Practice Update

Purdue Pharma Foretells a Troubled Future for Bar Orders

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In *Harrington v. Purdue Pharma L.P.*, the Supreme Court held that the Bankruptcy Code does not authorize a bankruptcy court to grant a release and injunction that extinguishes direct claims against nondebtor third parties without the claimants' consent. Bankruptcy courts are not the only courts that issue orders of this sort. Receivership courts do so as well. Does *Purdue Pharma* disallow bar orders outside of bankruptcy?

In answering this question, it is important to distinguish among the bar orders that courts typically issue. The first is an order barring non-settling defendants from seeking contribution or indemnity from settling defendants. The *Purdue Pharma* court did not address this type of bar order, and there is no reason to think they would be affected. The second is an order barring claimants from asserting derivative claims belonging to the estate. The *Purdue Pharma* court acknowledged that courts could bar derivative claims. So neither of these types of bar orders should be affected by *Purdue Pharma*.

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Instead, *Purdue Pharma* deals with a third type of bar order: those that bar claims against third parties that are owned by claimants, not by the estate. Both bankruptcy trustees and receivers own claims that the debtor could bring in its own name as well as claims such as fraudulent transfer or turnover that are based on the dissipation of the debtor's assets. Neither, however, owns claims that are personal to the claimants based on direct injuries to them, called "direct claims." Accordingly, orders that prevent claimants from bringing direct claims against nondebtors remain highly controversial. Although the direct claims are not technically before them, a number of bankruptcy and receivership courts have barred claimants from bringing these claims against settling nondebtor parties (e.g., *Zacarias v. Stanford International Bank, Ltd.*; *SEC v. DeYoung*; *In re Dow Corning Corp.*; *In re A. H. Robins Inc.*). A number of bankruptcy and receivership courts have refused to do so (e.g., *Digital Media Solutions v. South University of Ohio, LLC*; *In re Pacific Lumber Co.*; *In re Lowenschuss*). Interestingly, the Fifth and Sixth Circuits reached opposite conclusions depending upon whether the case arose in receivership or bankruptcy. The Fifth allowed bar orders in receivership (*Zacarias*) but not in bankruptcy (*Pacific Lumber*). The Sixth did the opposite (*Digital Media* and *Dow Corning*).

Certainly in bankruptcy and likely in other contexts, the Supreme Court held that courts may not bar direct claims against nondebtors. *Purdue Pharma* is the Oxycontin or Sackler case. The Sacklers owned and controlled Purdue Pharma. Its most successful product was Oxycontin, an opioid pain reliever that was supposed to be safer and less addictive than traditional opioids such as morphine. It wasn't. Criminal and civil litigation against the company and the Sacklers ensued. The Sacklers responded by taking increasingly vast sums — $11 billion — out of Purdue Pharma, forcing it into bankruptcy. (According to the Sacklers, some $4.6 billion of this amount was used to pay taxes.)

The Sacklers agreed to settle the estate's fraudulent transfer and breach of fiduciary duty claims for about $6 billion. In addition to a release of the claims belonging to the estate and the debtor, the Sacklers demanded and received a bar order enjoining all persons from suing the Sacklers not only for claims derived from the estate (e.g., fraudulent transfer claims) but also for their personal, direct claims against the Sacklers. This settlement was approved by the bankruptcy court and made part of the plan of reorganization. While many claimants affirmatively consented to the bar order by voting for the plan, many more did not, either by not voting or by objecting.

The Supreme Court began its analysis by stating the fundamental bargain in bankruptcy: "A debtor can win a discharge of its debts if it proceeds with honesty and places virtually all its assets on the table for its creditors." Observing that the Sacklers "have not filed for bankruptcy and have not placed virtually all their assets on the table for distribution to creditors, yet they seek what essentially amounts to a discharge," the Court framed the question before it as "whether a court in bankruptcy may effectively extend to *nondebtors* the benefits of a Chapter 11 discharge usually reserved for *debtors*."

As such (and in contrast to the dissent), the Court viewed the issue not as one of public policy or equity (e.g., whether bar orders are necessary or even helpful) but of a court's authority. To determine whether a court had the authority to bar direct claims against nondebtors, the Court looked solely to the Bankruptcy Code. It briefly considered and dispensed with section 105 of the Code. Section 105 allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. The Court held that section 105 could not provide the necessary authority because it serves only to carry out authority expressly conferred elsewhere in the Code.

The Court then moved to section 1123(b), which sets out terms that may be included in a plan of reorganization. The only provision of section 1123(b) that even arguably could authorize a bar order was section 1123(b)(6), which allows the inclusion of "any other appropriate provision not inconsistent with the applicable provisions of this title." The Court read this section as necessarily limited by the remainder of section 1123(b), which concerned the debtor's rights and responsibilities as well as its relationships with its creditors. Accordingly, it held that subsection (b)(6) "cannot be fairly read to endow a bankruptcy court with the 'radically different' power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants."

Continuing its statutory analysis, the Court found it significant that Congress elected to allow bar orders in asbestos cases but not in other cases: "For asbestos-related bankruptcies—and only for such bankruptcies—Congress has provided that, '[n]otwithstanding' the usual rule that a debtor's discharge does not affect the liabilities of others on that same debt, § 524(e), courts may issue 'an injunction ... bar[ring] any action directed against a third party' under certain statutorily specified circumstances." By expressly authorizing bar orders in asbestos cases only, the Code could not be read to authorize bar orders in other cases.

The *Purdue Pharma* court was wholly unmoved by the appeal of the plan proponents and the dissent to both public policy and the merits of the settlement. The dissent stressed that the settlement with the Sacklers was a very good deal for the claimants. Describing the plan as "a shining example of the bankruptcy system at work," the dissent reasoned that the settlement and bar order were "necessary to facilitate a fair settlement with the officers and directors and produce a significantly larger bankruptcy estate that can be fairly and equitably distributed among the victims and creditors." It found that the settlement allowed about $7 billion to be distributed to victims and trusts providing support for opioid victims in a bankruptcy where the victims and creditors would otherwise have recovered nothing due to a $2 billion super priority claim held by the United States.

The dissent argued that public policy required that the bar order be sustained. It reasoned that bankruptcy law was designed to solve what it termed the "collective action problem." In the dissent's view, the collective action problem arises when creditors seeking to maximize their own recovery race other creditors to the courthouse. The few creditors that win the race will deplete the debtor's assets, leaving nothing for the other creditors. The bankruptcy laws solve the collective action problem by staying litigation against the debtor and by forcing all creditors to accept a reorganization plan approved by the majority. All creditors are bound by the plan, even if some opposed it.

To the dissent, mass tort cases present the same collective action problem as bankruptcies. Thus, debtors have used bankruptcy to require "the mass tort victims who are seeking relief from the bankrupt company to work together to reach a fair and equitable distribution of the company's assets." Bringing nondebtor assets into the estate enhances recovery for the victims. Allowing nondebtor releases solves the collective action problem by channeling all claims against the nondebtors into the bankruptcy process. Thus, without nondebtor releases, victims would recover unequally and some not at all.

In response, the Court determined that the dissent's policy argument was best addressed to Congress. It also contrasted derivative claims with the direct claims that Purdue Pharma's plan sought to bar.

> The dissent neglects *why* a bankruptcy court may resolve derivative claims under paragraph [1123(b)](3): It may because those claims belong to the debtor's estate. In a

> derivative action, the named plaintiff is only a nominal plaintiff. The substantive claim belongs to the corporation. And no one questions that Purdue may address in its own bankruptcy plan claims wherever located and by whomever held, including those claims derivatively asserted by another on its behalf. The problem is, the Sackler discharge is nothing like that. *Rather than seek to resolve claims that substantively belong to Purdue, it seeks to extinguish claims against the Sacklers that belong to their victims. And precisely nothing in § 1123(b) suggests those claims can be bargained away without the consent of those affected, as if the claims were somehow Purdue's own property.*

The Court's rejection of the public policy arguments in favor of bar orders and its focus on the ownership of the claims to be barred spells trouble for bar orders outside of bankruptcy as well. The courts that have approved bar orders in receivership cases both rely heavily on the public policy argument that the *Purdue Pharma* Court rejected and elide over the ownership of the claims to be barred. To illustrate this, consider three cases on bar orders in receiverships: the Tenth Circuit's opinion in *SEC v. DeYoung*, the Fifth Circuit's opinion in *Zacarias v. Stanford International Bank, Ltd.* (both allowing bar orders), and the Sixth Circuit's opinion in *Digital Media Solutions v. South University of Ohio, LLC* (which does not).

DeYoung involved the receivership of American Pension Services (APS), a third-party IRA administrator. Because it was not a bank, APS used First Utah Bank as the custodian of its customers' funds. APS's principal, DeYoung, used his control over the custodial account to embezzle millions of dollars of customer money held at the bank. The receiver threatened to sue First Utah in order to recover the money misappropriated from the bank account. Several IRA owners planned to sue the bank as well. Both the receiver and the IRA owners planned to pursue the same recovery — the money taken from the account. The receiver and First Utah ultimately settled. As part of the settlement, the receivership court entered an order barring the IRA owners from suing the bank.

The IRA owners argued that the court could not bar their claims because the receiver lacked standing to bring them. Rejecting this argument, the Tenth Circuit found that the receiver had standing to sue the bank because the bank allegedly violated contractual and fiduciary duties owed to APS leading to the loss of the funds that APS had deposited. It is not clear from the opinion whether the court found that the receiver's standing meant that the IRA owners were asserting APS's claims or their own. After finding that the receiver had standing, the *DeYoung* court affirmed the bar order because the settlement made sense and the bar order was necessary to the settlement.

The Fifth Circuit reached a similar conclusion in *Zacarias.* There, the receiver sued two insurance brokers who had sold policies to Stanford and had written letters to be delivered to prospective customers touting the quality of Stanford's management and falsely representing the coverage provided by the policies they sold to Stanford. These letters were a key part of the marketing for the Stanford Ponzi scheme. The receiver sued the brokers and extracted a large settlement. As with previous settlements, the receivership court entered a bar order preventing claimants from suing the brokers for any claim arising out of the Stanford Ponzi scheme. Several claimants who had not objected to the earlier bar orders (a fact that weighed heavily on the court) objected to this order, arguing that the court could not enjoin their personal, direct claims against the brokers.

> Like the dissenters in *Purdue Pharma*, the *Zacarias* court was very concerned with the "collective action problem."

> Without a receiver, investors encounter a collective-action problem: each has the incentive to bring its own claims against the entity, hoping for full recovery; but if all investors take this course of action, latecomers will be left empty-handed. A disorderly race to the courthouse ensues, resulting in inefficiency as assets are dissipated in piecemeal and duplicative litigation. The results are also potentially iniquitous, with vastly divergent results for similarly situated investors.

The court spent pages discussing how all of the claimants could participate in the estate's recovery from this and other settlements. It also criticized the objectors as "investors [who] rode the Receiver train until the end and then decided to hold up a settlement with a deep pocket."

The court's legal reasoning was driven by its policy views. The court began by conceding that the "receivership court cannot reach claims that are independent and non-derivative and that do not involve assets claimed by the receivership." To avoid this bar, the *Zacarias* court reasoned that the objectors' claims were derivative of the receivers' claims because both sets of claims arose from the same fraudulent scheme and the receiver's damages were based on the investors' losses. Because the investors' claims were related to the estate's claims in this manner, the court held that the court could bar the investors' direct claims as part of the settlement of the estate's claim.

> In dissent, Judge Willett criticized the majority's attempt to categorize the objectors' claims as derivative simply because they arose from the same Ponzi scheme.
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> But having defendants in common (Willis and BMB) or having a common destination for the plunder (Stanford officers) does not

> make claims the same. And the Objectors' right to participate in the receivership claims process does not change this. That process pays for *Stanford's* liability out of *Stanford's* assets. It will not and cannot cover *Willis and BMB's* distinct liability to the Objectors for their separate, affirmative actions against the individual Objectors.

Because the objectors' claims belonged to them individually and not to the receiver, Judge Willett would have held that the receivership court could not bar them. Judge Willett's reasoning in his *Zacarias* dissent is very similar to that of the Supreme Court majority in *Purdue Pharma*.

Noting the same ownership issue raised by Judge Willett's dissent in *Zacarias*, the Sixth Circuit declined to follow either *DeYoung* or *Zacarias* in *Digital Media*. In that case, a private college misrepresented its financial condition and accreditation to potential and current students. The students filed a class action based on these fraudulent misrepresentations, alleging that they either would not have attended the college or would have transferred had they known the truth. Facing mounting bills, the college sought the appointment of a receiver. Among the college's assets were several policies of insurance that covered the college's directors and officers against potential liability. The receiver asserted claims against the directors and officers, which he settled. As part of the settlement, the court entered an order barring third parties, including the students, from pursuing claims against the directors, officers, and their insurers. The students appealed.

The Sixth Circuit held that the receivership court could not bar the students' claims against the directors and officers. Reviewing the history of receiverships, the *Digital Media* court found that a receivership court's jurisdiction is limited to the debtor's property. As a result, the receiver is bound by the debtor's contracts and by any defenses that could be asserted against it. Similarly, a receiver cannot assert a cause of action that did not belong to the debtor. Moreover, a court's authority to issue injunctions was limited to the debtor's property and could not "extend[] so far as to protect assets outside the receivership."

Accordingly, the propriety of the bar order turned on the ownership of the claims to be barred. To answer that question, the court distinguished between derivative actions, where shareholders sue on a corporation's behalf for injuries suffered by the corporation, and direct actions, such as those brought by investors in a fraudulent scheme against the brokers who lied to convince them to invest. A receivership court could bar the first but not the second. Because the students' claims were directly analogous to defrauded investors' claims, the receiver lacked authority to bring or settle them and the court lacked authority to bar them. The *Digital Media* court declined to follow *DeYoung* and *Zacarias* on the ground that neither court directly addressed the ownership of the barred claims.

The *Digital Media* court also held that the court lacked general equitable authority to enter a bar order to preserve a recovery for the estate. It noted that the Sixth Circuit allowed bankruptcy courts to bar third parties from suing nondebtors only because the Bankruptcy Code granted that authority. Without the authority granted by the Code, bankruptcy courts lacked the inherent equitable authority to bar claims against nondebtors. Citing *In re Dow Corning Corp.*, the *Digital Media* court reasoned that "non-debtor releases were 'unprecedented in traditional equity jurisprudence.'"

While *Purdue Pharma* is a bankruptcy case, the Supreme Court's reasoning tracks that of Judge Willett's dissent in *Zacarias* and the Sixth Circuit's opinion in *Digital Media*. All three hold that court-appointed fiduciaries and the courts that appoint them lack the power to bar claims that do not belong to the estate. (The majority in *Zacarias* agreed with this rule but in this author's opinion misapplied it.) None gave any particular weight to the argument that settlements would not occur but for bar orders or that the settlements would maximize the claimants' recovery. In other words, the "collective action problem" identified in *Zacarias* and the *Purdue Pharma* dissent cannot be solved by equity.

Moreover, *Purdue Pharma* is part of an extensive and growing number of cases where the current Supreme Court has prohibited government actors — either agencies or courts — from asserting the authority to solve a problem simply because the problem needs to be solved. To this Court, equity is no basis for expanding a court's authority. Either a court has authority to take an action or it does not regardless of that action's substantive merit.

In that light, it is perhaps notable that no one in *Purdue Pharma* at any level argued that the bankruptcy court had inherent equitable authority to bar direct claims by third parties. According to *Digital Media*, this is because no one has seriously contended that there is equitable authority to bar direct claims against nondebtors: "Circuits on both sides recognize that only statutory authority—not any inherent equitable authority—can give bankruptcy courts the power to bar direct claims against nondebtors."

An issue that *DeYoung*, *Zacarias*, and *Digital Media* did not address was the receivership court's personal jurisdiction over the parties to be enjoined. In *SEC v. Stanford International Bank, Ltd.*, the Fifth Circuit recently held that a receivership court must have personal jurisdiction over potential claimants in order to bar their suits. In *Stanford*, the receiver settled his claims against a Swiss bank. As part of the settlement, he sought a worldwide bar order, which the court granted. Stanford's Antiguan liquidators objected to the bar order on the ground that the receivership court lacked personal jurisdiction over them. As the court noted, there is a lengthy history of friction between Stanford's U.S. receiver and its

Antiguan joint operating liquidators. The receiver argued that personal jurisdiction was unnecessary because *Zacarias* held that bar orders against non-present parties were permissible and the receivership court's *in rem* jurisdiction provided sufficient authority. The *Stanford* court rejected both of these arguments. First, it distinguished *Zacarias* on the ground that its holding "implicated the equitable remedies available to the district court and not its jurisdiction." The court noted that no party had objected to personal jurisdiction and that any such objection would have been frivolous as the objectors had sued the settling defendants in Texas, which would give rise to personal jurisdiction in the Northern District of Texas. Second, the court held that *in rem* jurisdiction could not support a bar order or other injunction. The *Stanford* court explained:

> True, *in rem* jurisdiction enables a court to determine all the claims that anyone has to the property or thing in question, whether the persons are named parties or not. Thus, a court with *in rem* jurisdiction over a piece of land can consider and decide all of the potential claims to that land, regardless of whether all of the potential claimants are within its jurisdiction. But it is another thing entirely for a court to enjoin the whole world from bringing suits related to that piece of land. Injunctions bind people, not property, so *all* injunctions require *in personam* jurisdiction.

The practical import of *Stanford* on bar orders or antisuit injunctions involving domestic parties remains to be seen. Pursuant to 28 U.S.C. § 1692, a receivership court can have nationwide jurisdiction. But, to invoke that jurisdiction, the receiver must file the notice required by 28 U.S.C. § 754. Thus, even if *Zacarias* and *DeYoung* remain good law, receivers may have to file section 754 notices in all federal districts where potential claimants may be located. Normally, the receiver must file section 754 notices within 10 days of appointment. Courts will, however, enter an order reappointing the receiver to restart section 754's 10-day clock. The reappointment order must be entered and the notices filed before the injunction is entered in order to bind the claimants (see *SEC v. Vision Communications, Inc*).

Is this the end of bar orders enjoining direct claims against nondebtors, at least in those jurisdictions (e.g., the Fifth and Tenth Circuits) that currently allow them? Arguably not, or at least not immediately. Ultimately, *Purdue Pharma* turned on the interpretation of the Bankruptcy Code, which was not even mentioned as a basis for authority in *DeYoung* and *Zacarias*. As such, neither was directly overruled, and both arguably remain good law. But, *Purdue Pharma* may well result in cases like *DeYoung* and *Zacarias* being limited to true derivative claims — the rule that the *Zacarias* court acknowledged but ignored. And, receivers will need to deal with the jurisdictional limitations identified in *Stanford*.

Receivers, therefore, should consider other ways to achieve the same result. Settlement classes are a potential option. To make that happen, receivers would need to work cooperatively with plaintiffs' lawyers in bringing and settling cases. Opt-outs are potentially an issue, but a manageable one if the primary plaintiffs lawyers are involved. Another option is to seek releases from the claimants with the settlement conditioned upon a certain percentage of claimants agreeing. While this would not eliminate the settling party's liability, it would at least quantify or limit it.

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without seeking the advice of legal counsel. Prior results do not guarantee a similar outcome.