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USA: Trends and Developments

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Trends and Developments

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Purdue Pharma Did Not Invalidate Third-Party Releases in Full-Pay Cases

By now, most bankruptcy practitioners are familiar with the Supreme Court's decision in Harrington v. Purdue Pharma L.P. that § 1123(b)(6) of the Bankruptcy Code does not authorise "a release and injunction that... effectively seeks to discharge claims against a nondebtor without the consent of affected claimants." In issuing that ruling, however, the Supreme Court was careful to explain that its holding did not impact "a plan that provides for the full satisfaction of claims against a third-party nondebtor." Despite the Supreme Court's express statement that its decision in Purdue did not impact plans that provide for full payment of claims, some recent commentators argue that the Purdue decision also precludes releases granted in connection with full-payment plans. According to one recent article, "permitting full-pay plans as a justification for nonconsensual third-party releases eviscerates the majority's holding in Purdue."

The criticisms of releases in full-payment plans are focused primarily on the difficulty in determining whether a plan will, in fact, be able to pay claims in full. Those are legitimate concerns. Especially in the context of mass tort claims, determining whether a plan will fully compensate current and future claims is exceedingly difficult because there is inherent uncertainty in any projection. As critics of "full-pay" releases correctly point out, the risk that funds set aside for payment of claims later prove to be insufficient is typically borne by the claimants rather than the parties receiving the release. However, criticisms based on the difficulty of determining whether a plan will fully satisfy claims do not address the underlying legal bases for granting releases in connection with full-pay plans. The fact that it is difficult to show that a plan will pay all claims in full does not justify a blanket rule precluding releases in full-pay plans in all cases. Courts are frequently required to make difficult decisions, and there is no reason for a court to deny legally justified relief simply because the factual questions are difficult. As discussed below, Purdue did not invalidate the legal justifications for releases in full-pay plans.

One seminal case standing in favour of third-party releases is In re A.H. Robins Co., Inc. There, the Fourth Circuit affirmed a plan that contained third-party releases in part because the plan provided for full satisfaction of claims. A.H. Robins was forced into bankruptcy due to mass tort product liability claims stemming from a contraceptive device, the Dalkon Shield. The court conducted an estimation proceeding and concluded that the sum of USD2.475 billion would be sufficient to pay in full all Dalkon Shield personal injury claims.

Subsequently, A.H. Robins proposed a plan of reorganisation that provided for A.H. Robins to be merged into a subsidiary of American Home Products Corporation. The merger consideration plus contributions from others, including A.H. Robins' insurers, created a trust fund of USD2.475 billion for full payment of all Dalkon Shield claims. The plan channelled all Dalkon Shield claims to the trust and released all parties contributing funds to the trust from any further liability to Dalkon Shield claimants.

On appeal, certain claimants objected to the channelling injunction contained in the plan and argued that the bankruptcy court lacked authority to enjoin claims against any entity other than A.H. Robins. The Fourth Circuit determined that based on prior settlements in the case, the only claimants actually impacted by the releases and channelling injunction contained in the plan were a subset of claimants referred to as the class B claimants. The class B claimants were to be satisfied from insurance policies providing coverage up to USD100 million. In its decision upholding the non-consensual releases and related injunction, the Fourth Circuit emphasised that no party challenged the sufficiency of the insurance policies to fully pay the class B claims.

The Fourth Circuit cited to the equitable doctrine of marshalling as support for the releases. According to the court, the "ancient but very much alive" doctrine of marshalling meant that "a creditor has no right to choose which of two funds will pay his claim." Thus, the court held that a bankruptcy court "has the power to order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors." Because allowing class B claimants to pursue claims against third parties would defeat the interests of other creditors by disrupting the plan, the Fourth Circuit analogised to the marshalling doctrine and approved the third-party releases. Thus, in the Fourth Circuit, non-consensual releases provided as part of a full-payment plan remain viable, at least in situations where there is no legitimate question as to whether claims will actually be paid in full.

The issue of third-party releases granted in connection with full-payment plans is currently pending before the Third Circuit in the appeal of the plan confirmed in In re Boy Scouts of Am. & Delaware BSA, LLC. In that case, potentially liable parties, including the Boy Scouts of America (BSA), local boy scout councils, religious organisations, and settling insurance companies agreed to contribute cash, property, and insurance rights to a settlement trust. In exchange, the plan channels the sexual abuse claims against those parties to the settlement trust and releases the parties and their respective representatives from liability for the abuse claims. The bankruptcy court estimated the aggregate value of the abuse claims to be between USD2.4 billion and USD3.6 billion. The plan provided for USD2.484 billion in fully non-contingent cash funding from released parties, along with insurance rights assigned to the settlement trust with an estimated value of at least USD4.0 billion. The bankruptcy court and district court confirmed the plan and found that it provided for full satisfaction of all claims.

In the pending appeal, a group of claimants argue that the non-debtor releases in Boy Scouts run afoul of Purdue. In response, BSA articulates why Purdue does not invalidate releases in full-pay cases. According to BSA, the Supreme Court's statement that its holding in Purdue did not impact full-payment plans invoked the "one-satisfaction rule." The "one-satisfaction rule" stands for the proposition that if one tortfeasor fully satisfies a plaintiff's claim, the plaintiff's claims against any other party for the same injury are released and barred by operation of law. BSA noted that courts consistently determine that multiple claims for the same injury are barred under the "one-satisfaction rule" and that application of that rule supported the third-party releases and related injunctions in its plan.

BSA claims that the "one-satisfaction rule" supports confirmation of third-party releases in its plan because the plan "fully satisfies third-party claims against nondebtors and uses third-party releases to prevent double recoveries for injuries that are indivisible from those asserted in claims against BSA." Further, harkening back to A.H. Robins, BSA argues that the marshalling doctrine supports a "third-party release and related channelling injunction under a plan that fully satisfies third-party claims".

As of the date of this article, the Third Circuit has yet to rule on the issue in Boy Scouts, and it is possible that the court will resolve the appeal on equitable mootness grounds without reaching the release issue. However, the one-satisfaction rule cited by the court in Boy Scouts, and the marshalling doctrine relied upon by the Fourth Circuit in A.H. Robins demonstrate why the reasoning of Purdue does not apply to full-payment plans. In Purdue, the Supreme Court emphasised that "we hold only that the bankruptcy code does not authorise a release and injunction" that effectively discharges claims against a non-debtor without the consent of the affected claimants. Releases in full-payment cases, however, do not depend on a section of the Bankruptcy Code and, instead, are based on the longstanding equitable principles underlying the one-satisfaction rule and marshalling doctrine. Thus, releases in full-payment cases stand on a completely different legal footing than the releases invalidated in Purdue.

The issue was addressed more recently in the Bird Global case pending in the Northern District of Florida. In that case, the court confirmed a plan that included a channelling injunction and bar order in favour of third parties. The court justified the non-consensual release based on its conclusion that the contributions from third parties would allow for all tort claims to be paid in full. The court considered the effect of Purdue and recognised that Purdue did not address third-party releases in full-payment plans. The court determined that, unlike in Purdue, the weight of the evidence indicated that the confirmed plan would satisfy the claims in full. Unlike A.H. Robins or Boy Scouts, Bird Global was not a mass tort case, and the Bird Global court did not cite to the one-satisfaction rule or the marshalling doctrine. Instead, the court cited the case of Matter of Munford, Inc., 97 F.3d 449 (11th Cir. 1996), an Eleventh Circuit case that relied on Bankruptcy Rule 9019 and § 105(a) of the Bankruptcy Code for approval of a settlement containing a bar order.

By relying on § 105(a), the reasoning of the Bird Global court could be questioned in light of Purdue, and it remains to be seen whether Bird Global will have any impact on larger mass tort cases. Nevertheless, the Bird Global decision is notable because it demonstrates that bankruptcy courts recognise the limits of the Purdue decision and that third-party releases in full-payment plans remain a viable option even after Purdue. The case is now on appeal, and it will be interesting to see if the appellate courts address the marshalling or one-satisfaction rules. As discussed above, those doctrines explain why Purdue has no impact on third-party releases in full-payment cases better than the rationale provided by the Bird Global court.

Although Purdue should not be interpreted to completely invalidate third-party releases in full-payment cases, there are legitimate concerns regarding how to determine whether claims will be fully satisfied, and courts should not make that determination lightly. There is also the risk that fully solvent entities will attempt to manipulate bankruptcy jurisdiction in an improper attempt to cap their liabilities. Bankruptcy courts must be vigilant and use all tools available to prevent abuse. Any conclusion that a plan will satisfy claims in full must be based on detailed findings, and "full-pay" releases should not be granted without overwhelming support of claimants.

In appropriate situations and with appropriate claimant support, however, "full-pay" releases can be very beneficial. An insolvent tortfeasor may be able to use the prospect of a "full-pay" release to entice third parties facing potential indirect liability to contribute funds that will allow all claims to be paid in full. To deny relief in that situation would be harmful to all claimants, and especially to future claimants who would have no hope of recovery from the insolvent tortfeasor in a liquidation. Purdue does not require that harsh result. The legal justifications for releases in full-payment plans were not impacted by Purdue, and "full-pay" releases remain a valuable tool in appropriate cases.