American College of Bankruptcy
Seventh Circuit Education Seminar, 2024

Year in Review

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Harrington v. Purdue Pharma L.P.

Supreme Court of the United States, June 27, 2024

<u>Background of Facts:</u>

In 2007, a Purdue Pharma affiliated pleaded guilty to a federal felony for false marketing OxyContin as "less addictive", affirming Purdue's role in the Opioid Crisis

The Sackler family, owners of Purdue, initiated a "milking program" withdrawing about $11 billion (75% of total assets) from Purdue after thousands of lawsuits following the false marketing decision, leaving Purdue Pharma in a poor financial state

In 2019 Purdue filed Chapter 11 Bankruptcy. The Sacklers proposed to return about $4.3 billion to Purdue's bankruptcy estate in exchange for 1) extinguishing any claims the estate might have against the family members and 2) releasing the family from all opioid related claims in the future (the Sackler discharge)

> 2) contained a release and injunction banning claims by anyone who might otherwise sue Purdue

Purdue agreed to these terms and included them in the reorganization plan. Additionally, Purdue would help individual victims with a minimum payment of $3,500 and maximum of $48,000. Any victim receiving more than the base would receive payment installments over up to 10 years.

Creditors were polled on the proposed plan and overwhelmingly supported it.

The bankruptcy court approved, but the district court vacated that decision saying nothing in the law gives bankruptcy courts the authority to extinguish claims against third parties without claimants consent. The Second Circuit reversed the District Court's ruling.

During appeal, the Sacklers proposed a new plan where they would contribute an additional $1.175-1.675 billion if the eight objecting States and District of Columbia dropped their objections to the reorganization plan. The States agreed.

Question Presented: Whether the Bankruptcy Code authorizes a bankruptcy court to extinguish claims against third parties (non debtors) without claimants consent?

Legal Reasoning and outcome:

The Court rules the Bankruptcy Code does not authorize a release and injunction to discharge claims against a non debtor without consent of affected claimants within a Chapter 11 reorganization plan. They reverse the Second Circuit.

§1141(d)(1)(A) of the Bankruptcy Code states when a court confirms a reorganization plan it discharges the debtor from any debt arising before the date of confirmation and operates as an injunction from creditors to collect or recover that debt. §524(e) says this only operates for the benefit of the debtor against creditors not other parties

> The Sacklers did not file bankruptcy and thus did not place all of their assets for distribution to the creditors, yet they seek a discharge such as the one described

Text: §1123 outlines the contents or terms of Chapter 11 reorganization plans. §1123(b) states six things a plan “may” contain. The Court, like the Second Circuit,

focuses on §1123(b)(6) which says it can "include any other appropriate provision not inconsistent with the applicable provisions of this title"

> The Court claims §1123(b)(6) is a catchall phrase and thus it does not receive broad interpretation but rather interpreted only in the light of surrounding context (ejusdem generis canon).
>
> The link between the listed items (1-5) are "appropriate provision[s]" concerning the *debtor's* rights, responsibilities, and relationships between its creditors. Therefore, it does not give authority to discharge the debt of a non debtor.
>
> Looking at the code more broadly, a discharge is usually reserved for the debtor alone. The code also constrains the debtor and requires them to come forward with virtually all its assets.

The dissent reading of §1123(b)(3) that states bankruptcy estates settle creditors derivative claims against non debtors does not address the reason a bankruptcy court may do so: because those claims belong to the debtor's estate. The Sackler discharge is not like this because it seeks to resolve claims against the Sackler's not Purdue

Statutory purpose: The Court must look at how far Congress has gone in a statue to pursue one policy over another. The Bankruptcy Code does not allow a bankruptcy court to resolve all collective-action problems blind to the role of other mechanisms. §1123(b)(6) say a bankruptcy court can address certain collective-action problems, but also states those powers are not limitless

§524(e) and §524(g)(4)(A)(ii) provides a notable exception to the Code for asbestos-related bankruptcies stating the court may issue an injunction barring action directed against a third party. The code only doing so in one context makes it more unlikely that §1123(b)(6) applies to third parties.

History/context: every bankruptcy law from 1800-1978 (the enactment of the present Bankruptcy Code) generally reserved the benefits of discharge to the debtor who offered a fair and full surrender of property

The Court should not rule on the policy debates presented by either side - those are for Congress to add to the Bankruptcy Code rules for opioid-related bankruptcy like it did for asbestos-related cases.

The Court clarifies it did not rule on consensual third party releases in connection with a reorganization plan. Nor do they say what qualifies a consensual release providing full satisfaction claims against a third party debtor

Office of the United States Trustee v. John Q. Hammons Fall 2006, LLC

Supreme Court of the United States, June 14, 2024

Issue: What is the appropriate remedy for debtors who overpaid their quarterly U.S. Trustee fees after the Supreme Court found an unconstitutional disparity with Bankruptcy Administrator districts in *Siegel v. Fitzgerald*, 142 S.Ct. 1770 (2022).

Holding: Given the "small, short-lived disparity caused by the constitutional violations" found in *Siegel*, prospective parity is the only appropriate remedy. In other words, debtors who paid unconstitutionally higher quarterly U.S. Trustee fees were not entitled to any refunds.

Facts: In 2022 the Supreme Court held in *Siegel* that disparate quarterly fees for debtors in U.S. Trustee districts versus Bankruptcy Administrator districts violated the uniformity requirement of the Constitution's Bankruptcy Clause. In deciding *Siegel*, the Supreme Court specifically declined to address the appropriate remedy. The debtors in *John Q. Hammons* – like the trustee in *Siegel* – had challenged the constitutionality of the fee disparity. The *John Q. Hammons* debtors litigated their challenge up to the Tenth Circuit. After *Siegel*, the Tenth Circuit ordered a refund of the overpaid fees. The U.S. Trustee sought certiorari. Although there was no circuit split and three other circuits had also ordered refunds after *Siegel*, the Supreme Court granted certiorari to determine the appropriate remedy.

Analysis: In a 6-3 decision authored by Justice Ketanji Brown Jackson, the Supreme Court held that prospective parity was the only appropriate remedy in this case. The Court noted that "the nature of the violation determines the scope of the remedy." In *Siegel*, the Constitutional violation was non-uniformity, rather than the magnitude of the fees. The disparity was short-lived – lasting only about seven months. And the disparity was "small," because only about 50 out of more than 2,000 large chapter 11 cases during this time period were filed in Bankruptcy Administrator districts. In other words, only about 2% of debtors during this period paid non-uniform fees. Concluding that the constitutional violation was short-lived

and small, the Court then turned to the appropriate remedy.
To make that determination, it considered what Congress would have done had it been aware of the Constitutional infirmity. Consistent with Congress' intent to keep the U.S. Trustee system self-funded, Congress having itself fixed the problem in 2021 by mandating uniform fees prospectively, and the prospect taxpayers footing the bill for a $326 million refund for a program that was supposed to be self-funded, the Court determined that prospective parity was the only appropriate remedy. The Court reversed the Tenth Circuit, denying the debtors a refund.

Truck Insurance Exchange v. Kaiser Gypsum Co., Inc

Supreme Court of the United States, June 6, 2024

On June 6, 2024, the Supreme Court decided *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.,* clarifying who can qualify as a "party in interest" under §1109(b) of the Bankruptcy Code. The Court held that a "party in interest" includes insurers with financial responsibility for bankruptcy claims, and that those parties can "raise" and "appear and be heard on any issue" in Chapter 11 cases.

The Petitioner Truck Insurance Exchange (Truck) served as the primary insurer for many companies involved in the production and distribution of products containing asbestos. The Debtors, Kaiser Gypsum Co. and its parent company Hanson Permanente Cement both filed for bankruptcy under Chapter 11 after facing thousands of asbestos-related lawsuits. The reorganization plan (the Plan) created a §524(g) Asbestos Personal Injury Trust (Trust), channeling all current and future asbestos claims into the Trust while also enjoining further legal action against the Debtors for any of those claims.

As the Debtors' primary insurer, Truck's contractual obligations included defending asbestos personal injury claims and indemnifying the Debtors' for up to $500,000 for each claim. Truck was the only party to oppose the Plan. They argued that the Plan lacked the same disclosures and authorizations for uninsured claims as it did for insured claims. The disparity rose concerns for Truck being at financial risk for fraudulent claims. Truck also asserted that the Plan modified its rights under insurance policies.

After the Bankruptcy Court recommendation, the District Court confirmed the Debtors' Plan, concluding that Truck's standing to object was limited. The court deemed the Plan "insurance neutral,"—unchanging Truck's prepetition obligations or its contractual rights. The Fourth Circuit affirmed the District Court's decision that Truck did not qualify as a "party in interest" under §1109(b).

The Supreme Court reversed the lower courts' decision and remanded the case. Justice Sotomayor delivered the opinion of the Court, in which all other Justices joined. Justice Alito took no part in the consideration or decision of the case. The Court emphasized the broad application of §1109(b), supported by the provision's text, context, and legislative history. When Congress enacted the Bankruptcy Code in 1978, §1109(b) expanded participatory rights, enabling any entity significantly impacted by a bankruptcy proceeding to participate and voice their concerns while also encouraging fair and equitable reorganization processes.

The Court concluded that by bearing the majority of the Trust's liability, Truck faced potential financial harm. Its financial responsibility thus gave Trust an interest in the bankruptcy proceedings, allowing their objections to be heard. In this case, Truck may be the only entity that would identify problems within the Plan, as the Plan already benefits the Debtors and any asbestos claimants.

Conceptually, the Court also found issue with the "insurance neutrality" doctrine, particularly that it conflated the merits of an objection with the question of whether an entity falls under a "party of interest." The inquiry in §1109(b) does not focus on the specific impact of a reorganization plan, but rather whether the proceedings can affect a prospective party. The Court reiterated that the narrow scope of "insurance neutrality" wrongly limits the numerous other ways that bankruptcy proceedings can impact insurers.

In response to Truck's objections, the Debtors point to the notion of peripheral parties potentially impeding a reorganization. However, the Court noted that §1109(b) does not provide parties in interest with a vote or a veto in bankruptcy proceedings—only the chance to be heard. While there may be other cases that include further evaluation on peripheral parties and direct interest, the Court decided that this case is not included. Thus, an insurer who bears financial responsibility for bankruptcy claims does in fact qualify as a "party in interest," and they can object to a Chapter 11 plan.

In Re LTL Management LLC

United States Court of Appeals for the Third Circuit (July 25, 2024)

Background of Facts:

- Johnson & Johnson (J&J), through its subsidiary JJCI, sold talc-based products that plaintiff's (starting around 2010) began claiming caused mesothelioma or ovarian cancer
- In 2021 J&J used a Texas divisional merger to spli JJCI into two entities: New JJCI and LTL Management LLC. The merger allocated most assets to New JJCI and all talc-related liability to LTL. But it also included a funding agreement requiring J&J and New JJCI to cover LTL's talc liabilities and bankruptcy expenses up to the value of the assets previously held by JJCI (estimated at $61.5 billion).
- LTL filed a Chapter 11 bankruptcy, which was dismissed on appeal by the Third Circuit for lack of finding financial distress. Hours after the dismissal became final, LTL filed for Chapter 11 again. In doing so, it had amended the funding agreement so that the guarantee provided access to only around $30 billion for talc-related claims.
- This was less than half of what was covered under the initial agreement. The new structure was intended to address the lack of financial distress noted in the dismissal of the first bankruptcy.
- An official committee of talc claimants moved to dismiss the bankruptcy for want of good faith claiming LTL was still not financially distressed. The bankruptcy court granted the motion.
- This case is an appeal by LTL and the Ad Hoc Committee from the Bankruptcy Court's decision dismissing LTL's bankruptcy for want of good faith.

Question Presented: Was LTL's second Chapter 11 bankruptcy petition filed in good faith?

Legal Reasoning and Outcome:

- No, The Court affirmed the Bankruptcy Court's dismissal of the LTL's second chapter 11 finding.
- The debtor bears the burden of proving a bankruptcy case was filed in good faith. LTL claims it will be unable to pay its liabilities in both the short and long term.
    - In the short term, the Court disagreed with the theory of costs related to trial and settlement presented.
    - In the long term, the Court compared LTL's $21 billion worst-case estimate for lifetime talc liabilities with J&J's estimated $22.3 billion forced liquidation value. Because J&J's forced liquidation value exceeds the worst-case estimate the Court does not find LTL to be in financial distress.
- LTL offered two additional challenges which the Court dismisses: 1. The Court erred in its fact finding 2. The Court misapplied the past decision from the first LTL case.
- Fact Finding: LTL disagrees with the expert witness's $21 billion worst case estimate on the grounds they did not consider blockbuster verdicts. But LTL points to no evidence to the likelihood or size of such verdicts.
- Application of Third Circuit decision to dismiss the first bankruptcy:
    - LTL argued that the first decision allows bankruptcy filings if there is a credible threat that mass tort litigation will result in liabilities greater than the firm's assets. The Court rejected this argument because the Bankruptcy Court found LTL's forced liquidation value exceeded the worst-case scenario talc liability.

- LTL argued the Bankruptcy Court misread the first Third Circuit opinion and looked only at current conditions. The Court rejected this argument, noting that LTL's arguments still did not establish the requisite financial distress. LTL did not point to any other financial distress such as difficulties paying employees, customers and vendors wary of the firm's credit risk, liquidity problems, etc.

- LTL's claim that J&J might be forced to liquidate assets does not demonstrate financial distress because the Court found such a forced liquidation would still exceed LTL's worst case talc liabilities.
- The Ad Hoc Committee claims that LTL's bankruptcy is protected by Section 1112(b)(2), which allows a court to decline to dismiss a bankruptcy case if unusual circumstances show that dismissal is not in the best interest of the creditors. The Bankruptcy Court said lack of financial distress is not the type of bad faith to trigger the 1112(b)(2) exception. The Third Circuit Court agreed.