in *Mahwah* focused on a violation of due process, stating:

> This appeal implicates the most fundamental right guaranteed by the due process clause in our judicial system: the right to be heard before the loss of one's rights. For more than a century the central meaning of procedural due process has been clear: Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified. . . . And, the Supreme Court has explained that the particular constitutional protection afforded by access to the courts is the right conservative of all other rights, and lies at the foundation of orderly government. . . . Relatedly, parties who choose to resolve litigation through settlement may not dispose of the claims of a third party, and a fortiori may not impose duties or obligations on a third party, without that party's agreement. . . . This is so, because the general rule provides that a person cannot be deprived of his legal rights in a proceeding to which he is not a party. . . .
>
> These fundamental principles resonate with force in this appeal from the Bankruptcy Court, as third-party releases strike at the heart of these foundational rights.[59]

While finding the releases at issue to be shockingly broad,[60] the district court in *Mahwah*, also determined the notice

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[57] 635 B.R. at 82 (citations and footnotes omitted). The district court explained that "[t]he practical impact of this holding is non-existent, as no one has challenged any of Judge Drain's findings of fact — only the conclusions he drew from them — and the court has always had the obligation to review those conclusions de novo." 635 B.R. at 82, n.54.

[58] *Patterson v. Mahwah Bergen Retail Group, Inc.*, 636 B.R. 641 (E.D. Va. 2022).

[59] 636 B.R. at 654 (citations and footnotes omitted).

[60] The court stated:

> The Third-Party Releases at issue in this case represent the worst of this all-too-common practice, as they have no bounds. The sheer breadth of the releases can only be described as shocking. They release the claims of at least hundreds of

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provided to be inadequate.[61] Further, the court held that the bankruptcy court exceeded its constitutional authority without engaging in required factfinding.[62] Under Fourth Circuit precedent, which governed in *Mahwah*, a multi-factor test was to be applied in the consideration of nonconsensual non-debtor releases.[63] Concluding that, in exceeding its

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> thousands of potential plaintiffs not involved in the bankruptcy, shielding an incalculable number of individuals associated with Debtors in some form, from every conceivable claim — both federal and state claims — for an unspecified time period stretching back to time immemorial. In doing so, the releases close the courthouse doors to an immeasurable number of potential plaintiffs, while protecting corporate insiders [through an exculpation provision in the plan] who had no role in the reorganization of the company.

636 B.R. at 655.

[61]The court rejected the opt-out process used in the case under which a party was deemed to release claims, unless it returned an opt-out form, stating:

> The Bankruptcy Court did not order that any notice or opt-out forms be sent to all of the Releasing Parties, including the current and former employees, consultants, accountants or attorneys of Debtors, their affiliates, lenders, creditors or interest holders. Nor did it even examine other possible causes of action released. . . .
>
> Throughout this process, Debtors sent notice of the Third-Party Releases and the opt-out procedure to roughly 300,000 parties believed to be potential members of the putative class action case pending in the New Jersey district court. The record lacks any information about how many of the parties actually received the notice or any mention of efforts to determine the success of the attempts at notice regarding the securities fraud litigation. As of November 18, 2020, Debtors had received approximately 596 Release Opt-Out Forms — approximately 0.2% of those targeted by the notice.

636 B.R. 641 at 660–661. "[T]he Bankruptcy Court erred as a matter of law in finding that failure to return the opt-out form could constitute consent to Article I adjudication." 636 B.R. 641 at 674.

[62]"The sheer breadth of the releases and the lack of findings with respect to each released claim renders appellate review virtually impossible and speaks to the impropriety of the approval of the Third-Party Releases." 636 B.R. at 669. The court further expanded on the need for detailed findings, stating that "[t]he exacting caution and detailed findings demanded of a bankruptcy court in granting a non-debtor release in a unique circumstance stems from the constitutional limitations placed on the bankruptcy court's jurisdiction." 636 B.R. at 682.

[63]The Fourth Circuit has made clear that the use of third-party releases is disfavored, saying that such releases should be "granted cautiously and infrequently." *Behrmann v. National Heritage Foundation*, 663 F.3d 704, 712, 55 Bankr. Ct. Dec. (CRR) 221, 66 Collier Bankr. Cas. 2d (MB) 1282, Bankr. L. Rep. (CCH) P 82124 (4th Cir. 2011). In *Mahwah*, however, the "Bankruptcy Court — acting with its limited Article I powers — extinguished these claims with little or no analysis. In doing so, the Bank-

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constitutional authority, the bankruptcy court had abdicated its responsibility to ensure that such authority existed, the district court stated:

> Here, by granting the Third-Party Releases, the Bankruptcy Court took jurisdiction over and extinguished the liability of an extraordinarily vast range of claims held by an immeasurable number of individuals against a broad range of potential defendants. However, before doing so, the Bankruptcy Court took no steps to determine if it had the power to extinguish the liability on any particular claim. Indeed, the only extinguished claims that the Bankruptcy Court considered were the securities fraud claims against the Individual Defendants (Jaffe and Giammatteo), and it ignored all of the other potential claims that it terminated by approving the releases. In so doing, the

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ruptcy Court exceeded the constitutional limits of its authority as delineated by the Supreme Court in *Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475, 55 Bankr. Ct. Dec. (CRR) 1, 65 Collier Bankr. Cas. 2d (MB) 827, Bankr. L. Rep. (CCH) P 82032 (2011), ignored the mandates of the Fourth Circuit in *Behrmann*, and offended the most fundamental precepts of due process." Patterson v. Mahwah Bergen Retail Grp., Inc., 636 B.R. at 655. In *Behrmann*, the Fourth Circuit adopted the Sixth Circuit's test for approving non-debtor releases outlined in In re Dow Corning Corp. The Fourth Circuit quoted in full from *In re Dow Corning Corp.*, 280 F.3d 648, 657–58, 39 Bankr. Ct. Dec. (CRR) 9, 47 Collier Bankr. Cas. 2d (MB) 1158, Bankr. L. Rep. (CCH) P 78582, 2002 Fed. App. 0043P (6th Cir. 2002) (rejected by, In re PTI Holding Corp., 346 B.R. 820 (Bankr. D. Nev. 2006)) ("Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in 'unusual circumstances.' "):

> We hold that when the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor:
>
> (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;
>
> (2) The non-debtor has contributed substantial assets to the reorganization;
>
> (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
>
> (4) The impacted class, or classes, has overwhelmingly voted to accept the plan;
>
> (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
>
> (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and,
>
> (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

Behrmann, 663 F.3d at 711–12 (quoting In re Dow Corning Corp., 280 F.3d at 658). Patterson v. Mahwah Bergen Retail Grp., Inc., 636 B.R. at 681.

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Bankruptcy Court failed to take the proper steps to ensure that it had the authority to grant the releases.[64]

VI. Subject Matter Jurisdiction

The federal courts are courts of limited jurisdiction, and "neither the bankruptcy court nor the parties can write their own jurisdictional ticket."[65] "Like all federal courts, the jurisdiction of the bankruptcy courts is created and limited by statute."[66] A bankruptcy court's subject matter jurisdiction is in rem and is limited to the *res* of the estate.[67] Its jurisdiction is limited to "civil proceedings arising under title 11, or arising in or related to cases under title 11."[68] Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11; (2) those that "arise in" a title 11 case; (3) and those that are "related to" a title 11 case. Cases that "arise under" or "arise in" a title 11 matter are known as core bankruptcy proceedings, while "related to" proceedings are non-core.[69]

The phrases "arising under" and "arising in" found in 28 U.S.C. Section 1334(b) are terms of art.[70] "Proceedings 'arising under' title 11 involve causes of action created or determined by a statutory provision of that title."[71] A matter "arises under" the Bankruptcy Code if its existence depends on a substantive provision of bankruptcy law, that is, if it involves a cause of action created or determined by a statutory provision of the Bankruptcy Code. "Similarly, proceedings 'arising in' title 11 are not those created or determined by the bank-

[64] 636 B.R. at 668.

[65] *In re Resorts Intern., Inc.*, 372 F.3d 154, 161, 43 Bankr. Ct. Dec. (CRR) 46 (3d Cir. 2004).

[66] *Celotex Corp. v. Edwards*, 514 U.S. 300, 307, 115 S. Ct. 1493, 131 L. Ed. 2d 403, 27 Bankr. Ct. Dec. (CRR) 93, 32 Collier Bankr. Cas. 2d (MB) 685, Bankr. L. Rep. (CCH) P 76456, 31 Fed. R. Serv. 3d 355 (1995).

[67] *Central Virginia Community College v. Katz*, 546 U.S. 356, 362, 126 S. Ct. 990, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006) ("Bankruptcy jurisdiction, at its core, is in rem.").

[68] 28 U.S.C. § 1334(b).

[69] 28 U.S.C. § 157(b)(1) to (2)(C).

[70] *In re Wilshire Courtyard*, 729 F.3d 1279, 1285, 58 Bankr. Ct. Dec. (CRR) 117 (9th Cir. 2013).

[71] 729 F.3d at 1285.

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ruptcy code, but which would have no existence outside of a bankruptcy case."[72] "A proceeding 'arises in' a case under the Bankruptcy Code if it is an administrative matter unique to the bankruptcy process that has no independent existence outside of bankruptcy and could not be brought in another forum, but whose cause of action is not expressly rooted in the Bankruptcy Code."[73] And a proceeding is "related to" a title 11 proceeding if its "outcome might have any conceivable effect on the bankrupt estate."[74]

The district court in *Purdue* did not view subject matter jurisdiction as a problem. "The Bankruptcy Court had undoubted subject matter jurisdiction to enter the challenged releases."[75] The district court stated that, "[u]nder the law of this Circuit, as most recently set forth in *SPV Osus Ltd. v. UBS AG*, 882 F.3d 333, 65 Bankr. Ct. Dec. (CRR) 60 (2d Cir. 2018), the Bankruptcy Court has broad 'related to' jurisdiction over any civil proceedings that 'might have any conceivable effect' on the estate."[76] Further, the district court expounded that "[b]ecause the civil proceedings asserted against the non-debtor Sackler family members might have a conceivable impact on the estate, the Bankruptcy Court has subject matter jurisdiction to approve the Section 10.7 Shareholder Release and release the claims against the non-debtor Shareholder Released Parties."[77]

The district court identified the release of most third-party claims against a non-debtor as touching "the outer limit of

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[72] 729 F.3d at 1285 (citations omitted).

[73] *In re Ray*, 624 F.3d 1124, 1131, 53 Bankr. Ct. Dec. (CRR) 222, 64 Collier Bankr. Cas. 2d (MB) 700, Bankr. L. Rep. (CCH) P 81873 (9th Cir. 2010).

[74] *In re Cuyahoga Equipment Corp.*, 980 F.2d 110, 114, 35 Env't. Rep. Cas. (BNA) 1793, Bankr. L. Rep. (CCH) P 75020, 23 Envtl. L. Rep. 20308 (2d Cir. 1992) *Parmalat Capital Finance Ltd. v. Bank of America Corp.*, 639 F.3d 572, 579 (2d Cir. 2011); *SPV Osus Ltd. v. UBS AG*, 882 F.3d 333, 339–340, 65 Bankr. Ct. Dec. (CRR) 60 (2d Cir. 2018).

[75] In re Purdue Pharma, L.P, 635 B.R. at 37.

[76] 635 B.R. at 78.

[77] 635 B.R. at 78.

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the Bankruptcy Court's jurisdiction."[78] However, the district court recognized that the Second Circuit defines that limit quite broadly, stating:

> The standard is not that an action's outcome will certainly have, or even that it is likely to have, an effect on the res of the estate, as is the case in some other Circuits. It is, rather, whether it might have any conceivable impact on the estate. . . .Bound to adhere to this broad standard, which has been consistently followed in this Circuit for almost three decades and was applied most recently in *SPV Osus*, I agree with the Debtors that the Bankruptcy Court had subject matter jurisdiction over the direct (non-derivative) third party claims against the Sacklers, under the "related to" prong of bankruptcy jurisdiction.[79]

VII. Lack of Statutory Authority

Although bankruptcy courts are often referred to as courts of equity,[80] bankruptcy judges exercise their equitable powers within the confines of the Bankruptcy Code.[81] The Bankruptcy Code is comprised of detailed statutory provisions. Further, under section 105(a), "[a] bankruptcy court has statutory authority to 'issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bank-

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[78] 635 B.R. at 83, citing *In re Johns-Manville Corp.*, 517 F.3d 52, 55, 49 Bankr. Ct. Dec. (CRR) 144, Bankr. L. Rep. (CCH) P 81107 (2d Cir. 2008), rev'd and remanded, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99, 51 Bankr. Ct. Dec. (CRR) 210, 61 Collier Bankr. Cas. 2d (MB) 1441, Bankr. L. Rep. (CCH) P 81505 (2009) ("*Manville III*"), rev'd and remanded on other grounds sub nom, and *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99, 51 Bankr. Ct. Dec. (CRR) 210, 61 Collier Bankr. Cas. 2d (MB) 1441, Bankr. L. Rep. (CCH) P 81505 (2009).

[79] 635 B.R. at 83, *145, citing SPV OSUS Ltd., 882 F.3d at 339–340.

[80] See *Pepper v. Litton*, 308 U.S. 295, 304, 60 S. Ct. 238, 84 L. Ed. 281 (1939) ("This Court has held that for many purposes 'courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity.' ") (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 240, 54 S. Ct. 695, 78 L. Ed. 1230, 93 A.L.R. 195 (1934)).

[81] *Law v. Siegel*, 571 U.S. 415, 420–21, 134 S. Ct. 1188, 188 L. Ed. 2d 146, 59 Bankr. Ct. Dec. (CRR) 43, Bankr. L. Rep. (CCH) P 82592 (2014) (In exercising its statutory and inherent powers, "a bankruptcy court may not contravene specific statutory provisions."). The Ninth Circuit Court of Appeals stated that "[e]quity may not be invoked to defeat clear statutory language, nor to reach results inconsistent with the statutory scheme established by the Code." *In re Powerine Oil Co.*, 59 F.3d 969, 973, 27 Bankr. Ct. Dec. (CRR) 623, 33 Collier Bankr. Cas. 2d (MB) 1778, Bankr. L. Rep. (CCH) P 76554 (9th Cir. 1995).

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ruptcy Code."[82] The Supreme Court has stated that "[i]t is hornbook law that § 105(a) 'does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.' . . . Section 105(a) confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits."[83] Accordingly, the Supreme Court has dictated that a bankruptcy court's statutory powers under section 105(a) and any remaining equitable powers "may not be exercised in contravention of the Code."[84]

Finding little guidance on whether a bankruptcy court is statutorily authorized to grant non-debtor releases from Second Circuit precedent, the district court bemoaned that "although the Second Circuit identified the question as open back in 2005, it has not yet had occasion to analyze the issue. Its only guidance to the lower courts, uttered in that 2005 opinion, is this: because statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in 'unique' cases."[85] The *Purdue Pharma* district court, however, rejected the view that the releases at issue could be justified as unique and upheld as necessary in "rare cases." Further, the court rejected the view that non-debtor releases were actually rare, stating:

> As one of my colleagues on the Bankruptcy Court recently noted, plans releasing non-debtors from third party claims are no rarity: "Unfortunately, in actual practice the parties . . .often seek to impose involuntary releases based solely on the contention that anybody who makes a contribution to the case has earned a third-party release. Almost every proposed Chapter 11 Plan that I receive includes proposed releases." *In re Aegean Marine Petroleum Network Inc*., 599 B.R. 717, 726 (S.D.N.Y. 2019) (Wiles, B.J.) (emphasis added). When every case is unique, none is unique. Given the frequency with which this issue arises, the time has come for a comprehensive analysis of whether authority for such releases can be found in the Bankruptcy Code — that "comprehensive scheme" devised by Congress for resolving debtor-creditor relations. See *RadLAX*

[82] 571 U.S. at 420, citing 11 U.S.C. § 105(a).

[83] 571 U.S. at 421 (citation omitted).

[84] 571 U.S. at 423.

[85] In re Purdue Pharma, L.P, 635 B.R. at 37.

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> *Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S. Ct. 2065, 182 L. Ed. 2d 967 (2012).[86]

In its opinion issued shortly after the district court's decision in *Purdue Pharma*, the district court in the *Mahwah* case found that the regular approval of third-party releases in the Eastern District of Virginia attracted major companies to file bankruptcy there.[87] Further, the court perceived the common use of third-party release compelled their close scrutiny, stating:

> The ubiquity of third-party releases in the Richmond Division demands even greater scrutiny of the propriety of such releases. And, their prevalence also undermines assertions that they are integral to the success of this particular reorganization plan. As District Judge Colleen McMahon astutely observed: "When every case is unique, none is unique." In re Purdue Pharma, L.P., 2021 WL 5979108, at *3.[88]

The *Purdue Pharma* district court concluded that "the Bankruptcy Code does not authorize such nonconsensual non-debtor releases: not in its express text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or 'residual' powers on a court sitting in bankruptcy. For that reason, the Confirmation Order . . . must be vacated."[89] The district court noted that its "opinion will not be the last word on the subject, nor should it

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[86]635 B.R. at 37.

[87]"This recurrent practice contributes to major companies like Mahwah (a New Jersey company) using the permissive venue provisions of the Bankruptcy Code to file for bankruptcy here." *Patterson v. Mahwah Bergen Retail Group, Inc.*, 636 B.R. 641, 654–655 (E.D. Va. 2022). Clarifying that proper venue did exist in *Mahwah*, the court stated:

> [V]enue properly exists in the Richmond Division, as Debtors latched onto the existing bankruptcy of one of their affiliates, Dress Barn, which is incorporated in Virginia, as the basis for venue. 28 U.S.C. § 1408. Consequently, the question is not whether venue was proper here, but instead why Debtors chose this venue over the many other venue options that it had available to it. During oral argument, counsel for Debtors had no explanation for his client's choice of Richmond to file for bankruptcy.

636 B.R. at 655, n.4.

[88]636 B.R. at 655.

[89]In re Purdue Pharma, L.P., 635 B.R. at 115.

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be" and emphasized that "the lower courts desperately need a clear answer."[90]

The bankruptcy court in *Purdue Pharma* explicitly relied on Bankruptcy Code sections 105(a), 1123(a)(5) and (b)(6), and 1129, together with court's "residual authority" as providing it with the power to approve the releases as "necessary or appropriate" to carry out the provisions of the Bankruptcy Code.[91] The district court concluded that none of the sections confers any substantive right such that a release to enforce that right could be entered pursuant to section 105(a), stating that "each of the cited sections, like Section 105(a), confers on the Bankruptcy Court only the power to enter orders that carry out other, substantive provisions of the Bankruptcy Code. None of them creates any substantive right; neither do they create some sort of "residual authority" that authorizes the action taken by the Bankruptcy Court."[92]

The district court found various aspects of the non-

[90] 635 B.R. at 37.

[91] 635 B.R. at 113.

[92] 635 B.R. at 106 "Section 1123(b)(6) provides that a plan may 'include any other appropriate provision not inconsistent with the applicable provisions of this title.' 11 U.S.C § 1123(b)(6). 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." "Section 1123(a)(5) of the Bankruptcy Code provides that a plan of reorganization must 'provide adequate means for [its] implementation.' 11 U.S.C. § 1123(a)(5). That section contains a laundry list of things that a plan can include in order to make sure that resources are available to implement the plan — any of which can be ordered by a bankruptcy court." 635 B.R. at 108. The district court rejected the argument that section 1123(a)(5) grants any special rights or powers to support the releases at issue. 635 B.R. at 109 ("Section 1123(a)(5) does not authorize a court to give its imprimatur to something the Bankruptcy Code does not otherwise authorize, simply because doing so would ensure funding for a plan. Nothing in Section 1123(a)(5) suggests that a debtor has the right to secure sufficient funds for implementation by any means necessary."). The district court also found that "[s]ection 1129(a)(1) does not provide the substantive authority for a Section 105(a) injunction or approval of a release." 635 B.R. at 109 ("Like the cited sections of § 1123, § 1129(a) confers no substantive right that could be used to undergird a § 105(a) injunction. One highly general provision simply does not confer substantive authority that is required to invoke another highly general provision.").

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consensual Section 10.7 Shareholder Release to be inconsistent with certain provisions of the Bankruptcy Code. "[T]he 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."[93] Further, the district court pointed out that "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 . . ."[94]

The district court, however, rejected the argument that the Section 10.7 Shareholder Release and corresponding injunctions are inconsistent with Section 524(e) of the Bankruptcy Code, which provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."[95] 11 U.S.C. § 524(e). The district court explained:

> On the facts of this case, I cannot agree with that argument — but not because the Code is silent on the subject. Section 524(e) says, in sum and substance, that releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. But the claims that would be released by the Section 10.7 Shareholder Release are not claims on which the Sacklers are jointly liable with Purdue. The various state statutes being invoked by Appellants give rise to

[93] 635 B.R. at 106, citing 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, 41 Bankr. Ct. Dec. (CRR) 12, 49 Collier Bankr. Cas. 2d (MB) 1019, Bankr. L. Rep. (CCH) P 78821 (2003) (internal citation omitted).").

[94] 635 B.R. at 107, citing 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.").

[95] 635 B.R. at 107.

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> Sackler liability independent of Purdue's liability — albeit for the very same violations of the very same laws — because those laws impose an independent duty on persons who occupy certain managerial positions in a corporation. We would not have this appeal if the Sackler debts being eliminated by the Section 10.7 Shareholder Release were also debts owed by Purdue; we would be back in Section 10.6 land, dealing with derivative claims, where the Bankruptcy Court's power is unchallenged. . .. I am, therefore, constrained to conclude that the Section 10.7 Shareholder Release is not inconsistent with § 524(e), because it contains the discharge of debts that are not contemplated by § 524(e).[96]

Finally, the district court rejected the argument that the bankruptcy court has "residual power" enabling it to authorize the releases at issue and held that the bankruptcy court's power is bounded by the Bankruptcy Code.[97] Rejecting achieving a bankruptcy goal as the justification for the release at issue, when the relief finds no direct support in and, in fact, is inconsistent with the Bankruptcy Code, the district court stated:

> No reference in *Energy Resources* to a bankruptcy court's "residual power" authorizes the learned Bankruptcy Judge's approval of the Section 10.7 Shareholder Release under any "residual power" theory. Just two years prior to the *In re Energy Resources* decision, the same Supreme Court — made up of the same nine justices — held that the bankruptcy court's residual equitable authority was bounded by the provisions of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S. Ct. 963, 99 L. Ed. 2d 169 (1988) (holding "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). *Energy Resources* is consistent with this principle. Congress legislated a particular right into the Bankruptcy Code; the Supreme Court refused to allow lower courts to expand that right and held that the Bankruptcy Court had the power to authorize anything that was not inconsistent with

[96] 635 B.R. at 108.

[97] 635 B.R. at 113 ("Debtors rely heavily on the Supreme Court's decision in *U.S. v. Energy Resources Co., Inc.*, 1990-2 C.B. 263, 495 U.S. 545, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 20 Bankr. Ct. Dec. (CRR) 840, 22 Collier Bankr. Cas. 2d (MB) 1093, Bankr. L. Rep. (CCH) P 73381, 90-1 U.S. Tax Cas. (CCH) P 50281, 65 A.F.T.R.2d 90-1078 (1990) for the proposition that a bankruptcy court has "residual authority" to approve reorganization plans that includes all "necessary and appropriate" provisions, as long as those provisions are not inconsistent with title 11.").

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> that right. But the Bankruptcy Code conferred a specific right. In this case, there is nothing in the Bankruptcy Code that specifically authorizes the Section 10.7 Shareholder Release; the Bankruptcy Court (and this Court) is being asked to insert a right that does not appear in the Bankruptcy Code in order to achieve a bankruptcy objective.[98]

Concluding that necessary statutory authority was lacking, the district court expounded that "[i]n *Metromedia*, the Second Circuit signaled that a Bankruptcy Court could not order the non-consensual release of third-party claims against non-debtors unless some provision of the Bankruptcy Code aside from Section 105(a) authorized it to do so."[99] In summation, the district court outlined the basis for its conclusion as follows:

> The Bankruptcy Code does not authorize a bankruptcy court to order the nonconsensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. The Confirmation Order fails to identify any provision of the Bankruptcy Code that provides such authority. Contrary to the bankruptcy judge's conclusion, Sections 105(a) and 1123(a)(5) & (b)(6), whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code. Second Circuit law is not to the contrary; indeed, the Second Circuit has not yet taken a position on this question.[100]

The district court lamented that the unsettled state of the law on the third-party release question had led to several years of approaching the issue incorrectly, stating:

> It is indeed unfortunate that that this decision comes very late in a process that, from its earliest days in 2019, has proceeded on the assumption that releases of the sort contemplated in Section 10.7 of the Debtors' Plan would be authorized — this despite the language of the Bankruptcy Code and the lack of any clear ruling to that effect. I am sure that the last few years would have proceeded in a very different way if the parties had thought otherwise. But that is why the time to resolve this question for once and for all is now — for this bankruptcy, and

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[98] 635 B.R. at 113–114.

[99] 635 B.R. at 115 ("I conclude that there is no such section, and so no such authority.").

[100] 635 B.R. at 78.

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> for the sake of future bankruptcies. It should not be left to debtors and their creditors to guess whether such releases are statutorily authorized; and it most certainly should not be the case that their availability, or lack of same, should be a function of where a bankruptcy filing is made.
>
> I also acknowledge that the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction. But just as, "A court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions" (*Manville III*, 517 F.3d at 66), so too its power to grant relief to a non-debtor from non-derivative third party claims "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington*, 485 U.S. at 206.
>
> Because the Bankruptcy Code confers no such authority, the order confirming the Plan must be vacated. Because the Advance Order is an adjunct of and follows from the Confirmation Order, it, too, must be vacated.[101]

Approximately two months after the Southern District of New York district court's decision in *Purdue Pharma* and one month after the Eastern District of Virginia district court's opinion in *Mahwah*, a Delaware bankruptcy court, in *In re Mallinckrodt PLC*,[102] applying governing Third Circuit law, upheld nonconsensual non-debtor releases. In that case, the court stated: "I find that because the Opioid Releases are integral to the success of Debtors' Plan, I have the jurisdictional authority to approve them as both fair and reasonable."[103] Following recent Third Circuit precedent addressing the authority of bankruptcy courts to approve plans of reorganization that contain non-consensual third-party releases and related injunctions in *In re Millennium Lab Holdings II, LLC*,[104] the bankruptcy court exclaimed:

> The *Millennium* Court cautioned that courts should "approach the inclusion of nonconsensual third-party releases or injunc-

[101] 635 B.R. at 115.

[102] *In re Mallinckrodt PLC*, 2022 WL 334245 (Bankr. D. Del. 2022), corrected and superseded, 639 B.R. 837 (Bankr. D. Del. 2022), stay pending appeal denied, 2022 WL 1206489 (D. Del. 2022).

[103] 2022 WL 334245 at *13.

[104] *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, Bankr. L. Rep. (CCH) P 83470 (3d Cir. 2019), cert. denied, 140 S. Ct. 2805, 207 L. Ed. 2d 142 (2020)

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> tions in a plan of reorganization with the utmost care and [] thoroughly explain the justification for any such inclusion." *Millennium*, 945 F.3d at 139. With these principles in mind, I consider the proposed releases.[105]

The *Mallinckrodt* court was satisfied with the evidence that was presented, and found it to be uncontroverted and persuasive that reorganization was impossible without the third-party releases and that, therefore, the releases were necessary and approved.[106] Recognizing that its ruling was inconsistent with the district court decisions in *Purdue Pharma* and *Mahwah*, the bankruptcy court in *Mallinckrodt* explained:

> I am also aware of the recent rulings from courts in the Second Circuit and the Fourth Circuit that hold otherwise. See *In re Purdue Pharma L.P.*, 633 B.R. 53, 66 (Bankr. S.D.N.Y. 2021) overruled on other grounds by 2021 U.S. Dist. LEXIS 242236, 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021) (concluding that "the Bankruptcy Code does not authorize a bankruptcy court to order the nonconsensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan.") and *Patterson v. Mahwah Bergen Retail Grp.*, Inc., No. 3:21cv167 (DJN), 2022 U.S. Dist. LEXIS 7431 (E.D. Va. Jan. 13, 2022) (same). In this case, however, I am applying the law of the Third Circuit which has recognized that bankruptcy courts do have statutory and constitutional authority to approve a plan of reorganization that contains non-consensual third-party releases, albeit, only in extraordinary cases.[107]

VIII. Federal Common Law

Although there is no reference to the term in the bankruptcy court or district court decisions, the bankruptcy court's ruling in Purdue Pharma can be viewed as an application of federal common law. While definitions of federal common law may vary, the Supreme Court views the term, "in the strictest sense, [as] a rule of decision that amounts, not simply to an interpretation of a federal statute, but rather to the judicial

[105] 2022 WL 334245 at *14.

[106] 2022 WL 334245 at *12.

[107] 2022 WL 334245 at *14, n. 69.

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'creation" of a special federal rule of decision."[108] Longstanding precedent, as famously proclaimed by Justice Brandeis, in *Erie R. Co. v. Tompkins* is that there is "no federal general common law."[109] It is also long established, however, that there is federal common law in limited circumstances.

The Supreme Court has exclaimed that "[t]he cases in which federal courts may engage in common lawmaking are few and far between."[110] *Rodriguez v. FDIC*,[111] involved a dispute between a bankruptcy trustee and a Federal Deposit Insurance Corporation receiver litigated in an adversary proceeding in a chapter 7 bankruptcy case. The dispute was over tax refund rights under a tax allocation agreement. The Supreme Court did not resolve this dispute. Rather, it explained that "[w]e did not take this case to decide how this case should be resolved under state law or to determine how IRS regulations might interact with state law. We took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking."[112] Moreover, while not directly cited by the district court, the Supreme Court's caution against use of federal common law can serve as an additional basis for overturning the bankruptcy court's ruling on non-debtor releases in *Purdue Pharma*.

Nonetheless, in many instances, it is necessary for bankruptcy courts to exercise discretion. In making discretionary determinations, courts may be guided by the policies underlying the Bankruptcy Code. In some instances, the approaches developed by courts may appear to be at odds with the Bankruptcy Code. For example, the Supreme Court has acknowledged that it is standard practice to violate ordinary priority

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[108] *Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742, 118 S. Ct. 2257, 141 L. Ed. 2d 633, 77 Fair Empl. Prac. Cas. (BNA) 1, 73 Empl. Prac. Dec. (CCH) P 45340, 170 A.L.R. Fed. 677 (1998).

[109] *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A.L.R. 1487 (1938).

[110] *Rodriguez v. Federal Deposit Insurance Corporation*, 140 S. Ct. 713, 716, 206 L. Ed. 2d 62, 65, Bankr. L. Rep. (CCH) P 83475, 2020-1 U.S. Tax Cas. (CCH) P 50124, 125 A.F.T.R.2d 2020-1027 (2020).

[111] *Rodriguez v. Federal Deposit Insurance Corporation*, 140 S. Ct. 713, 206 L. Ed. 2d 62, Bankr. L. Rep. (CCH) P 83475, 2020-1 U.S. Tax Cas. (CCH) P 50124, 125 A.F.T.R.2d 2020-1027 (2020).

[112] 140 S. Ct. at 719.

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rules as set forth in the Bankruptcy Code during the course of Chapter 11 bankruptcy reorganization cases with, for example, "first-day" wage orders, "critical vendor" orders, and "roll-ups" in debtor in possession financing.[113] The approaches that bankruptcy courts have taken in these matters and in addressing other issues such as recharacterization and structured dismissals can be viewed as a form of common lawmaking.[114]

In *Rodriguez*, the Supreme Court expounded on the limited use of federal common law, stating:

> Judicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government's "legislative Powers" in Congress and reserves most other regulatory authority to the States. . . . As this Court has put it, there is no federal general common law. . . . Instead, only limited areas exist in which federal judges may appropriately craft the rule of decision. . . . These areas have included admiralty disputes and certain controversies between States. . . . In contexts like these, federal common law often plays an important role. But before federal judges may claim a new area for common lawmaking, strict conditions must be satisfied. . . .

In the absence of congressional authorization, common lawmaking must be necessary to protect uniquely federal interests.[115]

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[113] *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 137 S. Ct. 973, 985, 197 L. Ed. 2d 398, 63 Bankr. Ct. Dec. (CRR) 242, 77 Collier Bankr. Cas. 2d (MB) 596, 41 I.E.R. Cas. (BNA) 1613, Bankr. L. Rep. (CCH) P 83082 (2017).

[114] Another use of federal common law in bankruptcy, for example, involves substantive consolidation. Substantive consolidation is generally viewed as the merging of assets and liabilities of two or more related debtors into a single pool to pay creditors. *In re Meruelo Maddux Properties, Inc.*, 667 F.3d 1072, 1075, 55 Bankr. Ct. Dec. (CRR) 279, 67 Collier Bankr. Cas. 2d (MB) 202, Bankr. L. Rep. (CCH) P 82159 (9th Cir. 2012) ("Substantive consolidation is an uncodified equitable doctrine allowing the bankruptcy court for purposes of the bankruptcy, to 'combine the assets and liabilities of separate and distinct — but related — legal entities into a single pool and treat them as though they belong to a single entity.' "), citing *In re Bonham*, 229 F.3d 750, 764 (9th Cir. 2000).

[115] Rodriguez v. FDIC, 140 S. Ct. at 717 (citations and quotations omitted).

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In *Czyzewski v. Jevic Holding Corp.*,[116] cited by the district court in *Purdue Pharma*, the U.S. Supreme Court addressed a situation where the structure of the dismissal of a chapter 11 case provided for payments skipping a class of objecting creditors in favor of more junior creditors. The *Jevic* court examined whether bankruptcy courts have the legal power to approve the structured dismissal of a chapter 11 bankruptcy case "that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent?"[117] The court held that "[o]ur simple answer to this complicated question is 'no'."[118] The court explained that "the question . . . [in *Jevic*] concerns the interplay between the Code's priority rules and a Chapter 11 dismissal."[119] The court, however, declined to express an explicit view on structured dismissals in general, situations where no creditor opposition is present, and/or cases where priority skipping is not at issue.[120]

The Supreme Court found no other authority in the Code for priority skipping dismissals, stating:

> Nothing else in the Code authorizes a court ordering a dismissal to make general end-of-case distributions of estate assets to creditors of the kind that normally take place in a Chapter 7 liquidation or Chapter 11 plan—let alone final distributions that do not help to restore the *status quo ante* or protect reliance interests acquired in the bankruptcy, and that would be flatly impermissible in a Chapter 7 liquidation or a Chapter 11 plan because they violate priority without the impaired creditors' consent. That being so, the word "cause" is too weak a reed upon which to rest so weighty a power.[121]

Accordingly, the Supreme Court found priority-skipping

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[116] *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 137 S. Ct. 973, 197 L. Ed. 2d 398, 63 Bankr. Ct. Dec. (CRR) 242, 77 Collier Bankr. Cas. 2d (MB) 596, 41 I.E.R. Cas. (BNA) 1613, Bankr. L. Rep. (CCH) P 83082 (2017).

[117] 137 S. Ct. at 983.

[118] 137 S. Ct. at 983.

[119] 137 S. Ct. at 979.

[120] 137 S. Ct. at 985 ("We express no view about the legality of structured dismissals in general.").

[121] 137 S. Ct. at 984–85, citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371, 108 S. Ct. 626, 98 L. Ed. 2d 740, 16 Bankr. Ct. Dec. (CRR) 1369, 17 Collier Bankr. Cas. 2d (MB) 1368, Bankr. L. Rep. (CCH) P 72113 (1988), *Kelly v. Robinson*, 479 U.S. 36, 43, 107 S. Ct. 353, 93 L. Ed. 2d 216, 14 Bankr. Ct. Dec. (CRR) 1383, 14

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aspect of the structured dismissal in *Jevic* to be highly problematic.

The Supreme Court emphasized that the Code's priority system is "a basic underpinning of business bankruptcy law." The court explained:

> Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. In Chapter 7 liquidations, priority is an absolute command—lower priority creditors cannot receive anything until higher priority creditors have been paid in full. . . . Chapter 11 plans provide somewhat more flexibility, but a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors.[122]

Reversing the Third Circuit, the Supreme Court declined to express any view regarding the legality of structured dismissals in general.[123] Implicitly the court acknowledged them to be appropriate where creditors consent.[124] Further, the Supreme Court acknowledged that it is standard practice to violate ordinary priority rules during the course of chapter 11 cases with, for example, "first-day" wage orders, "critical vendor" orders, and "roll-ups" in debtor in possession financing.[125] The court recognized that such out-of-priority distributions, however, are found necessary to enable successful reorganization and benefit even disfavored creditors.[126] Moreover, the court emphasized the interim nature of such relief and distinguished the Second Circuit's decision in *In re Iridium Operating LLC*[127] as approving "an *interim* distribution of settlement proceeds to fund a litigation trust that would press

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Bankr. Ct. Dec. (CRR) 1384, 15 Collier Bankr. Cas. 2d (MB) 890, Bankr. L. Rep. (CCH) P 71475 (1986), and *Matter of Sadler*, 935 F.2d 918, 921, 21 Bankr. Ct. Dec. (CRR) 1385, 24 Collier Bankr. Cas. 2d (MB) 2017, Bankr. L. Rep. (CCH) P 74071 (7th Cir. 1991).

[122] 137 S. Ct. at 983.

[123] 137 S. Ct. at 985.

[124] The appropriateness of such consensual relief can be viewed as equivalent to consensual third-party releases under a chapter 11 plan.

[125] 137 S. Ct. at 985.

[126] 137 S. Ct. at 985.

[127] *In re Iridium Operating LLC*, 478 F.3d 452, 47 Bankr. Ct. Dec. (CRR) 243, Bankr. L. Rep. (CCH) P 80874 (2d Cir. 2007).

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claims on the estate's behalf."[128] In contrast, the priority-violating distribution under the *Jevic* structured dismissal is a final disposition that did not make the priority claimants better off.

Contrary to the Third Circuit's perspective that the bankruptcy court's approval of the structured dismissal constituted a wise use of discretion to allow the least bad alternative, the Supreme Court found fatal flaws in this approach in *Jevic*, explaining:

> In a structured dismissal like the one ordered below, the priority-violating distribution is attached to a final disposition; it does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not help to restore the status quo ante; and it does not protect reliance interests. In short, we cannot find in the violation of ordinary priority rules that occurred here any significant offsetting bankruptcy-related justification.[129]

The Supreme Court found that the Third Circuit's rare case limitation would prove to be illusory and posed a threat to warp into a more general rule.[130] Moreover, the court found the consequences of allowing priority-skipping structured dismissals to stand would include departing from protections Congress granted particular classes of creditors (e.g., employee wage priority), risks of collusion, and uncertainty making settlements more difficult to accomplish.[131] As a result, the Supreme Court struck down the Third Circuit's limited approval of nonconsensual priority-violating structured dismissals in "rare cases."

Focusing on the importance of the Code's priority system and perceived silence of the Code regarding structured dismissals, the Supreme Court stated "we would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans." Finding no such indica-

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[128] 137 S. Ct. at 985.

[129] 137 S. Ct. at 985–86.

[130] 137 S. Ct. at 986.

[131] 137 S. Ct. at 986–87.

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tion and the lack of "any significant offsetting bankruptcy-related justification", the court rejected the violation of ordinary priority rules through a structured dismissal.[132]

VIII. Equitable Mootness

In *Mahwah*, it was argued that the appeal from the plan confirmation order must be dismissed on equitable mootness grounds. The judicial doctrine of equitable mootness has been used to insulate plan confirmation orders from effective appeal. It allows appellate courts to dismiss bankruptcy appeals without reaching the merits. It is a judge-made abstention doctrine unrelated to and separate from the constitutional and statutory prohibitions against the court's hearing moot appeals. While some courts question the legitimacy and efficacy of the doctrine, it has been applied in every circuit court of appeals that addresses bankruptcy appeals.[133]

Courts uniformly emphasize that the doctrine of equitable mootness must be narrowly construed and cautiously applied. "It is important to observe that appellate cases generally apply equitable mootness with a scalpel rather than an axe."[134] Nonetheless, the scope of the doctrine's application and the parties it is intended to protect have become the subject of frequent disagreement over the appropriate exercise of discretion by courts of appeal.

In *Tribune Media Co. v. Aurelius Capital Mgmt., L.P.*,[135] the Third Circuit describes equitable mootness as "a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of

[132] 137 S. Ct. at 986–87

[133] *In re Tribune Media Co.*, 799 F.3d 272, 286, 61 Bankr. Ct. Dec. (CRR) 124, Bankr. L. Rep. (CCH) P 82861 (3d Cir. 2015) ("'Every Circuit Court has recognized some form of equitable mootness,' save the Federal Circuit (which does not hear bankruptcy appeals). . ..", quoting Nil Ghosh, Plan Accordingly: The Third Circuit Delivers a Knockout Punch with Equitable Mootness, 23 Norton J. Bankr. L. & Prac. 224 & n.8 (2014) (collecting cases). See also concurring opinion in *In re One2One Communications, LLC*, 805 F.3d 428, 433, 61 Bankr. Ct. Dec. (CRR) 94 (3d Cir. 2015), questioning both the legitimacy and efficacy of the doctrine.

[134] *In re Pacific Lumber Co.*, 584 F.3d 229, 240, 52 Bankr. Ct. Dec. (CRR) 46, Bankr. L. Rep. (CCH) P 81642 (5th Cir. 2009).

[135] *In re Tribune Media Co.*, 799 F.3d 272, 61 Bankr. Ct. Dec. (CRR) 124, Bankr. L. Rep. (CCH) P 82861 (3d Cir. 2015).

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consummated plans of reorganization."[136] The doctrine may be used to advance the Bankruptcy Code's purpose of promoting successful reorganization.[137] This policy goal underlying bankruptcy reorganization cases is in tension with the ordinary right to have and appeal heard on its merits in the federal courts of appeal. The Fifth Circuit has stated that "[d]espite its apparent virtues, equitable mootness is a judicial anomaly. Federal courts 'have a virtually unflagging obligation' to exercise the jurisdiction conferred on them."[138]

Some courts appear to limit application of equitable mootness to only prevent unscrambling of complex bankruptcy reorganizations.[139] Accordingly, use of the doctrine, has been

[136] 799 F.3d at 277 (footnote omitted). Explaining the doctrine, the Fifth Circuit stated:

> "Equitable Mootness" has evolved in bankruptcy appeals to constrain appellate review, and potential reversal, of orders confirming reorganization plans. Equitable mootness is a kind of appellate abstention that favors the finality of reorganizations and protects the interrelated multi-party expectations on which they rest.

In re Pacific Lumber Co., 584 F.3d at 240.

[137] See, e.g., *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 528, 104 S. Ct. 1188, 79 L. Ed. 2d 482, 11 Bankr. Ct. Dec. (CRR) 564, 9 Collier Bankr. Cas. 2d (MB) 1219, 5 Employee Benefits Cas. (BNA) 1015, 115 L.R.R.M. (BNA) 2805, Bankr. L. Rep. (CCH) P 69580, 100 Lab. Cas. (CCH) P 10771 (1984) ("[T]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."). See also *In re Continental Airlines*, 91 F.3d 553, 565, 29 Bankr. Ct. Dec. (CRR) 629, 36 Collier Bankr. Cas. 2d (MB) 785 (3d Cir. 1996).

[138] In re Pacific Lumber Co., 584 F.3d at 240, quoting *Colorado River Water Conservation Dist. v. U. S.*, 424 U.S. 800, 817, 96 S. Ct. 1236, 47 L. Ed. 2d 483, 9 Env't. Rep. Cas. (BNA) 1016 (1976). "Following confirmation of a reorganization plan by a bankruptcy court, an aggrieved party has the statutory right to appeal the court's ruling." One2One Communs., LLC v. Quad/Graphics, 805 F.3d at 433. Further, the concurring opinion in One2One Communs., LLC v. Quad/Graphics, states that "[t]he mandate that federal courts hear cases within their statutory jurisdiction is a bedrock principle of our judiciary." Id., at 439.

[139] See One2One Communs., LLC v. Quad/Graphics, 805 F.3d at 434, citing *Nordhoff Investments, Inc. v. Zenith Electronics Corp.*, 258 F.3d 180, 185, 38 Bankr. Ct. Dec. (CRR) 3, 46 Collier Bankr. Cas. 2d (MB) 802 (3d Cir. 2001).

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criticized for being applied broadly to dismiss appeals in uncomplicated bankruptcy cases.[140]

Equitable mootness has been criticized as a "legally ungrounded and practically unadministrable 'judge-made abstention doctrine.' "[141] Other judges have advocated the use of the doctrine to prevent the upset of a "successful reorganization" and to advance the "public interest in promoting reliance on the finality of bankruptcy court confirmation orders. . ..."[142] Moreover, some judges have gone so far as to point out that without the doctrine "it is hard to imagine that any complex plan would be consummated until all appeals are terminated."[143] Further, it has been argued the doctrine should be eliminated or, at least, reformed.[144]

In *Mahwah*, the district court characterized "equitable mootness" as a "pragmatic doctrine grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable."[145] The doctrine's application "is based on practicality and prudence, does not employ rigid rules, and requires that a court determine whether judicial relief on appeal can, as a pragmatic matter, be granted."[146] The *Mahwah* district court looked to the following relevant factors in addressing the issue: (1) whether the appellant sought and obtained a stay; (2) whether the reorganization plan or other equitable relief has been substantially consummated; (3) the extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and, (4)

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[140] See, e.g., One2One Communs., LLC v. Quad/Graphics, 805 F.3d at 438 (concurring opinion).

[141] 805 F.3d at 438 (concurring opinion).

[142] *In re Transwest Resort Properties, Inc.*, 801 F.3d 1161, 1168, 74 Collier Bankr. Cas. 2d (MB) 658 (9th Cir. 2015) (dissenting opinion).

[143] Tribune Media Co. v. Aurelius Mgmt., L.P., 799 F. 3d at 288 (concurring opinion).

[144] One2One Communs., LLC v. Quad/Graphics, 805 F.3d at 438–54 (concurring opinion).

[145] *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 2022 U.S. Dist. LEXIS 7431, *119, citing *In re Bate Land & Timber LLC*, 877 F.3d 188, 195, 65 Bankr. Ct. Dec. (CRR) 2 (4th Cir. 2017).

[146] Patterson v. Mahwah Bergen Retail Grp., Inc., 636 B.R. at 696.

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the extent to which the relief requested on appeal would affect the interests of third parties.[147]

Applying the factors, the district court in *Mahwah* rejected deploying equitable mootness and declined to avoid addressing the merits of the appeal.[148] First, appellants unsuccessfully sought stays at both the bankruptcy court and the district court. Second, the requested relief (invalidating all or parts of the releases at issue) would not involve unwinding the plan and would only prospectively affect the ability of parties to bring suits based on past events. Third, invalidating or altering the releases would not impact the recovery of any creditors. Moreover, creditors would not be materially harmed by allowing third parties to retain their causes of action against non-debtors.[149] Fourth, "[a]s the releases here only apply to claims arising on or before the Effective Date, no post-confirmation transactions with third parties have occurred in reliance on the releases. Thus, considering the merits of the appeal would not negatively affect any third parties who relied on the confirmation of the Plan."[150]

Most importantly, the *Mahwah* district court was unwilling to countenance the use of the doctrine to avoid judicial review where it believed the bankruptcy court had exceeded its constitutional authority and committed serious errors. The district court proclaimed:

> Finally, the doctrine of equitable mootness is all too often invoked to avoid judicial review, as Debtors seek to do here. . . . That concern takes on greater import here with the shockingly broad releases and the inclusion in the Plan of an attempted "poison pill" Nonseverability Provision. The errors committed by the Bankruptcy Court here are serious and command review by an Article III court. That Debtors invoke an equitable principle designed to promote a fair outcome embodies the height of irony.
>
> Consequently, the Court concludes that the equities strongly favor considering the merits of this appeal. Debtors' doomsday

[147] 636 B.R. at 696.

[148] "The Court declines the invitation to use its equitable powers to ignore the serious errors that have occurred here." 636 B.R. at 696.

[149] 636 B.R. at 699.

[150] 636 B.R. at 699 ("Conversely, extinguishing the claims of thousands of individuals without compensation, without consent and without due process reeks of inequity to third parties.").

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scenarios all stem from the inclusion of the Nonseverability Provision. However, the Court will not allow that provision or an equitable doctrine to preclude appellate review of plainly erroneous release provisions. Indeed, the Released Parties have given themselves broad releases and have sought to immunize the unconstitutional releases from appellate review with the inclusion of an inflexible Nonseverability Provision (which no longer has any effect). Equity does not support this.[151]

X Conclusion

The Circuit Courts have been split for decades on the question of the validity of nonconsensual non-debtor releases under a chapter 11 plan. In light of the intent that the Bankruptcy Code be comprehensive and the desire for uniform application of federal bankruptcy law throughout the United States, the District Court for the Southern District of New York in *Purdue Pharma* decried this lack of consistency. Further, shortly thereafter, in *Mahwah*, the Eastern District of Virginia district court expressed the perception that large chapter 11 cases are filed in the district in order to access the extraordinary relief of third-party releases.

Both the *Purdue Pharma* and *Mahwah* decisions vacated bankruptcy court plan confirmation orders imposing nonconsensual non-debtor releases, but for different reasons. While Purdue Pharma was based on a lack of statutory authority, Mahwah focused on constitutional defects, including a lack of due process in purporting to obtain consent to third-party releases. The inconsistency of decisions in different jurisdictions was soon further highlighted in the *Mallinckrodt* opinion that was issued shortly after *Mahwah*, where a Delaware bankruptcy court upheld nonconsensual third-party releases because, in accordance with Third Circuit precedent, they were integral to the success of the plan.

In *Purdue Pharma*, the district court viewed the issue before it as a bankruptcy court's power to release, on a

[151] 636 B.R. at 700. In addition to the releases that the district court held were beyond the authority of the bankruptcy court to approve, the *Mahwah* district court ruled that "the Bankruptcy Court erred by approving an overly broad Exculpation Provision that exceeds the bounds of similar provisions approved in other cases. However, unlike the Third-Party Releases that must be voided and severed from the reorganization plan, redrafting can salvage the Exculpation Provision on remand." 636 B.R. at 655.

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nonconsensual basis, direct/particularized claims asserted by third-parties against non-debtors. The district court pointed out that the Bankruptcy Code is silent on the question of third-party releases, except in the context of asbestos cases addressed by section 524(g). Further, the court was particularly troubled that, in *Purdue Pharma*, members of the Sackler family were being released from personal liabilities that could not even be discharged if they were to file personal bankruptcy. The court viewed this as being in direct conflict with the Bankruptcy Code, while at the same time providing significant benefits to creditors, the bankruptcy estate, and the public in the battle against the opioid crisis.

The district courts in both *Purdue Pharma* and *Mahwah* reject that the third-party releases could be justified since they were purportedly rarely granted and only in unique cases. Moreover, they found them to be granted on a regular basis in their jurisdictions, concluding that "when every case is unique, none is unique." On the other hand, in *Mallinckrodt*, the court was very much aware of the recent contrary decisions *Purdue Pharma* and *Mahwah* and, applying the law of the Third Circuit, held that it had the statutory and constitutional authority to approve a plan of reorganization that contains nonconsensual third-party releases, but only in "extraordinary cases."

The *Purdue Pharma* district court points out that the Supreme Court, in a different context, has held that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code — even in "rare" cases where the relief sought would help facilitate a particular reorganization. Additionally, the extra-statutory grant of third-party releases under chapter 11 plans in jurisdictions approving them, may be viewed as the kind of exercise in federal common law that the Supreme Court has frowned upon. In any event, it remains to be seen whether, on appeal, *Purdue Pharma* will ultimately provide the answer to the great unsettled question of whether the Bankruptcy Court is statutorily authorized to grant nonconsensual non-debtor releases.[152]

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[152] In an opinion issued on January 7, 2022, the district court in *Purdue Pharma* granted a motion brought by "the Debtors and their allies" pursuant to 28 U.S.C. § 1292(b), for certification of an interlocutory appeal to the

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United States Court of Appeals for the Second Circuit from the district court's order vacating the Bankruptcy Court's plan confirmation order. *In re Pharma*, 2022 U.S. Dist. LEXIS 8160, *31 (S.D.N.Y. 2022) ("I am conditioning the grant of this motion on Debtors' and the Sacklers' applying to the Second Circuit, not just for leave to appeal, but for an expedited appeal — relief that it is beyond my power to grant, but that I am sure the Second Circuit would seriously consider. . . . I have every reason to believe that the Circuit will appreciate, as this Court came to appreciate, the imperative of an expeditious resolution in light of the continuing opioid crisis that was precipitated in large measure by Purdue and the Sacklers."). Additionally, mediation and settlement discussions involving the Sacklers, the debtors, and various other parties followed the district court's ruling vacating the bankruptcy court's order confirming the plan. It remains to be seen whether a settlement will be reached or the appeal will continue before the Second Circuit and potentially beyond.