# Solicitor General to Seek *Certiorari* in *Purdue Pharma*

## *Protecting the Guardrails of Bankruptcy Democracy and Fairness*

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A recent article by Thomas Salerno criticizes the announcement by the U.S. Solicitor General that its office would be filing a petition for a writ of *certiorari* in the *Purdue Pharma* bankruptcy case.[2] The article is titled, "When Will the Fool's Errand End: The U.S. Trustee's Continued Pursuit of the Destruction of Third-Party Releases in *Purdue Pharma*," and the title says it all.

The article challenges the need for such an appeal, claiming that the concerns were too "hypothetical" and that most of the victims of the *Purdue* catastrophe were now in favor of the plan of reorganization that includes releases for the Sackler family — third-party releases for nondebtor parties. His thesis seems to be that if most creditors approve the releases, then why should the U.S. Trustee (UST), who has no economic stake, enter the fray? The article concludes with this statement: "It is time for the UST's fool's errand to end. Let the victims get the benefit of their bargain. Do no harm, indeed."[3]

I respectfully disagree.

First, at its most elementary level, one should ask, "How could the UST not challenge the validity of third-party releases?" The issue of whether nonconsensual third-party releases of nondebtor parties are permitted under the Bankruptcy Code may well be one of the most important bankruptcy issues currently before the courts — one that will shape the reorganization process for years to come. It was the focus of a recent meeting of the American College of Bankruptcy, which discussed the backlash against permitting such releases.[4] This issue has been recognized as the "great unsettled question" among the courts[5] and "the most controversial issue[] in Chapter 11 bankruptcy."[6] The time has come for the Supreme Court to resolve it.

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[2] More precisely, the Solicitor General authorized the U.S. Trustee to seek *certiorari*. In its motion to stay the mandate of the Second Circuit (denied on July 15), the UST indicated it was going to do so by the deadline, Aug. 28. Memorandum of Law in Support of Motion to Stay Mandate Pending Disposition of a Writ of *Certiorari*, *In re Purdue Pharma L.P.,* Case No. 22-0110-bk(L), ECF No. 1012, filed July 7, 2023.

[3] An article in the *Washington Post* by Charles Lane makes similar arguments. *See* www.washingtonpost.com/opinions/2023/07/26/sackler-opioid-purdue-pharma-oxycontin-immunity.

[4] *See* American College of Bankruptcy 2022 Induction Education Sessions, Third-Party Releases: Are We In for a Backlash?, *available at* www.americancollegeofbankruptcy.com/file.cfm/29/docs/third-party%20releases%20panel%20materials.pdf.

[5] *In re Purdue Pharma L.P.,* 635 B.R. 26, 37 (S.D.N.Y. 2021) (*Purdue Pharma*).

[6] Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances,* 100 TEX. L. REV. 1079, 1106 (2022).

The academic community has vigorously challenged the legitimacy and lawfulness of third-party releases.[7] The academic criticism focuses on a broad range of legal deficiencies, including: (1) there is no express statutory authority that permits such releases; (2) in the absence of any statutory grant of authority, the courts have adopted judge-made criteria that supposedly authorize such releases, but that are constitutionally infirm under principles of federalism and separation of powers, as set forth in *Erie v. Tompkins*[8] and *Butner v. United States*;[9] (3) Congress lacks the power under the Constitution's Bankruptcy Clause to permit them;[10] (4) nondebtor releases extinguish claims without an adjudication of the merits and violate due process; and (5) the use of third-party releases "cause[s] direct harm to survivors, to public trust in the justice system and the corporate economy."[11] Scholars decry such provisions as part of the "descent of [bankruptcy law] into lawlessness"[12] and urge the Supreme Court to disavow this unlawful device.[13]

**Why the *Purdue Pharma* Case Creates a Systemic Risk**

Despite this mountain of criticism, which speaks to the existential threat to bankruptcy as we know it, Salerno's article suggests that if most of the creditors want the plan, then the UST need not object to it. There are at least three reasons why the Solicitor General's decision is wise and urgent, for reasons that have not received the widespread attention they merit.

That "most" of the creditors were in favor of the plan misses a major problem with the entire issue of third-party releases. A core value of bankruptcy law is found within the best-interests test.[14] This is the statutory mandate required of all chapter 11 plans of reorganization, and it states that if a class of creditors votes to approve a plan, a dissenting member of that class *must* receive at least as much as it would in a chapter 7 liquidation. This section has not garnered much press attention in the extensive writing about third-party releases. It is time to reconsider its impact in this debate.

This best-interests test is at the core of bankruptcy fairness and lawfulness. It ensures that creditors are not wrongfully deprived of the minimal return they would receive under a hypothetical chapter 7 liquidation. It is one of the underpinnings of bankruptcy law that makes the law itself just and fair. It is why the Code provides that contracts may be amended and impaired, but never to the point where a creditor is forced to take less than in liquidation.

The case law insists that this test cannot be met through coming close; it must be satisfied absolutely.[15] It is the gatekeeper to all valid plans of reorganization. As the U.S. Supreme Court

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[7] *See* American College of Bankruptcy 2022 Induction Education Sessions, *supra* n. 3 (noting that Third Circuit's rulings have been "equivocal").

[8] 304 U.S. 64 (1938).

[9] 440 U.S. 48 (1979). *See generally* Ralph Brubaker, *Mandatory Aggregation of Mass Tort Liability in Bankruptcy*, 131 YALE L. J. F. 960, 973 (2022).

[10] Brief of Professor Adam J. Levitin as *Amicus Curiae* in Support of Appellees and Affirmance, *Purdue Pharma II*, ECF No. 594-2, March 18, 2022, at p.5.

[11] Pamela Foohey & Christopher Odinet, *Silencing Litigation Through Bankruptcy,* 109 VA. L. REV. (forthcoming 2023).

[12] *See* Lynn LoPucki, "Chapter 11's Descent into Lawlessness," 96 *Am. Bank. L. J.* 247 (Spring 2022).

[13] Brubaker, *supra* n. 9 at 966.

[14] 11 U.S.C. § 1129(b)(7).

[15] "§ 1129(a)(7)(ii) is a bright-line test and does not appear to provide for any de minimis exception. *In re Affiliated Foods Inc*., 249 B.R. 770, 788 (Bankr. W.D. Mo. 2000).

recently held, there is no "rare case" rule in bankruptcy that allows a court to trump the Bankruptcy Code.[16]

But third-party releases do precisely that: Such releases "trump" the Code by, among other things, bypassing the best-interests test, and dramatically so in *Purdue Pharma.* The Sacklers, who did not file for bankruptcy themselves, insisted on a release, which is the functional equivalent of a bankruptcy discharge. Because the Sacklers did not file for bankruptcy themselves, in calculating the liquidation value the bankruptcy court looked only to the liquidation value of Purdue, but not that of the Sacklers.[17] Yet there was substantial evidence that the Sacklers had enormous wealth that was not being utilized to pay the victims, and that this wealth was garnered, in part, through the Sacklers' alleged fraudulent transfer of billions of dollars from the company to themselves during the run-up to the chapter 11 filing.

When the *Purdue* confirmation order was appealed to the district court, Judge McMahon noted that Judge Drain had not considered the massive wealth of the Sacklers in computing the liquidation value of the company.[18] She also said it did not matter to her determination, because the releases were invalid for so many other reasons.

But it does matter. In its largest sense, the best-interests test is one of the guardrails of bankruptcy democracy. Not only does it protect minority interests, it preserves the core value of due process and guards against deprivation of property. When the test is satisfied, disgruntled creditors still receive all they would have received in a liquidation. When it is disregarded, they are being deprived of property rights, plain and simple. Without compliance with the best-interests test, bankruptcy loses its constitutional sheen.

**Whose Skin Is in the Game? The Government's, for One**

Salerno argues that the UST has no skin in the game and is simply seeking to protect against a "hypothetical abuse of the law in future cases." But Salerno is overlooking those who have ample skin in the game, and for whom the risk is not hypothetical and who will indeed face increased risk if the UST does not seek *certiorari*. The government is one of them.

Many of the creditors who initially objected to plan confirmation were state and municipal governmental entities (known as the "Nine"), which argued that the releases were unlawful because they sought to prohibit governmental actions for violations of state regulatory and police powers — such as consumer protection statutes.[19] But the bankruptcy court found that there was "wholesale preemption" of governmental regulation.[20] Only at the end of the case, when the Sacklers increased their monetary contribution, did the governmental entities agree to the plan. The preemption holding never was resolved.

But the pre-emption issue did not disappear, and without a reversal by the Supreme Court, this issue lies in wait to cause harm yet again. Fortunately, the Nine did not fully give up their appeal rights. Instead, they reserved the right to file amicus briefs if the Supreme Court accepts

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[16] *Czyzewski v. Jevic Holding Corp*., 137 S. Ct. 973 (2017).

[17] *In re Purdue Pharma L.P*., 635 B.R. 26, 77 (S.D.N.Y. 2021).

[18] *In re Purdue Pharma L.P*., 635 B.R. 26, 77 (S.D.N.Y. 2021). "[Judge Drain] concluded [that] the best interest test does not require analysis of the claimant's rights against third parties. He acknowledged that his reading of the statute was at odds with at least two of his colleagues' readings of the same statute. I mention this fact, but it has nothing to do with the ultimate decision on this appeal."

[19] The initial appellees were nine governmental entities, the U.S. Trustee and four *pro se* appellees.

[20] "By way of the Bankruptcy Code, Congress authorized wholesale preemption of state laws regarding creditors' rights and has delegated this preemptive power to the bankruptcy courts." *In re Purdue Pharma L.P*., 633 B.R. 53, 103 (Bankr. S.D.N.Y.).

*cert*.[21] This is significant and at a minimum shows that many of the non-federal governmental entities had legitimate concerns that the third-party releases were being used to undermine state regulatory and police powers — an issue that was submerged in the briefing, but that remains highly problematic.

Absent review by the Supreme Court, and if the Second Circuit decision remains the law, the bankruptcy court's ruling on federal preemption of police powers could drastically alter bankruptcy practice and give bankruptcy courts unwarranted powers to disrupt governmental functions. If the Code preempts state police powers, any bankruptcy court could approve a bankruptcy plan that enjoins and discharges obligations arising from a broad range of governmental exercise of critical police and regulatory powers, both federal and state, including the power to abate public nuisances, oil spills, environmental hazards, zoning violations, employment discrimination and fraud.[22]

**The Appeal Does Not Concern Hypothetical Victims, but All Who Come Next, Including the Boy Scouts**

Salerno writes that the UST appeal is hypothetical and focuses on the rights of future claimants. Isn't this what precedent is about? Isn't this how the rule of law works? A principle is enunciated and has enduring value and is not cast aside by majority vote. Didn't the Supreme Court say precisely this in *Czyzewski v. Jevic Holding Corp*.[23] when it tossed out a "good deal" for many creditors because it failed to comply with the statutory standards setting the priority of distribution to creditors?

Nor is the release issue hypothetical to the victims of sexual abuse who currently are contesting the validity of third-party releases in *In re Boy Scouts of America and Delaware BSA, LLC.* In that case, third-party releases are being given in part to entities that are making no monetary contribution to the "settlement" underlying the plan of reorganization. The inability of the victims of sexual abuse to seek compensation through state court tort litigation has thereby been distorted and undermined in a dramatic fashion. To these victims, the position of the UST is not hypothetical and, if adopted, will do much to prevent harm.

In the end, this debate determines the difference between a lawless system and one where the rule of law matters. Judge McMahon put her finger on it: "Either statutory authority exists, or it does not. There is no principled basis for acting on questionable authority in 'rare' or 'unique' cases, especially as the U.S. Supreme Court has recently held that there is no 'rare case' rule in bankruptcy that allows a court to trump the Bankruptcy Code."[24]

The UST is correct in asking the Supreme Court to review the legitimacy of third-party releases, and the academic community should support the petition for a writ of *certiorari* if and when it is filed.

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[21] *See* ECF Dkt. 4410, p. 15 (U.S. Bankr. Ct).

[22] *See also Pac. Gas & Elec. Co v. California,* 350 F.3d 932, 937 (9th Cir. 2003) (Department of Justice, as amicus, expressed concern that broad application of preemption could preclude enforcement of Clean Air Act, Clean Water Act, and even regulations issued by Nuclear Regulatory Commission).

[23] 137 S. Ct. 973 (2017).

[24] *In re Purdue Pharma L.P.,* 635 B.R. 26, 37 (S.D.N.Y. 2021) (citing *Czyzewski v. Jevic Holding Corp*., 137 S. Ct. 973 (2017)).