

THE REVIEW OF
**BANKING & FINANCIAL
SERVICES**
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS
AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 39 No. 5 May 2023

THIRD-PARTY RELEASES UNDER THE BANKRUPTCY CODE

A bankruptcy debtor may maximize distributions to its creditors by offering third-party releases and exculpations to corporate executives and equity security holders through its reorganization plan. Nevertheless, a significant circuit court split remains on whether the Bankruptcy Code authorizes such releases. The recent proceedings in the Purdue Pharma bankruptcy highlight the conflicting judicial opinions and accentuate the need for further guidance from Congress or the U.S. Supreme Court.

By Michael Schuster *

Ten months have passed since the Second Circuit Court of Appeals heard oral argument in the petition to overturn Bankruptcy Judge Robert Drain's order confirming the Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and its affiliated debtors.¹ As the nation awaits the Second Circuit's decision, bankruptcy practitioners continue to navigate the circuit court split on the permissible scope of third-party releases under the Bankruptcy Code. Although existing case law catalogs broadly acknowledged majority and minority approaches, debtor and creditor attorneys face significant uncertainties in litigating contested confirmation issues under either approach. Meanwhile, the basic policy questions attendant to releasing culpable non-debtor actors garners mainstream public attention due to the *Purdue Pharma* proceedings, often manifesting visceral lay opinions regarding the underlying equities. This article summarizes the *Purdue Pharma* proceedings and the current framework underlying the Bankruptcy Code's treatment of third-party releases.

¹ References to "Code" or "Bankruptcy Code" shall be to 11 U.S.C. Section 101, *et seq.*

*MICHAEL SCHUSTER is an associate in the Denver, Colorado office of Ballard Spahr LLP. Michael concentrates his practice on bankruptcy and related litigation. His e-mail address is schusterm@ballardspahr.com.

THIRD-PARTY RELEASES ARE A PREVALENT AND OFTEN INTEGRAL COMPONENT OF COMMERCIAL CHAPTER 11 PRACTICE

Third-party release issues often arise in cases with large creditor bodies that may have substantial monetary claims against corporate officers, directors, and shareholders for particularized injuries arising before the bankruptcy petition date. These individual targets often have a net worth significantly greater than the corporate debtor's assets for distribution. Under these circumstances, the aggrieved creditor's claim against the non-debtor third party may present a significantly better prospect of eventual distribution than exclusive participation in the bankruptcy claims process. Separate but related to the release of third-party claims of creditors, corporate Chapter 11 debtors often propose in their reorganization plans to grant corporate officers, committee members, lenders, and their professionals, exculpation for these parties' activities in connection with the bankruptcy case. Thus, bankruptcy releases of non-debtors generally fall into two categories: (1) settlement and release of claims held by third parties against other non-debtors and (2) release and