

INSIDE: Evolution of Chapter 11 Practice ♦ A Guide to Types of Bankruptcies ♦ Chapter 11 and *Purdue Pharma*

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BANKRUPTCY PRACTICE
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Mass Tort

Liability

The Use of Chapter 11 Both Pre- and Post- *Purdue Pharma*

The defense of mass tort cases can overwhelm a company in terms of both expense and administrative burden. Companies that are subject to mass tort liabilities are often required to defend multiple suits in different jurisdictions, while facing the risk of disparate judgments.

Dating back to *In re Johns-Manville Corp., et al.*, Case No. 82-11656 (CGM) (*Johns-Manville*), the bankruptcy process has provided companies with useful tools for addressing current and future mass tort liability in a centralized forum. Indeed, Chapter 11 has been used as a means for addressing mass tort liabilities related to, among other things, asbestos exposure, opioid addiction, airbag malfunctions, sexual abuse, talc exposure and defective medical devices.

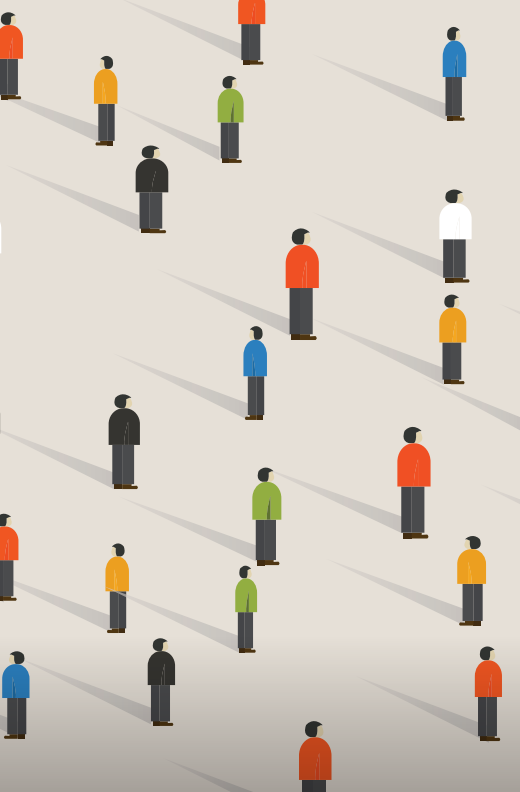
The Delaware Bankruptcy Court, being one of the most sophisticated and experienced venues for handling Chapter 11 cases, has played a significant role in the mass tort bankruptcy space. A small sampling of the mass tort cases that have been handled by the Delaware Bankruptcy Court includes *Mallinckrodt* (opioids), *Boy Scouts of America* (abuse claims), *TK Holdings* (defective airbags), *Blitz U.S.A.* (defective gas cans), *Paddock Enterprises* (asbestos), *Imerys Talc America* (talc/asbestos), *Federal Mogul Global* (asbestos)

and the *USG Company* (asbestos).

This article is intended to provide a high-level overview of the use of Chapter 11 as a means of addressing a company's mass tort liability, as well as a discussion of the Supreme Court's opinion in *Harrington v. Purdue Pharma*, 603 U.S. 204 (2024) (*Purdue Pharma*), and the effect that it may have on the mass tort bankruptcy practice moving forward.

1. Chapter 11 as a Means of Addressing Mass Tort Liability

Chapter 11 provides a company with the ability to create a process for resolving all claims against the company and potentially against certain non-debtor entities in a single centralized bankruptcy proceeding. The tools available under the Bankruptcy Code also provide a debtor with, among other things, the ability to stay actions pending against the company in various jurisdictions on account of prepetition claims, enter into settlements with insurers and other joint tortfeasors that provide for the funding of a settlement



trust in exchange for consensual and/or non-consensual third-party releases (with respect to asbestos-related liabilities), and channel all current and future tort claims to such settlement trust to be administered in connection with court-approved trust distribution procedures.

2. *Johns-Manville* and the Rise of Mass Tort Bankruptcy Cases

The modern use of the bankruptcy process to address mass tort liabilities finds its origins in *Johns-Manville*, a case filed in 1982. Johns-Manville Corp., a large asbestos processor and cement manufacturer, filed a Chapter 11 case in response to significant asbestos litigation. The plan structure in *Johns-Manville* involved the channeling of current and future claims to a trust that was funded by a percentage of the reorganized entity's future earnings, as well as contributions from the company's insurers and other third parties. In exchange for such contributions, the insurers and settling third parties received consensual and non-consensual releases of asbestos-related claims from the debtors and all creditors.

Congress subsequently enacted Section 524(g) of the Bankruptcy Code, which codified the trust structure established in *Johns-Manville* as a construct

for addressing asbestos-related liability in bankruptcy. Section 524(g) provides specific statutory authority for the channeling of current and future asbestos liability pursuant to a channeling trust structure under which non-debtor third parties may contribute consideration to the trust in exchange for the non-consensual release of creditor claims (claims typically related to liability arising from exposure to the debtor's products). These are commonly referred to as "non-consensual third-party releases" and were the focus of the Supreme Court's decision in *Purdue Pharma* (as discussed herein).

While Section 524(g) is specific to asbestos-related claims, Chapter 11 has also been used as a means of addressing non-asbestos mass tort liabilities. Bankruptcy practitioners have traditionally relied upon Sections 105(a) and 1123(b) (6) of the Bankruptcy Code in expanding the channeling trust structure to non-asbestos cases. Section 105(a) of the Bankruptcy Code allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

11 U.S.C. § 105. Section 1123(b) of the Bankruptcy Code lists certain things that a debtor can accomplish through a Chapter 11 plan. The first five subsections of Section 1123(b) concern the rights and responsibilities of the debtor and its relationship to its creditors. Section 1123(b) (6), however, contains a "catch-all" provision which provides that a Chapter 11 plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title."² These two sections of the Bankruptcy Code served as a statutory basis for implementing a *Johns-Manville* type trust structure for non-asbestos tort liabilities, including the implementation of non-consensual third-party releases relating to mass tort liabilities. Post-*Johns-Manville*, the Delaware Bankruptcy Court has been a preeminent jurisdiction for both asbestos and non-asbestos-related mass tort bankruptcy cases.

3. Bankruptcy Tools for Dealing with Mass Tort Claims

In addition to the escalation of defense costs, the defense of multiple tort cases in different forums creates a risk of disparate judgments as plaintiffs pursue venues where they are more likely to receive favorable outcomes. The commencement of a bankruptcy case, however, allows a company to funnel all claims, including latent or future claims, into a centralized Chapter 11 proceeding. Moreover, bankruptcy provides a company with not only a forum for dealing with its mass tort liability, but also an avenue for addressing issues with its capital structure resulting from funded and trade debts and other contractual liabilities.

The Bankruptcy Code provides a debtor with various tools for addressing its mass tort liabilities. As soon as the debtor files its bankruptcy petition, the automatic stay afforded under Section 362(a) of the Bankruptcy Code will halt all pending actions and the commencement of future actions against the debtor outside of the bankruptcy court on account of pre-petition claims. A debtor may also seek to extend the automatic stay (by adversary proceeding) to related actions against co-defendants (e.g., directors, officers, affiliates and joint tortfeasors). The automatic stay is thus a fundamental component of the "breathing spell" afforded to debtors throughout the bankruptcy process.

During this "breathing spell," the debtors are afforded an opportunity to negotiate with key constituencies regarding a plan and potential resolution of the Chapter 11 case. An official committee will likely be appointed pursuant to Section 1102 of the Bankruptcy Code to represent tort claimants and/or other general unsecured creditors. To the extent that a debtor seeks to channel future asbestos-related claims to a trust, a future claims representative must also be appointed in accordance with Section 524(g) of the Bankruptcy Code to protect the rights

of future claimants with unmanifested claims. Other key constituents, including secured parties, insurers, non-debtor affiliates and joint tortfeasors, will likewise be separately represented in connection with the Chapter 11 case. Thus, the ability to interact and negotiate with all constituencies in a single forum provides an effective tool for reaching consensus.

In addition to the automatic stay, the Bankruptcy Code provides a debtor with numerous other instruments for resolving mass tort claims. Indeed, consistent with the framework established in *Johns-Manville* (and incorporated into Section 524(g) for asbestos-related liabilities), the treatment of mass tort liabilities is often resolved through the implementation of a channeling injunction that directs all tort claims to a settlement trust. The settlement trust may then be funded with cash, equity interests in the reorganized debtor, insurance proceeds, settlement amounts received from third parties or joint tortfeasors (often contributed in exchange for consensual and non-consensual third-party releases to be provided pursuant to the plan) and other estate assets. As a result of the channeling injunction, the debtor's mass tort liability is effectively capped at the value of the trust assets. The plan structure will typically incorporate trust distribution procedures (TDP) that establish a set of rules by which the settlement trustee may determine the validity and value of tort claims and the path by which claimants can challenge or appeal the trust's determination of their claims. This settlement trust structure has provided companies with an effective bankruptcy option for addressing mass tort liability.

4. *Purdue Pharma and the Use of Non-Consensual Third-Party Releases*

The Supreme Court's decision in *Purdue Pharma* arose in the context of a settlement with the company's long-time owners, the proceeds of which would be used to compensate opioid victims and fund various abatement initiatives. In exchange

for the settlement payment, the former owners sought, among other things, non-consensual third-party releases of any current or future opioid-related claims that could be asserted against them.

Basing its decision primarily on its reading of Section 1123(b) of the Bankruptcy Code (identifying things that a Chapter 11 plan "may" do), the Court concluded that a bankruptcy court does not have the power to discharge claims against a non-debtor without the consent of affected non-debtor claimants. Of particular importance in the mass tort context, the Court noted that because the Bankruptcy Code specifically authorizes non-consensual third-party releases in asbestos-related cases, "it is all the more unlikely that § 1123(b)(6) is best read to afford courts that same authority in *every* context."³ Thus, the breadth of the "catch-all" provision in Section 1123(b)(6) of the Bankruptcy Code did not provide sufficient statutory authority for granting non-consensual third-party releases in non-asbestos related cases.

Prior to the Court's decision in *Purdue Pharma*, a debtor was able to utilize non-consensual third-party releases as an effective tool for addressing the potential liabilities of third parties caused by the debtor's conduct. This often enabled the debtor to secure significant settlements with insurers and joint tortfeasors in exchange for plan releases that would bind potential plaintiffs. Except with respect to asbestos-related cases, a debtor no longer has the ability to offer third-party non-consensual releases (unless Congress acts to amend Section 524(g) of the Bankruptcy Code to extend it to other types of mass tort claims).

The practical implication of the Court's ruling is that tort claimants in non-asbestos cases will have the ability to opt out of bankruptcy third-party releases and future claimants will no longer be bound by such releases. Thus, the inability to provide complete finality to non-debtor affiliates and other potential settling parties with regard to their tort exposure will

undoubtedly affect a debtor's leverage in negotiating settlements with such parties.

All is not lost, however, as *Purdue Pharma* did not affect a debtor's ability to effectuate consensual releases for third parties or to release derivative causes of action that are "owned" by the debtor's estate upon the commencement of a bankruptcy case. Courts differ in their views of what constitutes a "consensual release," but generally a claimant is deemed to have consented to a third-party release where it has failed to affirmatively opt out of such release pursuant to court-approved solicitation procedures. The use of an opt-out approach, combined with a broad noticing process, can maximize the scope of any consensual releases received by settling parties.

The Delaware Bankruptcy Court has been at the forefront of addressing the bounds of consensual releases post-*Purdue Pharma*. Moreover, derivative claims "owned" by the estate may include, among other things, fraudulent transfer, successor liability, breach of fiduciary duty, insurance coverage and *alter ego* claims. Additionally, some debtors have effectively used the "buy back" of insurance policies free and clear of any liens, claims and encumbrances under Section 363(f) of the Bankruptcy Code as an effective means of providing relief to settling insurers. This approach was likewise not addressed by the Supreme Court in its decision. Accordingly, a debtor still maintains effective tools for resolving claims in non-asbestos cases even without the ability to utilize non-consensual third-party releases, and the Delaware Bankruptcy Court will undoubtedly continue to be an attractive forum for such cases moving forward. ♦

NOTES

1. Michael J. Merchant is a director of Richards, Layton & Finger in Wilmington, Delaware. The views expressed in this article are those of the author and do not reflect the views of Richards, Layton & Finger or its clients.
2. 11 U.S.C. § 1123(b)(6).
3. *Purdue-Pharma*, 603 U.S. at 222.