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Please Don't Forget the Victims: Mass Torts, Third Party Releases and the U.S. Bankruptcy Code

For decades, third-party releases have been the cornerstone of mass tort bankruptcies that have resolved previously intractable litigation and provided meaningful compensation to victims who might well have otherwise recovered nothing. These cases include *Johns-Manville* (asbestos),[2] *A.H. Robins* (Dalkon Shield),[3] *Dow Corning* (silicone breast implants),[4] *Mallinckrodt* (opioids),[5] and *Boy Scouts of America.*[6] In each, courts concluded, on a developed factual record informed by pre-bankruptcy litigation history, that value-maximizing settlements and plans of reorganization were viable only by providing settling parties paying into the estate third-party releases of appropriate scope.[7] The alternative to these broadly and deeply supported settlements, many in the

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[2] *In re Johns-Manville Corp. et al.*, Nos. 82-B-11656 to 82-B-11676 (Bankr. S.D.N.Y).

[3] *In re A.H. Robins Co. Inc.*, No. 85-10307-R (Bankr. E.D. Va.).

[4] *In re Dow Corning Corp.*, No. 95-20512 (Bankr. E.D. Mich.).

[5] *In re Mallinckrodt PLC*, No. 20-12522 (JTD) (Bankr. D. Del.).

[6] *In re Boy Scouts of America and Delaware BSA, LLC*, No. 20-10343 (LSS) (Bankr. D. Del.).

[7] *See, e.g.*, *In re Boy Scouts of America*, 642 B.R. 504, 610 (Bankr. D. Del. 2022) (describing third-party releases and associated channeling injunction as "the cornerstone of the Plan" and noting that "without the potential for third-party releases, a BSA plan spirals into a 'death trap' of litigation with minimal recoveries in sight"); *In re Mallinckrodt*, 639 B.R. 837, 873 (Bankr. D. Del. 2022) ("The settlement of those claims, of which the releases are a necessary and integral part, will remove an existential threat to Debtors' business while at the same time ensuring that Opioid Claimants receive recoveries far in excess of what they could obtain through continued litigation."); *In re Purdue Pharma L.P*, 633 B.R. 53, 109 (explaining that "without the releases the plan would unravel and the Debtors' cases would likely convert to cases under chapter 7 of the Bankruptcy Code" and "in a liquidation, unsecured creditors would probably recover nothing from the Debtors' estates"); *In re Dow Corning Corp.*, 287 B.R.
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billions of dollars, was years of costly and uncoordinated litigation—including competitively among victims—in scores of fora and resulting in greatly diminished victim recoveries—or no recoveries at all.[8] It is ironic, and potentially tragic, that recent attacks on third-party releases (mostly by academics and other commentators) go against the overwhelming will, vote, and interests of the victims, and of the representatives and fiduciaries who have fought for them for decades and crafted these settlements.

In many respects, the last few years represent a return of chapter 11 third-party releases to their roots. Before the recent spate of complex mass tort bankruptcies, judicial criticism of third-party releases usually focused on whether, and under what circumstances, such releases would be appropriate outside of the mass tort context.[9] This is understandable, as the detailed body of law governing third-party releases and channeling injunctions first developed more than thirty years ago and thereafter in the mass tort context. In the foundational cases of *Johns-Manville*, *A.H. Robins*, and *Dow Corning*, the Second, Fourth, and Sixth Circuits authorized the use of third-party releases to resolve massive, complex, and otherwise intractable mass tort litigation, unlocking

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396, 413 (E.D. Mich. 2002) (explaining that in the absence of releases and associated settlements "the Debtor would not have had sufficient funds to finance the Joint Plan").

[8] *Id.*

[9] Judge Wiles' opinion in *In re Aegean Marine Petroleum Network Inc.* is perhaps the leading judicial critique of the application of third-party releases outside of the mass tort context. There, Judge Wiles observed that "in actual practice parties . . . often seek to impose involuntary releases based solely on the contention that anybody who make a contribution to the case has earned a third-party release" and that parties "almost never explain why an order extinguishing a particular third-party claim is fair to the party whose claim is being extinguished." *In re Aegean Marine,* 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019). Judge Wiles contrasted such "routine"—and in his view, unsupported—requests for a third-party release from cases such as *Johns-Manville*, where releases were "important in order to accomplish a particular feature of the restructuring" and the court could assess "whether the terms of the restructuring really depended on those releases." *Id.* at 727.

value-maximizing settlements for victims.[10] The settlements reached in these cases were settlements that the victims themselves negotiated, voted overwhelmingly in favor of, and supported and defended, often after years of litigation and failed alternatives.

Since that time, the overwhelming judicial consensus has been that the Bankruptcy Code (including sections 105 and 1123) authorizes third-party releases and channeling injunctions where they are important or essential to a value-maximizing reorganization, meet additional limiting tests, and are within the court's jurisdiction. Each of the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits has expressly upheld the legality of third-party releases and channeling injunctions in appropriate cases.[11] They are joined by several other circuit courts, and dozens of district and bankruptcy courts in these circuits, that have confirmed or affirmed the confirmation of plans that release third-party claims.[12] And <u>no</u> circuit has forbidden third-party releases and channeling injunctions in the mass tort context. The three circuits that are often—imprecisely—described as prohibiting third-party releases have not considered them in the mass tort context.[13] In fact, as even the Fifth Circuit (one of these three) recently

[10] *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93-94 (2d Cir. 1988); *In re A.H. Robins Co., Inc.*, 880 F.2d 694, 701-02 (4th Cir. 1989); *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 656-58 (6th Cir. 2002).

[11] *See, e.g.*, *In re Global Indus. Techs., Inc.*, 645 F.3d 201, 206 (3d Cir. 2011) (en banc); *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 347 (4th Cir. 2014); *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 656-58 (6th Cir. 2002); *Airadigm*, 519 F.3d at 655-59; *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070, 1076-79 (11th Cir. 2015).

[12] *See, e.g.*, *Monarch Life Ins. Co. v. Ropes Gray*, 65 F.3d 973, 982-83 (1st Cir. 1995); *In re AOV Indus., Inc.*, 792 F.2d 1140, 1153 (D.C. Cir. 1986); *In re Charles St. African Methodist Episcopal Church of Boston*, 499 B.R. 66, 100 (Bankr. D. Mass 2013); *In re Master Mtg. Inv. Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).

[13] *See, e.g.*, *In re Pacific Lumber*, 584 F.3d 229, 252 (5th Cir. 2009) (distinguishing that case from other Circuits' cases authorizing third-party releases, and noting that those cases suggest "non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets"); *In re*
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acknowledged,[14] the Ninth Circuit (another of the three) recently upheld a nonconsensual release of claims against a non-debtor, opining that sections 105(a) and 1123 of the Code grant bankruptcy courts the power to "approve an exculpation clause intended to trim subsequent litigation over acts taken during the bankruptcy proceedings and so render the Plan viable." *Blixeth v. Credit Suisse*, 961 F.3d 1074, 1084-85 (9th Cir. 2020). In sum, the substantial majority of Circuits have long approved third-party releases in the mass tort context, and none has held to the contrary. Congress, for its part, has both codified the requirements for third-party releases and channeling injunctions in asbestos cases, and expressly legislated that the enactment of the detailed asbestos provisions shall not "be construed to modify, impair or supersede any other authority the court has to issue injunction in connection an order confirming a plan of reorganization." Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 § 111(b), 108 Stat. 4106, 4117. Accordingly, while Congress provided detailed rules for and specific to asbestos, it also expressly preserved courts' power to issue third-party releases in other contexts and to develop standards governing such releases outside of the asbestos context. And dozens of courts have done so for decades.

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Western Real Estate Fund, Inc., 922 F.2d 592, 602 (10th Cir. 1990) (reversing injunction on a single claim to collect attorneys' fees from a nondebtor third party); *In re American Hardwoods, Inc.*, 885 F.2d 621, 626-27 (9th Cir. 1989) (distinguishing case at hand from *A.H. Robins*, and observing that "district court [did not] find[] that the permanent injunction is 'essential to the plan' or that the entire reorganization 'hinged' on it"); *Resorts International, Inc. v. Lowenschuss (In re Lowenschuss*), 67 F.3d 1394 (9th Cir. 1995); *see also In re Midway Gold US, Inc.*, 575 B.R. 475, 516-17 (Bankr. D. Colo. 2017) (commenting that *Western Real Estate* does not support a "categorical bar of third-party releases in all cases").

[14] The Fifth Circuit recently commented that in *Blixeth*, "the Ninth Circuit joins the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits in reading § 524(e) to allow varying degrees of limited third-party exculpations." *In re Highland Capital Management, L.P.*, 48 F.4th 419, 436 (5th Cir. 2022).

In sum, that the Bankruptcy Code authorizes third-party releases where integral to a restructuring is settled law—and should be recognized as such. Several provisions of the Code give bankruptcy courts broad authority to modify debtor-creditor relationships, as well as significant flexibly to accommodate the needs of specific cases. Chief among them are section 1123(b)(6), which provides that a plan may contain "any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code],"[15] and section 105(a), in which Congress authorized courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."[16] Taken together, these provisions confer what the Supreme Court, in *United States v. Energy Resources Co.*, 495 U.S. 545 (1990), described as "residual authority" to craft plans that enable successful, value-maximizing reorganizations, and codify a bankruptcy court's "broad authority to modify debtor-creditor relationships," *id.* 495 U.S. at 549.

Despite this clear statutory foundation, some have argued that *Energy Resources*' endorsement of the "residual authority" conferred by the Code is too general a foundation to underpin third-party releases. They err. *Energy Resources* does not merely endorse the broad authority of bankruptcy courts to modify debtor-creditor relations or to confirm value-maximizing plans. What the Supreme Court specifically affirmed in *Energy Resources* was the power of bankruptcy courts to confirm plans of reorganization that nonconsensually adjust rights and liabilities among third parties when such adjustments

[15] 11 U.S.C. § 1123(b)(6).

[16] 11 U.S.C. § 105(a).

enable a successful reorganization. A thorough examination of the case demonstrates that it is almost on all fours with third-party release jurisprudence.

The Supreme Court's decision springs from two separate bankruptcy cases: *In re Newport Offshore, Ltd.*, 75 B.R. 919 (Bankr. D.R.I. 1987) and *In re Energy Resources Co., Inc.*, 59 B.R. 702 (Bankr. D. Mass. 1986). In each, the debtor owed the federal government both "trust fund" taxes—which, if unpaid, the IRS could also collect from certain officers or employees of the debtor ("responsible" individuals)—and non-trust fund taxes, which the IRS could collect only from the debtor.[17] Consequently, the debtor's court-approved payment of trust fund taxes first—contrary to IRS rules—would necessarily reduce or discharge the potential trust fund tax liability of the "responsible" third parties for such taxes.

In each case, the estates sought authority, over the objection of the IRS, to compel the IRS to accept the repayment of trust fund taxes first. The *Newport Offshore* plan provided that all tax claims would be paid by deferred cash payments, and directed that the IRS <u>first</u> credit payments against the principal and interest due for "trust fund" taxes, and only thereafter to non-trust fund taxes.[18] The *Energy Resources* plan established a liquidation trust, and provided that all taxes would be paid over time, or prepaid at the discretion of the liquidation trustee.[19] Using that authority, the liquidation trustee prepaid \$78,000 in taxes, and designated it to be credited against trust fund taxes.[20] The trustee

[17] *See Energy Resources*, 495 U.S. at 546-547.

[18] *In re Newport Offshore*, 75 B.R. at 920.

[19] *In re Energy Resources*, 59 B.R at 703.

[20] *Id.*

argued that the prepayment allowed the trust to "implement a settlement" with a former officer who paid $14,000 into the estate in exchange for the trustee's agreement to prepay trust fund taxes to "forestall personal liability assessed by the IRS against the former officers."[21] In short, the plan's provisions overriding IRS rules got the officer "off the hook" with the IRS in exchange for his payment of money into the estate. In both cases, the IRS objected to the forced allocation of payments to trust fund taxes ahead of non-trust fund taxes. Indeed, the IRS explicitly argued in *Newport Offshore* that the plan's attempt to force it to credit payments to trust fund taxes improperly benefited third parties by relieving them of their own direct tax liability to the IRS, and shifted to the government the risk that the plan would fail when only non-trust fund taxes (collectible only from the debtor) remained unpaid.[22] In each case, the bankruptcy court rejected the objection and directed that the IRS allocate the payment to trust fund taxes, overriding IRS rules.[23]

The First Circuit consolidated the two cases on appeal. *In re Energy Resources Co.*, 871 F.2d 223, 226 (1st Cir. 1989). Then-Judge Breyer, writing for the panel, observed that an order directing the allocation of payments to trust fund taxes first (exactly like a third-party release) relieves the third party "responsible" individuals of their own separate obligation to pay unpaid trust fund taxes to another third party, and "means that the government may find it harder to collect the *entire* tax debt (trust fund

[21] *Id.*, 59 B.R. at 704.

[22] *Newport Offshore*, 75 B.R. at 923.

[23] *Newport Offshore*, 75 B.R. at 923; *Energy Resources*, 59 B.R. at 707.

and non-trust fund)" if the debtor becomes unable to pay only after discharging some or all trust fund debt.[24]

The First Circuit concluded that bankruptcy courts *do* have the power to direct the IRS to apply plan payments first to "trust fund" taxes, even if contrary to IRS rules.[25] The First Circuit's analysis began by noting that "Congress has granted bankruptcy courts broad equitable powers, including those powers 'expressly or by necessary implication conferred by Congress,'"[26] and observed that section 105(a) of the Code authorizes bankruptcy courts to issue any order that is "necessary or *appropriate*" to carry out the provisions of the Code.[27] Thus, to the First Circuit, the question of whether the bankruptcy court had the statutory power to direct the IRS to allocate payments to trust fund taxes turned on whether such an order was "appropriate" to carry out the other provisions of the Code. In reasoning on all fours with third-party releases, then-Judge Breyer's opinion explains why such an order would be appropriate in certain circumstances:

> Suppose, for example, that certain third parties that included "responsible" individuals were willing to advance enough money to rehabilitate the corporation only if the court would assure them that the reorganized corporation would pay its "trust fund" tax debts first. That assurance would diminish the likelihood that the third parties would have to pay the debts personally; without it they might prefer immediate liquidation, which could mean total payment of all tax debt, and a guarantee that no tax penalty will be assessed against

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[24] *In re Energy Resources*, 871 F.2d at 225 (emphasis in original).

[25] *Id.*, 871 F.3d at 226.

[26] *Id.*, at 230 (quoting *Johnson v. First National Bank of Montevideo*, 719 F.2d 270, 273 (8th Cir. 1983) *cert. denied*, 465 U.S. 1012 (1984)).

[27] *Id.* (emphasis in the opinion).

them personally.[28]

The *Energy Resources* panel recognized that directing such an allocation (whose very and only purpose was to get settling creditors off the hook with the IRS, a third party), "might diminish the chances that the reorganizing firm will pay its entire tax debt."[29] The First Circuit nonetheless found these orders "appropriate" and authorized by statute because "by giving this assurance, and thereby keeping the firm alive, the bankruptcy court would also increase the chances that the debtor will pay something to its general unsecured creditors."[30] The First Circuit's *Energy Resources* decision unambiguously held that the Code authorizes bankruptcy courts to confirm plans that have the effect of altering the rights among third parties when doing so is necessary and appropriate to achieve a value-maximizing reorganization of the debtor.

The government sought certiorari of the consolidated appeals, which the Supreme Court granted.[31] In its Supreme Court briefs, the government argued—as do opponents of third-party releases—that bankruptcy courts lacked the statutory authority to compel a third party to act as set forth in the plan because there is "no provision in the Bankruptcy Code or elsewhere" that "expressly confers" such authority.[32] That such an order might

[28] *Id.* at 230 (quotations and emendations in *Energy Resources* omitted for legibility).

[29] *Id.*

[30] *Id.* at 230.

[31] *United States v. Energy Resources Co., Inc.*, 493 U.S. 963 (1989).

[32] *United States v. Energy Resources Co., Inc.* No. 89-255, Petitioner's Brief, 1989 WL 428936, at *28-30.

be "appropriate" to maximize recoveries, the Government argued, was not adequate ground to conclude that the Code authorized such orders.[33]

The Supreme Court rejected these arguments, and (again in language virtually on all fours with circuit level third-party release cases) held that bankruptcy courts had "the authority to order the IRS to apply the payments to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan."[34] The Court agreed with the government that the Code "does not explicitly authorize the bankruptcy courts to approve reorganization plans designating tax payments,"[35] but found this argument irrelevant because section 1123(b)(6)[36] "grants the bankruptcy courts residual authority to approve reorganization plans including 'any appropriate provision not inconsistent with the applicable provisions of this title,'" and section 105(a) authorizes issues of orders necessary or proper to carry out the provisions of the Code.[37] Because the orders directing the IRS to comply with the plans' allocation dictates, and not IRS rules, were "not inconsistent" with any provision of the Code, and were "appropriate" under the facts of those cases, the Court concluded they were within the statutory powers of the bankruptcy court.[38]

The Supreme Court's decision in *Energy Resources* should have put to rest any question about the statutory power of bankruptcy courts to issue third-party releases in

[33] *Id.*

[34] *United States v. Energy Resources Co., Inc.*, 495 U.S. at 549 (emphasis added).

[35] *Id.* at 549.

[36] At the time of the *Energy Resources* decision, that provision appeared at 11 U.S.C. § 1123(b)(5).

[37] 495 U.S. at 549.

[38] *Id.*, at 549-550.

appropriate cases. The Supreme Court not only reaffirmed the long-established "broad authority" of bankruptcy courts "to modify creditor-debtor relationships," and endorsed the Code's grant of residual authority to include "any appropriate provision" in a plan so long as it is not inconsistent with the Code.[39] It also <u>specifically</u> authorized the exercise of those powers where the express purpose was to alter nonconsensually the relationship between a creditor (the IRS) and third parties (the "responsible parties") where the "bankruptcy court determines" that it is "necessary to the success of a reorganization plan."[40] That is precisely the description of a third-party release. That the Court so ruled over the objection and appeal of the federal government is striking. Then-Judge Breyer's First Circuit opinion leaves no doubt that the Supreme Court was squarely presented with the question of whether a plan provision that effectuates the release of third party claims is "appropriate" under section 1123(b)(6) where the potential defendants made contributions to the estate that help achieve a value-maximizing reorganization—and answered it in the affirmative.[41] It is thus unsurprising that over twenty years ago, the Sixth Circuit, in *Dow Corning*, cited extensively to *Energy Resources* for its conclusion that the Code authorizes third-party releases.[42] As did the Seventh Circuit in *Airadigm*.[43]

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[39] *Id.*, 495 U.S. at 549.

[40] *Id.*

[41] *Energy Resources*, 871 F.2d at 230-231.

[42] *Dow Corning*, 280 F.3d at 656.

[43] *In re Airadigm Communications*, 519 F.3d at 657. Indeed, a 2006 law review article extensively explored the view that *Energy Resources* "ends the debate" over whether third-party releases are authorized by the code. *See* Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 Emory Bankr. Dev. J. 13 (Fall 2006).

Given that the Supreme Court—and the majority of circuits—have settled the question of authority to grant third-party releases in appropriate cases, the question remains of why these releases continue to attract so much controversy. One objection is that the releases are in some way "unfair" to parties subject to the release, an assertion apparently driven by the false and unsupportable assumption that those parties would achieve better recoveries (however measured) were third-party releases not available. Another related objection is that third-party release cases privilege maximizing value and fairly distributing monetary recoveries over justice. These criticisms are entirely misplaced. Existing law, properly applied, ensures that third-party releases will be granted only in rare cases—such as mass tort cases—in which they appropriately maximize recoveries. And the factual record developed in mass tort cases consistently demonstrates that the only alternative—years or decades of protracted and uncoordinated litigation in state and federal courts by and also among victims—results in lower recoveries, inequitable recoveries, or for many no recovery at all, greater costs, and great uncertainty regarding whether nonmonetary goals can be achieved.

In *Purdue*, for example, the plan's contemplated (and in some cases already effectuated) nonmonetary relief[44] includes:

- A hearing at which victims and their loved ones confronted the Sacklers with the personal consequences of their alleged conduct;
- Transfer of Purdue's operating assets to a newly created entity, Knoa Pharma LLC, which will be run by a board of managers selected exclusively by creditors;

[44] *See generally*, *Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and its Affiliated Debtors*, Docket No. 3726, Case No. 19-23649 (SHL); *Motion of Debtors Pursuant to 11 U.S.C. § 105(a) and 363(b) for Entry for an Order Authorizing and Approving Settlement Term Sheet*, Docket No. 4410, Case No. 19-23649(SHL), Exhibit B (Settlement Term Sheet).

- Knoa Pharma will be authorized to invest in development of opioid overdose reversal and addiction treatment medications and to distribute them at cost;

- Knoa Pharma will be subject to strict governance covenants that will ensure, *inter alia*, that it develops and distributes treatments for opioid addiction and opioid overdose reversal and takes into account long-term public health interests;

- Knoa Pharma will continue to be subject to an operating injunction (as Purdue has been since the commencement of the chapter 11 cases) that ensures it will operate its business safely and responsibly;

- Knoa Pharma will operate under the oversight of a monitor (as Purdue has since early in the chapter 11 cases) further to ensure that it complies with the governance covenants and operating injunction;

- A Public Document Repository hosted by an academic institution will be created and populated with over 13 million documents (and over 100 million pages), including privileged materials relating to subjects such as lobbying, public relations, compliance, and marketing;

- Members of the Sackler family must divest their interests in foreign pharmaceutical companies, and key members of the Sackler family may not be involved in opioid businesses in perpetuity;

- Members of the Sackler family must not seek, request, or permit any new philanthropic naming rights, and agreed to allow any institution or organization in the United States to remove the Sackler name from facilities and programs;

- Members of the Sackler family are subject to anti-secretion and other restrictive covenants that prohibit actions that would frustrate their ability to satisfy settlement obligations, and limit their ability to incur debt, distribute or dispose of assets, and enter into related party transactions.

As examined in a forthcoming article, all of these material nonmonetary achievements might have been lost in litigation.[45] The third-party releases in the Purdue plan improved and achieved both monetary and nonmonetary recoveries and goals not available in continued uncoordinated litigation outside of bankruptcy court.

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[45] William Organek, *A "Bitter Result": Purdue Pharma, a Sackler Bankruptcy Filing, and Improving Monetary and Nonmonetary Recoveries in Mass Tort Bankruptcies*, 96 Am. Bankr. L. J. 362.

Although the courts of appeal that have expressly authorized third-party releases and channeling injunctions have not articulated a uniform standard for them, common factors underlie the law of each circuit. Third-party releases are generally authorized when the factual record demonstrates that (1) they are important, or essential, to the reorganization, and (2) the case presents "rare" or "unusual" circumstances that make third-party releases appropriate.[46] Several courts of appeal, such as the Second, Fourth, and Sixth Circuits, have articulated additional considerations to guide application of that overarching standard. Common factors include: (a) whether the enjoined suits will impact the debtor or the reorganization through an "identity of interests" such as indemnity or contribution;[47] (b) whether the estate receives substantial contributions in return for the releases;[48] (c) the treatment of the class or classes subject to the third-party release;[49] and (d) whether the class or classes subject to the third-party release have voted "overwhelmingly" in favor of the reorganization.[50] Review of these common factors demonstrates why existing law appropriately limits third-party releases to circumstances

[46] For example, the Second Circuit authorizes third-party releases where "truly unusual circumstances render the release terms important to the success of the plan." *Deutsche Bank AG London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 143 (2d Cir. 2005). Similarly, the Third Circuit authorizes third-party releases that are "fair" and "necessary to the reorganization." *See In re Continental Airlines*, 203 F.3d 203, 214 (3d Cir. 2000); *In re Global Inds. Technologies, Inc.*, 645 F.3d 201, 206 (3d Cir. 2011) (citing *Continental Airlines* for twin requirements that a release be "both necessary to the reorganization and fair").

[47] *See, e.g.*, *In re Metromedia*, 416 F.3d at 142 (explaining that releases have been authorized when "the enjoined claims would indirectly impact the debtor's reorganization 'by way of indemnity or contribution'"); *In re Dow Corning Corp.*, 280 F.3d at 658 (listing "an identity of interests between the debtor and the third party, usually an indemnity relationship" as a factor to be weighed when evaluating a third-party release); *In re A.H. Robins*, 880 F.2d at 702 (referring to indemnity or contribution claims as "indirect" claims against the debtor).

[48] *See, e.g.*, *In re Metromedia*, 416 F.3d at 142; *In re Dow Corning*, 280 F.3d at 658.

[49] *See, e.g.*, *In re Metromedia*, 416 F.3d at 142 (explaining that releases have been authorized when "the enjoined claims were 'channeled' to a settlement fund rather than extinguished").

[50] *See, e.g.*, *In re Dow Corning*, 280 F.3d at 658.

in which they maximize value for, and are broadly supported by, victims and other creditors.

First, limitation of such releases to claims that have a conceivable impact on the estate,[51] and for which the debtors and party against whom claims are enjoined share an identity of interest,[52] ensures that there is an essential nexus between the claims released and the restructuring. This, in turn, both cabins the scope of permissible releases and precludes third parties from using a contribution to the estate to secure a release of unrelated claims (which could well exceed the jurisdiction of the bankruptcy court).[53]

Second, requiring a "substantial contribution" to the estate, and consideration of the treatment of the class or classes subject to the release, direct courts to consider whether the release is fair, from an objective point of view, to both the parties subject to the release as well as all estate constituents. Because the indicia of fairness necessarily depend on the circumstances of the case under consideration, courts of appeals have afforded the lower courts flexibility in their analysis. Courts have considered:

- The absolute size of the contribution to the estate made on account of the release;[54]

[51] The existence of a conceivable impact on the estate is also a jurisdictional prerequisite for issuing a third-party release, providing an additional safeguard against the potential for an "abusive" release of claims unrelated to the restructuring. *See, e.g., SPV Osus Ltd. v. UBS AG*, 882 F.3d 333 (2018); *Johns-Manville Corp. v. Chubb Indemn. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52, 66 (2d. Cir. 2008) (explaining jurisdictional limitations on power to grant a third-party release) *rev'd and remanded sub nom. Travelers Indemn. Co. v. Bailey*, 557 U.S. 137 (2009).

[52] Cases point to indemnity and contribution claims as examples of such an "identity of interest." *See, e.g., In re Metromedia*, 416 F.3d at 142; *In re Dow Corning*, 280 F.3d at 658.

[53] *See* note 51, *supra*.

[54] *See, e.g., In re Purdue*, 633 B.R. 107; *In re Boy Scouts of America*, 642 B.R. at 602–03; *In re Mallinckrodt,* 639 B.R. at 869–70.

- The recoveries anticipated under the plan providing for the releases as compared to what had been or could be expected to be recovered through uncoordinated litigation outside of bankruptcy court;[55]

- Whether the contribution supporting the releases, and total estate recoveries, reflect a "peace premium" or are otherwise larger than could be expected outside of bankruptcy;[56]

- Whether the plan and its releases achieve important nonmonetary goals such as behavioral remedies or disclosure;[57] and

- Whether creditors benefit from more timely and more certain recoveries than would otherwise be achieved.[58]

Taken together, these factors ensure that courts consider the adjustment of creditors' rights against third parties only when fair, appropriate, and value-maximizing, consistent with the Supreme Court's directive in *Energy Resources*.[59] Rarely, if ever, is an objection made that there is a better alternative for the actual victims.

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[55] *In re Purdue*, 633 B.R. at 108–109 (weighing plan recoveries against recoveries without plan, and concluding "if I denied confirmation of the plan, the objectors' aggregate net recovery on their claims against the Debtors and the shareholder released parties would be materially less than their recovery under the plan."); *In re Boy Scouts of America*, 642 B.R. at 613 (explaining that the alternative to the release plan is a "'death trap' of litigation with minimal recoveries in sight"); *In re Mallinckrodt*, 639 B.R. at 873 (concluding that the settlement supported by releases would "ensure[] that Opioid Claimants receive recoveries far in excess of what they could obtain through continued litigation.").

[56] *E.g.*, *In re Purdue*, 633 B.R. at 94 (questioning "are the Sacklers paying a 'settlement premium' in their settlements than they would pay in litigation, as Ms. Conroy suggested? Perhaps."); *In re Boy Scouts*, 642 B.R. at 604 (noting "global participation, which maximized" settlements with settling insurers).

[57] *In re Purdue*, 633 B.R. at 84 (noting Sacklers' agreements to relinquish naming rights, not engage in business with Purdue's successor, to exit the worldwide opioid business, and to put documents in a document depository"); *id* (noting testimony that "the document depository is perhaps the most important aspect of the settlement . . . . It will provide far more transparency as to the conduct of Purdue and those it did business with and those who regulated it…and guide legislators and regulators about how to better address other companies with lawful products that are also incredibly dangerous.").

[58] *E.g.*, *In re Boy Scouts*, 642 B.R. at 610 (explaining that in the absence of releases "recoveries to holders of Abuse Claims would be delayed for countless years"); *In re Mallinckrodt*, 639 B.R. at 873 ("The nature of the claims at issue here—personal injury claims arising out of the use of opioid medications—makes time of the essence.").

[59] Some courts have taken a different approach, and have expanded the "best interests" test of section 1129(a)(7) in the third-party release context. It is blackletter law that a plan may not be confirmed absent a finding that the value dissenting creditors will "receive or retain under the plan on account of" their claims against the debtor is "not less than the amount that such holder would so receive or retain if the
(….continued)

Finally, required consideration of substantial or overwhelming support of the class or classes subject to the releases serves as a critical further check on the evaluation just described. The value achieved by the settlement supported by third-party releases must not only convince the court that it is objectively superior to the alternatives; in addition, the parties most directly affected by the release, and who will bear the consequences if the settlement is rejected, must also concur that the release is better than the alternative, and vote in favor of the plan by an "overwhelming" margin.[60] It is no surprise, therefore, that consummated mass tort settlements have been supported by

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(continued….)

debtor were liquidated under chapter 7." 11 U.S.C. § 1129(a)(7). A handful of courts have read "receive or retain" to require courts to compare the value of causes of action against third parties that creditors would "retain" in a chapter 7 liquidation against the value that will be received under a plan providing for third-party releases of such causes of action. *See, e.g., In re Ditech Holding Corp.*, 606 B.R. 544, 614-15 (Bankr. S.D.N.Y. 2019); *In re Quigley Co.*, 437 B.R. 102, 107 (Bankr. S.D.N.Y. 2010).

While it is essential that courts evaluate the fairness of a settlement supported by third-party releases against the likely alternatives—as has already been argued—the better course is to weigh this factor while evaluating third-party releases, rather than superimposing this test upon the Code's best interests standard. For one, the statutory language does not support consideration of third-party recoveries: section 1129(a)(7) requires comparison of the amount a creditor will "receive or retain under the plan on account of such claim or interest" against the amount the creditor would "so receive or retain" in a liquidation. As Judge Drain correctly observed in *Purdue*, as a "matter of grammar," the use of "so receive or retain" in the second clause points back to the first clause—and thus directs courts to compare the amount that a creditor would receive or retain "on account of its claim" in a chapter 7 liquidation against the amount a creditor would recover under the plan. *In re Purdue*, 633 B.R. at 110. The alternative readings of *Quigley* and *Ditech*, which require evaluation of third-party claims a creditor would "retain" in a liquidation, would render the word "so" superfluous. That reading is contrary to the basic canon of construction that courts "must give effect to every word of a statute wherever possible." *Leocal v. Ashcroft*, 543 U.S. 1, 12 (2004).

Moreover, expanding the scope of the "best interests" test to consider recoveries from claims against third parties would either risk requiring courts in all chapter 11 cases to consider the collateral consequences that a plan might have on creditors' actual or hypothetical claims against third parties, or crafting an ad hoc rule that this expansion only applies to third-party release cases. Neither approach is attractive—which is why courts have limited the best interests test to only what may be recovered from the debtor in a liquidation in a variety of contexts. *See, e.g., In re W.R. Grace*, 475 B.R. 34, 148 (D. Del. 2012); *In re Plant Insulation Co.*, 469 B.R. 843, 888 (Bankr. N.D. Cal. 2012); *In re ARO Liquidation, Inc.*, Case No. 16-11275 (Bankr. S.D.N.Y. March 28, 2018), Hr'g Tr. at 20:4-10; *In re Dow Corning Corp.*, 237 B.R. 380, 411 (Bankr. E. D. Mich. 1999) ("When employing the best-interest-of-creditors test, courts look at the dividend the creditor would recover from the chapter 7 trustee—and only that amount—for comparison with the dividend available under the plan.").

[60] *E.g., In re Dow Corning*, 280 F.3d at 658.

extraordinarily high margins of voting victim creditors.[61] One frequent commentator on these issues, in a post entitled "Elizabeth Warren & the Dow Corning Bankruptcy: Nothing to See" observed that 94.1% of the voting personal injury victims in the *Dow Corning* case supported the plan, and that this level of support—and the fact the plan was "the product of lengthy, mediated negotiations"—showed both that "no one can credibly claim that the [*Dow Corning*] settlement was the result of an unfair process" and that the settlement in that case "was as good as there was to be had, and it was a deal that helped maximize value while ensuring fair treatment to tort victims."[62]

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The bankruptcy courts that recently approved the plans of reorganization in *Mallinckrodt*, *Purdue*, and *Boy Scouts of America* each concluded that those plans—and, in particular, the third-party releases at their center—were far better for victims than any available alternatives. These findings underscore the importance, in each of these cases, of the official committee of unsecured creditors and committees of tort victims working alongside the fiduciary debtors and other victims groups to craft the plan and underlying settlements, thereby ensuring that they reflect victims' voices and preferences. As just one example, counsel to Purdue's Official Committee of Unsecured Creditors explained

[61] *In re Purdue*, 633 B.R. at 61 (noting that 95.7% to 98% of voting personal injury claimants voted in favor of the plan, and that over 93% of voting creditors in each class voted to approve of the plan, other than the "hospital class," which voted to approve by a margin of 88%); *In re Boy Scouts*, 642 B.R. at 606 (noting that 85.72% of voting "Direct Abuse Claimants" and 82.41% of voting "Indirect Abuse Claims" voted to accept the plan); *In re Mallinckrodt*, 639 B.R. at 882 (noting plan supported by "88% of voting creditors"); *In re Dow Corning Corp.*, 255 B.R. 445, 505 (E.D. Mich. 2000) (noting "94%" of voting claimants voted to accept the plan); *In re Johns-Manville Corp.*, 68 B.R. 618, 631 (Bankr. S.D.N.Y. 1986) (approximately 95% of "asbestos health" class voted in favor of plan).

[62] Adam Levitin, *Elizabeth Warren & the Dow Corning Bankruptcy: Nothing to See*, Credit Slips, July 15, 2019 (*available at*: https://www.creditslips.org/creditslips/2019/07/elizabeth-warren-the-dow-corning-bankruptcy-nothing-to-see.html).

to the Second Circuit that the Purdue plan "was largely crafted by creditors."[63] Unsurprisingly, in each of these cases, the official committee of unsecured creditors and key committees of tort victims supported confirmation of the plan and, for *Purdue* and *Mallinckrodt*, its affirmance on appeal. Indeed, in *Purdue*, the Plan was supported (or not objected to) by every single one of the many organized creditor and victims groups including (1) the Official Committee of Unsecured Creditors; (2) the Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants (the "**AHC**"); (3) the Multi-State Governmental Entities Group; (4) the Native American Tribes; (5) the Ad Hoc Committee of NAS Children; (6) the Ad Hoc Group of Hospitals; (7) the Ad Hoc Group of Individual Victims; (8) the Third-Party Payor group; (9) the group of ratepayer mediation participants; (10) the group of public school districts; and (11) the majority of states not represented by the AHC. All 50 state attorneys general either support (the substantial majority) or no longer object to the Plan. Indeed, out of over 118,000 voting creditors, the only parties who opposed the plan on appeal to the Second Circuit in *Purdue* were the United States Department of Justice, three pro se claimants, and several Canadian municipalities and First Nations— and not a single representative group of public or private victims.

In closing, it is worth considering how mass-tort resolutions would necessarily change if third-party releases were to become unavailable. The record of recent mass-tort bankruptcies unassailably demonstrates that monetary and other recoveries and benefits to victims would be reduced in amount and greatly delayed, and that transaction costs

[63] Brief of the Official Committee of Unsecured Creditors, No. 2022-110, at 1.

from years of uncoordinated litigation would skyrocket, yet further eroding recoveries.[64] Moreover, claimants who are not amenable to class treatment—such as personal injury claimants in many cases—would lose the increased leverage and coordinated representation that flow from mandatory aggregation in bankruptcy. Fairness across classes of claimants would be reduced, as bankruptcy uniquely considers fairness from both the perspective of each class and of the estate as a whole. And the ability to achieve nonmonetary remedies such as disclosure and behavioral covenants would be reduced without the ability to secure a global resolution or use the broad injunctive powers of the bankruptcy court.[65] Recent legislative initiatives to categorically ban third-party releases outside the asbestos context would tragically make mass tort victims worse off without achieving countervailing benefits.[66]

Because it is critical that third-party releases remain available for the rare cases in which they are essential, legislation directed at third-party releases should (1) expressly authorize them to remove any lingering potential ambiguity; (2) establish uniform procedures for their proposal and consideration;[67] (3) establish uniform standards for their issuance, drawn from the existing circuit-level caselaw analyzed above. Uniform legislative standards would ensure consistency and rigor and limit the availability of

[64] *See* notes 7 and 55, *supra*.

[65] Organek, *A "Bitter Result": Purdue Pharma, a Sackler Bankruptcy Filing, and Improving Monetary and Nonmonetary Recoveries in Mass Tort Bankruptcies*, 96 Am. Bankr. L. J. at 394 *et seq.* (discussing limitations on achievement of "nonmonetary goals" in the *Purdue* case, such as disclosure and divestiture, in the absence of third-party releases).

[66] The proposed "SACKLER Act," H.R. 2096, 117th Cong. (2021) and the "Nondebtor Release Prohibition Act" S. 2497, 117th Cong. (2021) are examples of such legislation.

[67] Section 524(g)'s procedural framework for third-party releases in asbestos cases may serve as a useful template for the procedural aspects of any new legislation.

third-party releases, and afford victims, courts and practitioners greater certainty and predictability when working to craft value-maximizing and potentially life-saving settlements. By such legislation, Congress could address valid critiques of abusive and overused third-party releases while simultaneously ensuring that they remain available, under uniform standards and when proven to be justified and in stakeholders' best interests, for those unusual cases in which they are desperately needed—and in fact indispensable.