

# I can't get no release: Courts struggle with third-party releases

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Recent decisions from New York and Delaware bankruptcy courts reflect the unsettled state of the law regarding third-party releases. The decisions, in *In re Gulf Coast Health Care LLC* and *In re Stoneway Capital, Ltd*, do not directly refer to the groundbreaking decision of a New York district court in *In re Purdue Pharma, L.P.*,<sup>1</sup> which ruled that the Bankruptcy Code does not authorize a bankruptcy court to grant third-party releases, but rather illustrate both the broad range of issues raised by third-party releases and the variety of approaches used by bankruptcy judges faced with this problematic issue.

## Third-party releases

At issue is the controversial practice of "Third-Party Releases," which are provisions included in proposed plans of reorganization and proposed confirmation orders that would bar non-debtor creditors from suing non-debtor third parties.

Some of the scenarios in which Third-Party Releases have been proposed are:

- The debtor's insurers provide funding for the plan of reorganization in return for Third-Party Releases barring further claims on the insurance policies;
- The parties participating in the negotiation of the debtor's plan, such as management, officers and directors, professionals, and lenders, are protected from claims regarding the case;
- Defendants in a clawback action that has been or could be brought by the debtor settle the action and seek protection against claims that were or could be brought by non-debtor plaintiffs.

The Bankruptcy Code contains no provisions that expressly provide for Third-Party Releases (except for cases dealing with asbestos liability). Proponents of Third-Party Releases have instead relied upon general provisions such as Bankruptcy Code section 105, which says that "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

Critics of Third-Party Releases argue that such provisions do not contain specific authorization sufficient to provide so broad a power to bankruptcy judges, and that the express grant of authority in asbestos cases impliedly excludes other cases.

There is a circuit split regarding Third-Party Releases. The leading case in the Second Circuit, *In re Metromedia Fiber Network, Inc.*, is the subject of much debate concerning its precedential value.

## Purdue Pharma

The *Purdue Pharma* bankruptcy case revolves around the opioid liability of (1) Purdue Pharma, the manufacturer of Oxycontin, which has agreed to plead guilty to multiple felonies regarding the prepetition marketing of Oxycontin, and (2) the Sackler family, which owned *Purdue Pharma* and managed it until the year in which *Purdue Pharma* filed its bankruptcy petition.

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The *Purdue Pharma* plan of reorganization granted Third-Party Releases to the Sackler family, shielding them from civil liability relating to Purdue Pharma's marketing and sales of Oxycontin. The attorneys general of nine states and the United States Trustee appealed the *Purdue Pharma* confirmation order to the district court. In December 2021, District Judge McMahon agreed with the appellants and voided the *Purdue Pharma* confirmation order.

Judge McMahon ruled that the Third-Party Releases contained in the *Purdue Pharma* plan are not authorized under the Bankruptcy Code outside of the asbestos context. She read recent Supreme Court bankruptcy decisions as being generally hostile to the concept that bankruptcy courts have broad equitable powers that go beyond the specific provisions of the Bankruptcy Code. She further read *Metromedia* restrictively, finding that it did not consider the issue of whether Third-Party Releases are authorized under the statute nor whether Third-Party Releases might be disapproved based on factors other than those discussed in the *Metromedia* decision.

The *Purdue Pharma* debtors have appealed Judge McMahon's decision to the Second Circuit, where it is pending.

### Gulf Coast

The debtors in *Gulf Coast* operated a series of nursing home facilities. Their proposed plan of reorganization was built around a settlement of personal injury/wrongful death litigations brought against the debtors and other defendants that owned, operated, controlled, managed and/or provided services to the debtors' facilities. The plan provided Third-Party Releases for those non-debtor defendants, which would relieve them of personal injury/wrongful death exposure to the non-debtor plaintiffs.

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*The judge in Purdue Pharma's bankruptcy case ruled that the Third-Party Releases contained in the plan of reorganization are not authorized under the Bankruptcy Code outside of the asbestos context.*

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Judge Owens, in *Gulf Coast*, reviewed what she termed the Third Circuit's "exacting" standards for Third-Party Releases, as requiring that the Third-Party Releases be (1) necessary to the success of the reorganization, (2) fair to the releasing creditors, and (3) given for reasonable consideration.

She identified several troubling features of the proposed releases:

- the plaintiffs had no say in the plan settlement negotiations
- the plaintiffs would receive nowhere close to payment in full
- the consideration paid to the plaintiffs was solely based on their claims against the debtors, and not at all on the released claims against non-debtor third parties
- the debtors submitted no analysis of the value of the claims to be released
- the debtors did not brief the issue of whether the claims to be released were derivative of estate claims or independent of estate claims

She concluded that the debtors had failed to satisfy their burden and declined to approve the Third-Party Releases.

### Stoneway Capital

The *Stoneway* debtors were holding companies for owners of Argentine power generation plants. Their proposed plan of reorganization contemplated a sale of the power generation assets and resolved claims among the debtors, their lenders, and unsecured creditors. It provided the benefits of a Third-Party Release to senior noteholders, term loan lenders, DIP lenders, the indenture trustee, directors, management and the buyer.

All creditors who voted to accept the plan were deemed to have consented to grant the Third-Party Releases, as well as those whose

votes were solicited but who failed to affirmatively opt out. The Third-Party Releases excluded claims arising from gross negligence, fraud or willful misconduct.

The *Stoneway* court reasoned that consensual Third-Party Releases are permissible under *Metromedia*. It approved the debtors' use of an opt-out structure to obtain consent because the affected classes of creditors were receiving substantial consideration. It further determined that the disclosure that had been provided by the debtors was sufficient to consider the proposed releases to be consensual and that because the case had not received substantial publicity the creditors were not likely to have been misled by news reports.

### Analysis

All three decisions highlight the importance of a careful assessment of the nature of the claims and releases in question.

The *Purdue Pharma* appellant States asserted direct claims against the Sacklers, that is, claims that were not derivative of claims against Purdue Pharma. The *Gulf Coast* court noted that the question of whether the third-party claims in that case were derivative had not been briefed or decided. The distinction between derivative and direct claims was not discussed in *Stoneway*.

Judge Owens' *Gulf Coast* decision and Judge McMahon's *Purdue Pharma* decision contain strikingly different analyses of the Third Circuit's decision in *In re Continental Airlines*. Judge Owens read *Continental* to permit Third-Party Releases in certain circumstances, while Judge McMahon stressed that *Continental* struck down the Third-Party Releases at issue in that case, concluding that *Continental* did not constitute a precedential *approval* of Third-Party Releases.

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*All three decisions — Purdue Pharma, Gulf Coast and Stoneway Capital — highlight the importance of a careful assessment of the nature of the claims and releases in question.*

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The key issue in *Stoneway* was whether the Third-Party Releases could be deemed to be consensual with regard to creditors that did not actively participate in the bankruptcy case. (By contrast, in *Gulf Coast* and *Purdue Pharma* the releases at issue were nonconsensual.)

Indeed, the only adverse party in *Stoneway* was the United States Trustee. While the *Stoneway* decision does not expressly discuss *Purdue Pharma* it is distinguishable as the *Purdue Pharma* releases are far broader, applying to all creditors and not just to those deemed to have consented.

Many of these issues may be clarified when the Second Circuit issues its decision on the *Purdue Pharma* appeal.

*Kleinberg Kaplan represents the State of Washington in the Purdue Pharma case.*

## Notes

<sup>1</sup> <https://bit.ly/3P7ZFZo>

## About the authors



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