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Opting Out of the Opt Out: SDNY Rejects Opt-Out Releases in Chapter 11 Plan

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Before the US Supreme Court's landmark decision in *Purdue Pharma*,[1] it had become common practice for Chapter 11 debtors to include a consensual or nonconsensual non-debtor third-party release in their plans of reorganization. As one bankruptcy judge colorfully quipped, third-party releases became somewhat of an industry standard in the US Bankruptcy Court for the Southern District of New York (SDNY) and the US Bankruptcy Court for the District of Delaware before "spread[ing] across the country like a highly contagious virus."[2] When the Supreme Court outlawed the use of nonconsensual releases, the debate among the lower courts shifted to the meaning of "consent." In her recent decision in *GOL Linhas*,[3] Judge Denise Cote of the US District Court for the SDNY issued the first district court opinion overruling a bankruptcy court's approval of an opt-out release.

Background: *Purdue Pharma*

By now, discussion of the Supreme Court's *Purdue* decision by bankruptcy practitioners is familiar ground. But for those of you in the bankruptcy industry who have been living under a rock the past few years, in brief: The Sackler family (and their affiliated entities) as the ultimate owners of Purdue Pharma sought to obtain in Purdue's Chapter 11 case a broad release barring current and future litigation against them by the bankruptcy estate, individual tort creditors and governmental entities, among others, relating to the opioid epidemic. As initially proposed, the debtors' Chapter 11 plan also included an injunction effectuating this release. In exchange, the Sacklers proposed to contribute more than $4 billion to the bankruptcy estate.[4]

The proposed nonconsensual release mechanism did not allow creditors to vote on the release independently of their vote on the plan. A rejection of the plan constituted a rejection of the third-party release. However, future tort claimants – along with unimpaired creditors – would have their claims extinguished without their consent or an opportunity to vote. While the US Bankruptcy Court for the Southern District of New York confirmed the plan, the district court reversed, finding that no provision in the Bankruptcy Code enabled the court to terminate tort claims against the Sacklers without the claimants' consent.[5] The US Court of Appeals for the Second Circuit promptly reversed, and the Supreme Court granted the petition for certiorari of the US Trustee, the lone remaining objector.

Writing for the majority, Justice Neil Gorsuch determined that the release amounted to a discharge for non-debtors who had not "placed virtually all their assets on the table."[6] Interpreting section 1123(b)(6) of the Bankruptcy Code, the Supreme Court found no support for the proposition that a debtor may obtain a release of claims against a non-debtor third party without the consent of the claimholder. While the Supreme Court eliminated the use of nonconsensual third-party releases, however, the opinion expressly refused to opine on the legality of consensual third-party releases. By further disclaiming any opportunity to define the bounds of what constitutes "consent,"[7] the Supreme Court invited the lower courts into this definitional quagmire.

Courts – and judges – diverge on what constitutes 'consent'

Following *Purdue*, litigation concerning third-party releases has focused on the definition of "consent." Although already heavily litigated, this issue took on renewed importance given that a consensual third-party release mechanism became the only way to effectively bind all creditors and shareholders. In particular, the split among the courts centered on whether creditors must affirmatively give consent to a third-party release (i.e., an opt-in structure), or whether silence (i.e., an opt-out structure) suffices for consent. Not surprisingly, debtors and the

third parties looking to benefit from the releases greatly prefer the latter structure, given the likelihood that many claimants will not bother to opt out. This distinction thus turns on the legal definition of "consent."

What constitutes "consent," in turn, depends on what law the court applies, of which there are two choices: federal common law or state law.[8] The latter approach leads to a potentially thorny choice-of-law issue that could require the court to evaluate the consent question vis-à-vis each claimholder, making an opt-out structure practically infeasible.[9] Courts applying the federal approach, on the other hand, can sidestep that question altogether.

Since *Purdue*, the three districts that see the most complex commercial Chapter 11 cases – the District of Delaware, the Southern District of Texas and the SDNY – have adopted divergent answers to the opt in versus opt out question:

- In the District of Delaware, it appears that the permissibility of opt-in versus opt-out releases depends on the particular bankruptcy judge. For example, Judge Craig Goldblatt recently disapproved of opt-out releases because they are "no longer an ordinary plan provision that can properly be entered by 'default' in the absence of an objection."[10] Chief Judge Karen Owens agrees, having written that the opt-in approach is the "gold standard."[11] However, Judges John Dorsey, Thomas Horan and Kate Stickles have endorsed a hybrid approach providing an opt-out mechanism for those creditors entitled to vote and an opt-in mechanism for nonvoting creditors.[12]

- In the Southern District of Texas, bankruptcy judges continue almost as a matter of course to approve opt-out third-party releases. For example, Judge Christopher Lopez found an opt-out release to be consensual where the creditors were given sufficient due process.[13] Judge Marvin Isgur arguably went further in finding that where a creditor did not receive an opt-out ballot due to its own failure to file a proof of claim, the opt-out release remained permissible.[14]

- Most judges in the Southern District of New York previously agreed with Judges Lopez and Isgur. For example, Judge Sean Lane recently affirmed opt-out third-party releases where the language was "clearly worded and prominently presented" in order to notify the claimholders of their rights.[15] And like Judge Lane, Chief Judge Martin Glenn in the *GOL Linhas* case approved of the opt-out third-party release proposed by that debtor because there was "constitutionally adequate service of process."[16]

One aside that bears noting: A divergence may be emerging between the run-of-the-mill Chapter 11 cases and mass tort bankruptcies. Specifically, Bankruptcy Judge Wendy Kinsella, in *Roman Catholic Diocese of Syracuse, New York*, approved opt-out releases applicable to creditors with claims based on sexual assault torts notwithstanding undertaking "a very conservative approach."[17] While the US Trustee objected citing *Purdue* and Judge Goldblatt's *Smallhold* decision, Judge Kinsella distinguished those cases on the basis that the Syracuse Diocese unsecured creditors committee consisted entirely of abuse survivors asserting the same type of claim based on common facts. The court therefore approved the opt-out procedures to the extent that the committee, acting "as the *de facto* class representative," approved.[18] It remains to be seen whether other courts in mass tort cases will follow Judge Kinsella's lead.

District Judge Cote rejects opt-out third-party releases

As noted above, in *GOL Linhas*, Chief Judge Glenn confirmed a Chapter 11 plan that included an opt-out release and injunction over the objection of the US Trustee. Although the US Trustee argued that the court must look to state law to determine consent, and that under New York contract law, silence cannot equate to consent, the bankruptcy court relied on a "close reading" of *Purdue* and case law from the US Court of Appeals for the Fifth Circuit to find that the federal common law of contracts applied.[19] First, nothing in *Purdue* forbade the use of consensual third-party releases under Section 1123(b)(6) of the Bankruptcy Code. Second, courts in the Fifth Circuit had approved consensual third-party releases that had specific language, were integral to the plan, a condition of settlement and obtained for consideration.[20] Because none of these cases relied upon or analyzed state law, the bankruptcy court determined that they must have (impliedly) relied on federal law.

Chief Judge Glenn also relied on two other, separate bases to apply federal contract law. First, he determined that federal law defined the "nature of the right at stake" because claimholders were releasing "the right to have their claims heard by an Article III court," which is a "personal constitutional right protected by federal

Constitutional law."[21] Second, applying state contract law would require the bankruptcy court to "engage in untold numbers of individualized choice-of-law analyses" in stark opposition to the need for a uniform bankruptcy system.[22]

On appeal of the confirmation order, Judge Cote found the opt-out releases and associated injunction to be impermissible, ordering those provisions stricken from the plan.[23] As an initial matter, Judge Cote agreed with the bankruptcy court that nothing in *Purdue* prevented a debtor from obtaining a consensual third-party release. And while her analysis focused on the meaning of "consent," Judge Cote found the federal common law versus state contract law dispute irrelevant because under either authority, a contract party cannot impliedly give consent through silence.[24]

Judge Cote found that under both state law and long-standing precedent of the Second Circuit, acceptance cannot be implied by silence except under two narrow limitations: either where the counterparty has a duty to respond or there was a contemporaneous oral agreement.[25] Rather than argue that one of these exceptions applied, the debtors provided three counterarguments:

1. Each releasee substantially contributed to the bankruptcy cases.
2. Creditors had the chance to reject the releases.
3. The "failure to [respond] may indeed carry consequences."[26]

Judge Cote found that these arguments simply did not meet the required test for consent under Second Circuit law. She also rejected the debtors' reliance on cases from the class action[27] or default judgment contexts, finding that, unlike in those cases, claimants had no duty to respond to the opt-out notice.

Implications

To date, no federal court of appeals has spoken on this issue following *Purdue*. The likelihood of a further appeal in the *GOL Linhas* cases provides the possibility that the Second Circuit will be the first. While neither the Third Circuit nor the Fifth Circuit have issued an opinion, the variance among the bankruptcy courts in Texas and Delaware suggests that a circuit-level opinion is inevitable in those jurisdictions as well.

Notes

1. *Harrington v. Purdue Pharma, L.P.*, 603 US 204 (2024).
2. *In re Berwick Black Cattle Co.*, 394 B.R. 448, 459 n.13 (Bankr. C.D. Ill. 2008).
3. Op. & Order, *In re GOL Linhas Aereas Inteligentes S.A.*, Case No. 25-cv-4610 (DLC) (S.D.N.Y. Dec. 1, 2025), Dkt. No. 46 [hereinafter GOL Dist. Ct. Op.].
4. *Purdue Pharma*, 603 US at 211–12.
5. *Id.* at 213.
6. *Id.* at 215.
7. *Id.* at 226.
8. Courts in at least two jurisdictions have rejected opt-out releases by applying the state law approach. Finding that nothing in the Bankruptcy Code authorizes the release of claims against a non-debtor, Judge Scott Everett of the US Bankruptcy Court for the Northern District of Texas has required opt-in procedures. Tr. at 11–15, *In re Ebix, Inc.*, Case No. 23-80004-swell (Bankr. N.D. Tex. Aug. 2, 2024), Dkt. No. 851 (analyzing consent as an issue "of contract between those non-debtor parties"). On a similar basis, Chief Judge Carl Bucki of the US Bankruptcy Court for the Western District of New York determined that the court must analyze a third-party release as an "ancillary offer that becomes a contract upon acceptance," where consent is governed by state law. *In re Tonawanda Coke Corp.*, 662 B.R. 220, 222 (Bankr. WDNY 2024). Because New York law requires written consent, the failure to return an opt-out form defeats the release provision.
9. *In re GOL Linhas Aereas Inteligentes S.A.*, 672 B.R. 129, 163–165 (Bankr. SDNY) (Glenn, C.J.) (examining the various approaches to the "consent" inquiry).
10. *In re Smallhold, Inc.*, 655 B.R. 704, 709, 720 (Bankr. D. Del. 2024) (Goldblatt, J.).
11. *In re First Mode Holdings Inc.*, Case No. 24-12794 (KBO) (Bankr. D. Del. Feb. 6, 2025), Dkt. No. 266.
12. See, e.g., Order Approving the Disclosure Statement, *In re FTX Trading Ltd.*, Case No. 22-11068 (JTD) (Bankr. D. Del. June 26, 2024), Dkt. No. 19068 (Dorsey, J.); Tr. of Hr'g at 45:5-19, *In re Fisker, Inc.*, Case No. 24-11390 (TMH) (Bankr. D. Del. Oct. 11, 2024) (Horan, J.); *In re Lumio Holdings, Inc.*, Case No. 24-11916 (JKS) (Bankr. D. Del. Jan. 3, 2025), Dkt. No. 428 (Stickles, J.).

13. *In re Robertshaw US Holding Corp.*, 662 B.R. 300, 323 (Bankr. S.D. Tex. 2024); see also Order, *In re DocuData Sols., L.C.*, Case No. 25-90023 (CML) (Bankr. S.D. Tex. June 23, 2025), Dkt. No. 834 at 15–16.
14. *In re Pipeline Health Sys., LLC*, Case No. 22-90291 (MI), 2025 WL 686080, at *4 (Bankr. S.D. Tex. Mar. 3, 2025).
15. *In re Spirit Airlines, Inc.*, 688 B.R. 689, 707 (Bankr. SDNY 2025).
16. *GOL Linhas*, 672 B.R. at 171.
17. *In re Roman Cath. Diocese of Syracuse, N.Y.*, 667 B.R. 628, 632 (Bankr. NDNY 2024).
18. *Id.* at 634.
19. *GOL Linhas*, 672 B.R. at 160.
20. *Id.* at 164–65 (collecting cases).
21. *Id.* at 166.
22. *Id.* at 166–67.
23. *GOL Dist. Ct. Op.*, Dkt. No. 46 at 1.
24. *Id.* at 12.
25. *Id.* at 13.
26. *Id.* at 14.
27. While Judge Cote did not analyze whether the elements of a class under Fed. R. Civ. P. 23(a) were present, there was no argument by the parties that this was the case. *Cf. In re Roman Cath. Diocese of Syracuse, N.Y.*, 667 B.R. at 634.

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Key Contacts

Dale Davis Washington, DC	dale.davis@cooley.com +1 202 776 2257

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