No. 21-07532 (CM) (Consolidated)
No. 21-08055 (CM) (California)

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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In re PURDUE PHARMA L.P., et al., Debtors.

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THE STATE OF CALIFORNIA AND
THE PEOPLE OF THE STATE OF CALIFORNIA, Appellants,

v.

PURDUE PHARMA L.P., et al., Appellees.

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ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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# APPELLANTS' REPLY BRIEF

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## INTRODUCTION

As California argued in its principal brief [Dkt. 95[1]] and those briefs that it joined in and adopted by reference [Dkt. 99], the Sackler Releases[2] are unlawful for at least two independent legal reasons: (1) there is no authority under the Bankruptcy Code for them; and (2) the bankruptcy court lacked adjudicatory and constitutional authority to enter a final order approving them. Either basis requires reversal.

A considerable portion of appellees' 400 pages of briefing is devoted to discussing the benefits of the Plan over the hypothetical, "value destroying" alternative. The issue on appeal, however, is the legality of the nonconsensual Sackler Releases. If those releases are held unlawful, the confirmation order must be reversed, and the case remanded to the bankruptcy court, notwithstanding any sincere "belie[f] that . . . creditors would be better off" under the Plan. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988); *accord Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 987 (2017).

Regardless, it is far from clear whether the unfair negotiating leverage that nonconsensual releases create for third parties results in better or more efficient settlements over the alternatives. Here, the specter of the bankruptcy court confirming a plan with sweeping nonconsensual releases empowered the Sacklers to negotiate from a position of strength, unavailable in a true arm's-length negotiation. Implicit in appellees' discussions of "the alternative" is that a global settlement could *never* be reached absent nonconsensual third-party releases. This too is far from clear.

California focuses its reply on responding to several arguments raised by appellees.

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[1] Docket entries refer to those in the consolidated case, 21-07532 (CM).
[2] Capitalized terms not otherwise defined in this reply have the same meaning as in California's Principal Brief [Dkt. 95].

Contrary to appellees' contentions (1) the Plan cannot release claims against individual Sacklers for civil penalties payable to a governmental unit exercising its police and regulatory authority; (2) the Plan's release of third-party claims is preclusive as to those claims and is therefore a "final judgment" of them, implicating the constitutional limits of *Stern v. Marshall*; and (3) the specter of supposed "frivolous" state law-enforcement claims cannot support the Sackler Releases extinguishing police and regulatory actions.

California also joins in and adopts by reference the reply briefs filed by the U.S. Trustee and by the States of Washington, Connecticut, Delaware, Rhode Island, and Vermont. Fed. R. Bankr. P. 8014(e).

## ARGUMENT

### I. THE SACKLER RELEASES ARE ILLEGAL BECAUSE THEY PURPORT TO OVERRIDE 11 U.S.C. § 523(A)(7)

The Sackler Releases are not permitted by the Bankruptcy Code because nondebtor Sackler individuals cannot receive a broader discharge from governmental penalties claims through Purdue's corporate bankruptcy filing than they could if they filed personal bankruptcy. It is indisputable that, in a personal bankruptcy, 11 U.S.C. § 523(a)(7) automatically excepts from discharge (i.e., without the need to file a nondischargeability complaint) claims for penalties payable to a governmental unit—precisely the types of civil law-enforcement claims brought by California against nine Sackler individuals for their role in fueling the opioids crisis. However, despite this specific mandate under the Bankruptcy Code, the Plan purports to release California's penalties claims against innumerable Sackler individuals. The Bankruptcy Code forbids this. "It is hornbook law that § 105(a) does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code." *Law v. Siegel*, 571 U.S. 415, 421 (2014) (citation and quotation marks omitted); *see also* 11 U.S.C. § 1123(b)(6) (authorizing plan

provisions "not inconsistent with the applicable provisions of this title").

Appellees raise a host of unavailing arguments to explain this away. For their part, Debtors claim that "a third-party release is not a bankruptcy discharge." [Dkt. 151 at 52.] To the extent that this is a semantical argument, it is wrong: "releases" and "discharges" are equivalents. *In re Archdiocese of Saint Paul*, 578 B.R. 823, 831 (Bankr. D. Minn. 2017) ("[A] release and permanent injunction are indistinguishable from a bankruptcy discharge.") (citation omitted); *see also In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d Cir. 2005) ("a release . . . may operate as a bankruptcy discharge"). Debtors further argue that the Sackler Releases comply with the Bankruptcy Code because they do not provide the "umbrella protection" of the discharge that comes at the end of an individual's successful bankruptcy. [Dkt. 151 at 52 (citing *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91 (2d Cir. 1988)).] This is irrelevant. The pertinent question is whether a corporate plan can override a specific provision of the Bankruptcy Code, here, prohibiting the discharge (or "release") of governmental penalties claims against individuals. The answer to that question is no. *See, e.g.*, *Siegel*, 571 U.S. at 421.

The Multi-State Governmental Entities Group (MSGE) argues that the states cannot "*assume*" that their direct and independent claims against the Sacklers would be automatically nondischargeable in an individual Sackler's bankruptcy. [Dkt. 155 at 29 (emphasis in original).] Not true. It is blackletter law that California's law-enforcement claims seeking civil penalties against individual Sacklers are *automatically* nondischargeable under 11 U.S.C. § 523(a)(7). *In re Taite*, 76 B.R. 764, 769 (Bankr. C.D. Cal. 1987) (civil penalties under California's Unfair Competition Law "automatically nondischargeable under Section 523(a)(7)"); *see also, e.g.*, *In re Williams*, 438 B.R. 679, 687 (10th Cir. BAP 2010) ("[Section] 523(a)(7) is self-executing—that is, it does not require either party to obtain a judgment declaring the debt excepted from

discharge . . . ."). The MSGE also argues the Sackler Releases do not provide "blanket immunity" and are therefore permitted. [Dkt. 155 at 30.] This is a rehash of Debtors' "umbrella protection" argument and therefore irrelevant. It is also false. The Sackler Releases purport to forever extinguish all civil law-enforcement claims against an unlimited number of Sacklers for their role in fueling the opioid crisis. This is the very definition of "blanket immunity" of which *Metromedia* warned. 416 F.3d at 142; *cf., e.g.*, *Obduskey v. McCarthy & Holthus LLP*, 139 S. Ct. 1029, 1040 (2019).

The Mortimer-side Initial Covered Sackler Persons raise an array of similar arguments, which should likewise be rejected. [Dkt. 156 at 43-45.] They also challenge appellants to identify authority that "a non-debtor release is appropriate . . . depend[ing] on what might hypothetically happen if an individual filed for bankruptcy." [Dkt. 156 at 45.] But this is precisely the inquiry that *Metromedia* invited when it warned that "a nondebtor release is a device that lends itself to abuse. . . . . In form, it is a release; *in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code.*" 416 F.3d at 142 (emphasis added). The Sackler Releases are an abuse of the bankruptcy process because they purport to extinguish law-enforcement claims for civil penalties against individual Sacklers who could never have these claims extinguished even if they filed bankruptcy themselves, in direct contravention of 11 U.S.C. § 523(a)(7).

It is for this reason too that appellees' repeated refrain that "police powers claims" are not afforded "special" treatment under the Bankruptcy Code is wrong. [*See, e.g.*, Dkt. 155 at 38.] They are. Besides being excepted from the automatic stay, 11 U.S.C. 362(b)(4), and immune from removal to federal court in a bankruptcy case, 28 U.S.C. § 1452(a), governmental units enjoy special creditor status when they exercise their police and regulatory authority to seek civil

penalties—those claims are automatically nondischargeable against individuals. 11 U.S.C. § 523(a)(7). This special creditor status cannot be overridden through a bankruptcy plan. *See, e.g.*, *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 986 (2017) (reversing decision "depart[ing] from the protections Congress granted particular classes of creditors"). A contrary position would lead to the "anomalous situation" in which a third-party release could provide "broader protection" for individuals than they could legally obtain through a personal bankruptcy filing. *In re Aegean Marine*, 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019).

## II. THE PLAN'S RELEASE OF THIRD-PARTY CLAIMS IS PRECLUSIVE AS TO THOSE CLAIMS AND THEREFORE CONSTITUTES A "FINAL JUDGMENT" ON THEM, IMPLICATING THE CONSTITUTIONAL LIMITS OF *STERN V. MARSHALL*

Understandably, appellees repeatedly rely on this Court's decision in in *In re Kirwan Offices*, 592 B.R. 489 (S.D.N.Y. 2018) (McMahon, J.), which held that an involuntary release in a confirmed plan of reorganization does not amount to a final judgment on the released claim and therefore does not implicate *Stern v. Marshall*, 564 U.S. 462, 503 (2011). [*See, e.g.*, Dkt. 151 at 78 (citing *In re Kirwan Offices*, 592 B.R. at 504-05).] California respectfully disagrees with this Court's holding and submits that the Supreme Court's decisions in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137 (2009) and *Stoll v. Gottlieb*, 305 U.S. 165 (1938) urge a different result.

The doctrine of *res judicata* bars re-litigating claims in a subsequent suit based on the same cause of action if there has been a final judgment on those claims. *Taylor v. Sturgell*, 553 U.S. 880, 892 (2008). *Travelers* and *Stoll* both address the *res judicata* effect of nonconsensual third-party releases in bankruptcy plans confirmed by final order. (Both expressly take no position on propriety of third-party releases. 557 U.S. at 155; 305 U.S. at 171 n.8.) Both hold that such final orders are entitled to *res judicata* claim preclusion, meaning that the final order is preclusive in any subsequent suit that asserts a released claim. 557 U.S. at 129; 305 U.S. at 171; *see also* Restatement (Second) of Judgments § 17(2) (1982) ("If the judgment is in favor of the defendant,

the claim is extinguished and the judgment bars a subsequent action on that claim.").

Because the preclusive bar of *res judicata* applies only when there has been a final judgment on the clam at issue, *Taylor*, 553 U.S. at 892, both *Travelers* and *Stoll* necessarily hold that an order confirming a plan containing nonconsensual releases of claims against nondebtor third parties is a final judgment on those claims.[3] *Accord In re Digital Impact*, 223 B.R. 1, 13 n.6 (Bankr. N.D. Okla. 1998) ("A release, or permanent injunction, contained in a confirmed plan . . . has the effect of a judgment—a judgment against the claimant and in favor of the non-debtor, accomplished without due process.").

Accordingly, California respectfully submits that, contrary to this Court's holding in *In re Kirwan Offices*, 592 B.R. at 504-05, nonconsensual third-party releases squarely implicate the constitutional limits addressed in *Stern v. Marshall*, which bar an Article I bankruptcy court from "enter[ing] final judgment" on non-core claims that are "not resolved in the process of ruling on a creditor's proof of claim." 564 U.S. 462, 503 (2011); *see also id*. at 494 ("What is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment by a court with broad substantive jurisdiction . . . ."). Here, the bankruptcy court's entry of an order confirming the Sackler Releases was a final judgment on California's (indisputably non-core) civil law-enforcement claims against nondebtors. Accordingly, this was an unconstitutional exercise of Article III judicial power by the bankruptcy court. *See id*.

This error cannot be remedied by treating the bankruptcy court's confirmation order as to

[3] Professor Brubaker has written extensively on the impropriety of nonconsensual third-party releases, arguing, among other things, that the confirmation order is necessarily a final judgment on each and every nonconsensually released third-party claim coming within the terms of the plan's release provision. *See generally, e.g.*, Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L. J. 18 (forthcoming 2022), available at SSRN: https://ssrn.com/abstract=3960117.

the Sackler Releases as proposed findings of fact and conclusions of law for this Court to review de novo under 11 U.S.C. § 157(c). For one thing, this Court's affirmance of the bankruptcy court's order approving the Sackler Releases would do nothing more than ratify the entry of an order extinguishing California's civil law-enforcement claims without an actual adjudication of them by an Article III court. *See, e.g.*, *United States ex rel. Toth v. Quarles*, 350 U.S. 11, 15 (1955) ("It is the primary, indeed the sole business of [Article III] courts to try cases and controversies . . . ."); *Murray's Lessee v. Hoboken Land & Imp. Co.*, 59 U.S. 272, 284 (1855) ("[W]e do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty[.]"). Moreover, this Court cannot enter final judgment on California's civil law-enforcement action against nine Sackler individuals currently pending in state court because removal to federal court is barred under 28 U.S.C. § 1452(a). Finally, even if California's claims against third parties could legally be extinguished through a bankruptcy plan, it would be a "a de facto removal," also prohibited by 28 U.S.C. § 1452(a). *In re Union Golf of Fla., Inc.*, 242 B.R. 51, 58 (Bankr. M.D. Fla. 1998).[4]

## III. THE SPECTER OF SUPPOSED "FRIVOLOUS" STATE LAW-ENFORCEMENT CLAIMS CANNOT SUPPORT THE SACKLER RELEASES EXTINGUISHING POLICE AND REGULATORY ACTIONS

The Sackler appellees argue that the Sackler Releases are "well justified" in covering "Sackler family members and related parties who had no meaningful involvement with Purdue" to prevent frivolous lawsuits "bounded only by the imagination—and not by the facts." [Dkt. 154

[4] The MSGE, citing *In re Methyl Tertiary Butyl Ether Prod. Liab. Litig.*, 522 F. Supp. 2d 557, 567 (S.D.N.Y. 2007), argues that 28 U.S.C. § 1452(a) is only a removal statute, which does not prevent this Court from exercising jurisdiction over California's law-enforcement claims under 28 U.S.C. § 1334(b). [Dkt. 155 at 39-40.] Even if technically correct, as a practical matter, this Court would need to enter a final judgment on California's claims, which are pending in state court, and thus would need to be removed to this Court in contravention of 28 U.S.C. § 1452(a).

at 20, 23.] This argument proves too much. Even if this were a basis for imposing sweeping releases—which it is not—it would be inapplicable to police and regulatory actions due to the "presumption that the prosecutor acted in good faith." *Miller v. Superior Court*, 101 Cal. App. 4th 728, 747-48 (2002). There is no basis to sweep into the Sackler Releases the claims of public prosecutors based on the notion that they may file "frivolous" actions. California's enforcement action against nine Sackler individuals should be resolved in state court where it is pending. If any of California's claims are frivolous, surely that court will ensure speedy justice.

The Sackler appellees specifically call out California to supposedly highlight the need for the Sackler Release's expansive coverage, taking particular issue with the fact that California named Marianna Sackler. [Dkt. 154 at 21; Dkt. 156 at 20.] They self-servingly characterize Marianna Sackler as "h[o]ld[ing] only a part-time, temporary position in Purdue's Research & Development Department for about four months in 2009-2010, when she was a young adult." [Dkt. 154 at 21; Dkt. 156 at 20 (Marianna Sackler's "role at Purdue was limited to working in Purdue's R&D group for a few months a decade ago").]

However, Marianna Sackler's deposition testimony in this bankruptcy case shows that she was in fact a "crisis project coordinator" in 2009-2010 on the OxyContin reformulation, a critical project that allowed Purdue to continue its monopoly over OxyContin as it led to the FDA withdrawing approval for OxyContin generics. [*See* JX-1991 (32:8-18; 238:10-24).] During this time, she was a "core team member" who regularly interacted directly with Purdue's Board of Directors, CEO, Vice President of Research & Development, and Chief Medical Officer, as well as Purdue's outside consultant, McKinsey & Company[5], to provide strategic options in

[5] In February 2021, McKinsey & Company agreed to pay nearly $600 million to settle its role in contributing to the opioid crisis, which included work with Purdue to drive sales of OxyContin. *See, e.g.*, http://www.nytimes.com/2021/02/03/business/mckinsey-opioids-settlement.html.

navigating this existential threat to OxyContin and Purdue's survival. [*See id*. (195:12-196:19; 202:22-203:23; 233:16-21; 243:16-244:20; 240:3-241:15; 249:20-23).] This is hardly the lowly intern role that the Sackler appellees paint her as having.

**CONCLUSION**

For these reasons and those in California's principal brief, as well as the briefs that it joined in and adopted by reference, Fed. R. Bankr. P. 8014(e), California respectfully requests that the Court reverse the bankruptcy court's order confirming the Plan.

November 22, 2021

Respectfully submitted,

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Supervising Deputy Attorney General

**CERTIFICATE OF COMPLIANCE**

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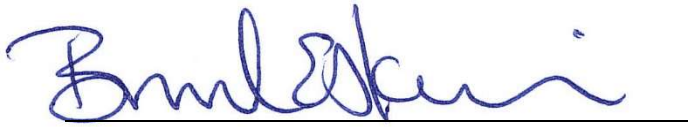

BERNARD A. ESKANDARI

**CERTIFICATE OF SERVICE**

I, Bernard A. Eskandari, hereby certify that, on November 22, 2021, I caused true and correct copies of the foregoing document to be served by the Court's CM/ECF System to all parties who are deemed to have consented to electronic service. I have also caused a courtesy copy of the foregoing document to be sent by overnight mail to the Chambers of Judge Colleen McMahon.

BERNARD A. ESKANDARI