IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
INSYS THERAPEUTICS, INC. *et al.*,	Case No. 19-11292 (KG)
Debtors.[1]	(Jointly Administered)
	Re: Docket No. 29
	Objection Deadline: June 25, 2019 at 4:00 p.m. (ET) **Hearing Date: July 2, 2019 at 9:00 a.m. (ET)**

OBJECTION OF THE MDL PLAINTIFFS TO MOTION OF DEBTORS FOR (I) ENTRY OF ORDERS PURSUANT TO 11 U.S.C. §§ 105(a) AND 502(c) (A) ESTABLISHING PROCEDURES AND SCHEDULE FOR ESTIMATION PROCEEDINGS AND (B) ESTIMATING DEBTORS' AGGREGATE LIABILITY FOR CERTAIN CATEGORIES OF CLAIMS, (II) ENTRY OF PROTECTIVE ORDER, AND (III) SUBORDINATION OF CERTAIN PENALTY CLAIMS

The court-appointed[2] claimants' leadership team in *In re: National Prescription Opiate Litigation*, Case No. 17-md-02804, MDL No. 2804 (N.D. Ohio) (the "Opioid MDL"), including the three Co-Lead Counsel, sixteen-member Plaintiffs' Executive Committee, and three Co-Liaison Counsel, for and on behalf of the thousands of plaintiffs and proposed classes in the Opioid MDL, including various individuals, hospitals, third-party payors, health departments, public welfare agencies, counties, municipalities (including cities, towns, villages, etc.), and Native American tribes, among others with litigation claims against the Debtors (collectively, the "MDL Plaintiffs"), by and through its counsel, respectfully submit this objection (the

[1] The above-captioned debtors in these cases (the "Debtors"), along with the last four digits of each Debtor's federal tax identification number, are: Insys Therapeutics, Inc. (7886), IC Operations, LLC (9659), Insys Development Company, Inc. (3020); Insys Manufacturing, LLC (0789); Insys Pharma, Inc. (9410); IPSC, LLC (6577); and IPT 355, LLC (0155). The Debtors' mailing address is 1333 South Spectrum Blvd. #100, Chandler, Arizona 85286.

[2] *See* Order Granting Plaintiffs' Renewed Motion to Approve Co-Leads, Co-Liaisons, and Executive Committee, *In re: National Prescription Opiate Litigation,* Case No. 17-md-02804, MDL No. 2804 (N.D. Ohio Jan. 4, 2018) [Dkt. No. 37], together with the Renewed Motion [Dkt. No. 34], annexed hereto as **Exhibit A**.

"Objection") to the *Motion of Debtors for (I) Entry of Orders Pursuant to §§ 105(a) and 502(c) (A) Establishing Procedures and Schedule for Estimation Proceedings and (B) Estimating Debtors' Aggregate Liability for Certain Categories of Claims, (II) Entry of Protective Order, and (III) Subordination of Certain Penalty Claims* [D.I. 29] (the "Motion").[3] In support of this Objection, the MDL Plaintiffs respectfully state as follows:

PRELIMINARY STATEMENT

1. The Motion was filed prematurely and asks this Court to consider and approve it on an expedited basis only 21 days into these cases. This Court should not do so, because the Motion is fatally flawed and should be denied.

2. Although the Debtors assert that their "only agenda" in these cases is "to set up a fair and transparent process to ensure the proportionate distribution of their limited assets among different creditor groups is equitable" the Motion ensures the opposite. It proposes a process that will limit the ability of similarly situated creditors to receive equitable distributions and offers no benefits whatsoever in proposing and confirming a plan. Worse, given likely future opioid participant-related Chapter 11 cases involving other debtor-defendants, the various creditor groups here will have to vigorously litigate, in the first stage of this proceeding, all issues that could be relevant to such other proceedings in a manner that will be entirely disproportionate to the limited assets of these Debtors.

3. Further, in addition to offering no practical benefits to the estates, the Motion is legally defective. The Debtors fail to offer any explanation as to how the Motion advances the administration of these cases or why it is necessary to avoid an "undue delay." Further, it seeks relief that this Court is expressly without statutory authority to grant, and this lack of authority as

[3] Capitalized terms utilized but not defined herein shall have the meanings ascribed to them in the Motion.

to part of the Motion renders the rest of the Motion pointless. Finally, it seeks to subordinate claims in a Chapter 11 proceeding based on law applicable only to a Chapter 7 proceeding.

4. The Motion is part of a flawed strategy for these cases. These cases are liquidation cases: the Debtors' only job is to sell their assets and create a low-cost method to liquidate the claims against the Debtors' estates and then to distribute those assets equally to all similarly-situated creditors. The Debtors appear to seek to inject an entirely pointless estimation process to set reserves for categories of claims – which can only have the effect of creating dissimilar recoveries for similarly-situated unsecured claims – and then resolve the individual claims within those categories later. This process offers no benefits whatsoever over the procedure the Debtors *should* follow that would allow a rapidly confirmed plan that avoids the needless litigation – and attendant expense – that the Debtors invite with this Motion.

5. To maximize recoveries for all stakeholders and to minimize needless litigation costs, the Debtors should liquidate their assets as contemplated by the proposed sale procedure, and then propose and confirm a plan that places the proceeds of that sale and all causes of action possessed by the Debtors into a liquidating trust. The liquidating trust, under the control of the actual parties in interest in these cases, would enable the creditors to agree on the best method to liquidate the myriad litigation claims against the Debtors arising from their wrongful and criminal conduct, and to litigate the claims that the Debtors may have against third parties for the benefit of the Debtors' creditors. Following this process, the liquidating trust can distribute its assets to the creditors of the estates *pro rata*. Such an approach (a) eliminates the needless and wasteful litigation that the Debtors seek to cause through this Motion; (b) allows a more rapid exit from Chapter 11, eliminating the attendant fee burn and administrative costs associated with

the Debtors, and (c) enables the actual parties in interest in these cases to negotiate a fair resolution of the issues arising in these cases in an economically rational, cost-effective manner.

FACTUAL BACKGROUND

6. The opioid epidemic is both a public health emergency and a national crisis. Millions of people have died from overdoses. Millions more are addicted and suffering from disorders relating to opioid use or other related medical issues. On the global scale, reports have estimated that resolving the opioid crises may cost hundreds of billions to trillions of dollars.

7. As a means to hold those responsible accountable, thousands of lawsuits have been filed across the country by states, cities and counties, Indian tribes, hospitals, union benefit funds, infants with neonatal abstinence syndrome, individual personal injury claimants, and countless others. The general allegations of these suits are that (i) manufacturers of prescription opioids overstated the benefits and hid the risks in using the drugs and used aggressive, deceptive marketing strategies directed to the public and through doctors paid to push opioids on patients and (ii) that distributors and retailers failed to monitor, investigate, report or halt suspicious orders of opioids.

8. Beginning in December, 2017 and continuing thereafter, over 1,900 cases have been consolidated in the multidistrict litigation (the "MDL") currently underway in the United States District Court for the Northern District of Ohio, before Judge Dan Polster (Case No. 17-2804). Estimation and allocation of claims has been one of the major topics at issue in the MDL and all major stakeholders have been pursuing a dual track of settlement and litigation. The majority of the litigation in the MDL has been effectively stayed through case management orders, except for two "tracks" of bellwether trials. The first trial in the MDL, of the Track One bellwether cases brought by Summit County and Cuyahoga County, Ohio, is scheduled to begin

on October 21, 2019 and is expected to last seven weeks. The parties litigating the MDL are actively engaged in fact and expert discovery, and they will soon be required to begin preparation for trial, including drafting direct and cross examinations, fact and expert witness preparation, and various other tasks.

9. While the Debtors' behavior has been reprehensible and criminal, the Debtors are a relatively small component of the overall opioid market and have relatively limited assets. The Debtors filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the District of Delaware on June 10, 2019 (the "Petition Date"), facing massive litigation risk, a plethora of investigations at all levels of government, and increased public scrutiny surrounding the opioid crisis. The Debtors are a specialty pharmaceutical company that develops and commercializes certain drugs and purportedly novel drug delivery systems for targeted therapies to improve patients' quality of life. The Debtors' business focuses on the research and development, manufacture, marketing, and sales in support of these drugs and drug delivery systems. However, in reality the Debtors were far from that of a simple specialty pharmaceutical company. Insys was a criminal enterprise that helped fuel the opioid crisis. Insys made thousands of payments to physicians nationwide, including in Ohio, ostensibly for activities including participating on speakers' bureaus, providing consulting services, assisting in post-marketing safety surveillance and other services, but in fact to deceptively promote and maximize the use of opioids, such as Insys' fentanyl product.

10. The various pending actions against, and other potential liability of, the Debtors related to Subsys, the Debtors' fentanyl product, can be categorized as follows: (1) U.S. Government investigations and U.S. and State Qui Tam litigation, (2) State Attorneys General investigations and litigation, (3) municipality (such as cities and counties) litigation, (4) private

insurance provider litigation, (5) personal injury litigation, (6) securities litigation, (7) Native American tribe litigation, and (8) indemnification claims of officers and directors.

11. Regarding the criminal investigation, Insys' founder was arrested and charged, along with other company executives, with multiple felonies in connection with an alleged conspiracy to bribe doctors to prescribe Subsys and defraud insurance companies. Other Insys executives and managers were previously indicted. In May 2019, Insys' founder and four other top executives were found guilty of racketeering conspiracy charges in a scheme involving bribes and kickbacks to physicians who prescribed large amounts of opioids to patients who didn't need the painkiller. This was the first-ever conviction of a drug company CEO in the federal government's fight to combat the opioid crisis.[4]

12. Also found guilty were: Richard M. Simon, the company's former national director of sales; Sunrise Lee and Joseph A. Rowan, both onetime regional sales directors; and former Vice President of Managed Markets, Michael J. Gurry.

13. The Debtors main product, Subsys, is an opioid pain medication prescribed for the management of breakthrough pain in cancer patients 18 years of age and older who are already receiving and who are tolerant to opioid medication for their underlying persistent cancer pain. This drug contains fentanyl and has been one of the drugs linked to the opioid crisis. According to the Debtors, 90% of its current revenue comes from the sale of opioids, but at their peak they accounted for only 0.03% of the national opioid market. Motion ¶ 19.

[4] *See, e.g., Insys CEO and execs convicted in opioid case*, PHARMA MANUFACTURING, May 3, 2019 ("This verdict marks the first-ever conviction of a drug company CEO in the government's fight to combat the opioid crisis"), https://www.pharmamanufacturing.com/industrynews/2019/insys-ceo-and-execs-convicted-in-opioid-case/ (last accessed June 24, 2019).

14. The Debtors have proposed bidding procedures that, if approved, would sell substantially all of their pharmaceutical assets in an auction scheduled for August 2, 2019 approved at a sale hearing on August 19, 2019. *See* Bidding Procedures Motion[5] ¶ 22.

OBJECTION

15. The Motion fails to explain the precise relief it seeks – specifically, for what purposes estimation is sought and how the Debtors intend to use the estimates that they seek from this Court in a potential plan of reorganization (which will, in fact, be a plan of liquidation). On that basis alone it should be denied: the Debtors should not be permitted to seek to invoke estimation – which necessarily abrogates the due process rights of claimants to the extent it is not merely for voting purposes – without making clear the extent to which those due process rights are abrogated and for what purpose.

16. For the purposes of this Objection, the MDL Plaintiffs have assumed that the Debtors seek to use "claims category" estimation (of State AG Claims; Municipality Claims; Personal Injury Claims; and Private Insurer Claims, as defined in the Motion) to establish the maximum allowable amount of all claims in each category, for the purposes of setting reserves in a forthcoming plan of reorganization that would limit each claim in a particular Claim Category to a *pro rata* share of the reserve for that Claim Category. Liquidation of each claim in each Claim Category would, apparently, be done after the effective date of such a plan. However, *nothing* in the Motion suggests these Claim Categories are composed of fundamentally different types of claims against the Debtors. To the extent that the Debtors adopt a different posture at

[5] Motion of Debtors for Entry of Orders (I)(A) Approving Bidding Procedures for Sale of Debtors Assets, (B) Scheduling Auction for and Hearing to Approve Sale of Debtors Assets, (C) Approving Form and Manner of Notice of Sale, Auction, and Sale Hearing, (D) Approving Assumption and Assignment Procedures, and (E) Granting Related Relief; and (II)(A) Approving Sale of Debtors Assets Free and Clear of Liens, Claims, Interests, and Encumbrances, (B) Authorizing Assumption and Assignment of Executory Contracts and Unexpired Leases, and (C) Granting Related Relief (D.I. No. 32).

the hearing on the Motion (the "Hearing"), the MDL Plaintiffs reserve all rights to raise any objections (including timeliness) necessary to respond to such statements at the Hearing.

A. The Debtors' Estimation Procedures Should be Abandoned or Substantially Revised.

17. Estimation for distribution purposes is required under the bankruptcy code to fix or liquidate "contingent or unliquidated" claims that would cause "undue delay [to] the administration of the case" if they were liquidated. 11 U.S.C. § 502(c). The party moving for estimation bears the burden of proving that "undue delay" exists. *See In re RNI Wind Down Corp.*, 369 B.R. 174, 191 (Bankr. D. Del. 2007).

18. Where undue delay would not be resolved by estimation, estimation (other than for voting purposes) is improper. *See In re Stone & Webster, Inc.,* 279 B.R. 748, 809 (Bankr. D. Del. 2002); *see also In re Dow Corning Corp.*, 211 B.R. 545, 562-3 (Bankr. E.D. Mich. 1997); *In re G-I Holdings, Inc.*, 323 B.R. 583, 599 (Bankr. D.N.J. 2005).

19. Alternatively, a court can estimate claims for the sole purpose of voting on a plan of reorganization. *See Fed. R. Bankr. P.* 3018(a); *see also Matter of Johns-Manville Corp.*, 68 B.R. 618, 631 (Bankr. S.D.N.Y. 1986) (noting broad discretion of bankruptcy court to temporarily allow a claim, and allowing disputed asbestos claims at $1 for voting purposes).

20. Here, although the Debtors could seek to estimate claims for voting purposes only, they have chosen to seek estimation (though again, only of categories of claims) under 502(c) for purposes of "plan allocation and setting claim distribution reserves" which will necessarily impact the potential recoveries of the creditors in classes so estimated. *See* Motion ¶ 7. The Debtors do not indicate what the structure of their proposed plan that would incorporate these estimates is, why this plan requires the category estimates called for under the Motion, or at what point the Debtors believe they would file a plan.

i. The Estimation Sought In the Motion Is Legally Inappropriate In These Proceedings

21. The Motion should be denied because the Debtors have failed to show (and cannot show) that failure to estimate the categories of claims for distribution purposes as sought in the estimation motion would "unduly delay" the administration of these cases. *See* 11. U.S.C. § 502(c) (estimation required for "any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case[.]")

22. Here, the Debtors offer no delay that would be reduced by estimation, let alone "undue" delay. The Debtors have no proposed plan (and do not describe one in the Motion) that would be advanced by estimation. Indeed, the Motion proposes a months-long foreseeably contentious and indisputably expensive process, with extensive discovery and a likely battle of experts, that will produce only estimated claim amounts *by category*, which offers no apparent advantages to getting a plan confirmed (and, by creating the near-certainty of non *pro rata* distributions between classes of creditors without any basis for such discrimination, creates new impediments to confirmation of a plan). Further, this plan will cost substantial amounts of money in professional fees on all sides, including that of the Debtors (further depleting the estates). The Debtors could (and should) propose a simple liquidating plan tomorrow, transferring all their assets to a liquidating trust which would reserve the liquidation of claims for a later date, but instead have chosen to file the Motion which inhibits proposing and confirming a plan for months (and requires extensive, costly litigation prior to such a plan – and, further, spends considerable amounts of money before it is determined there are substantial assets left to distribute). That the liquidation of claims might delay distributions to other, liquidated, claims is not a valid basis for estimation, because both types of claims enjoy equal standing as to the Debtors' assets and are entitled to share *pro rata*. *See In re Dow Corning Corp.*, 211 B.R. 545,

563 (Bankr. E.D. Mich. 1997) (estimation not proper to speed distributions to certain creditors due to need to make *pro rata* distributions); *see also id. at* 567 (noting that there was "almost no likelihood" any estimate of the value of litigation claims would prove accurate).

23. Further, the Debtors will be unable to show any "undue" delay because the Debtors are liquidating: there is no damage to the Debtors' business operations that must be considered, and a plan can be confirmed without the requested estimation. *See In re Statewide Realty Co.*, 159 B.R. 719, 725 (Bankr. D.N.J. 1993) (there is no undue delay where confirmation is not dependent on resolution of the claim). Accordingly there are no grounds to abridge the due process rights of litigants – and litigants amount to the overwhelming majority of creditors in these cases – because liquidating these claims would not potentially impact ongoing operations of a reorganized debtor, as none will exist. *See* Motion ¶ 1.

24. Additionally, the Debtors have made no showing that this expansive form of claims estimation requested in the Motion is needed rather than more limited forms, such as estimation for voting purposes only, or estimation as to the total amount of all litigating claims (rather than broken down by class), which is grounds for denying the requested relief. *See In re N. Am. Health Care, Inc.*, 544 B.R. 684, 689 (Bankr. C.D. Cal. 2016) ("if the goal of avoiding undue delay can be achieved through a limited mode or form of claim estimation, a bankruptcy court ought not to expand the estimation's scope beyond this limited extent absent compelling reasons to do so").

25. Finally, this Court may not estimate the Personal Injury Claims because the estimation or liquidation of such claims is outside the statutory authority of the Bankruptcy

Court.[6] *See* 28 U.S.C. § 157(b)(2)(B) (bankruptcy court may not estimate or liquidate personal injury or wrongful death claims); § 157(b)(2)(O) (personal injury and wrongful death claims carved out of the "other proceedings" component of the Bankruptcy Court's jurisdiction). Instead, such cases *must* be tried in a district court – either that in which the claim arose, or the district court in which these bankruptcy cases are proceeding). 28 U.S.C. § 157(b)(5). Where an estimation is claimed to be only for plan purposes but would have the actual impact of affecting distributions, it is considered to be an estimation for distribution purposes subject to the limitations of Section 157. *See In re Roman Catholic Archbishop of Portland in Or.*, 339 B.R. 215, 220-21 (Bankr. D. Or. 2006) (rejecting estimation for purposes of setting reserves for personal injury claims as disguised estimation of the claims for distribution purposes).

26. Because this Court may not estimate the Personal Injury Claims, there is no rational basis to estimate any of the other Claim Categories. Estimating some of the Claim Categories, but not the Personal Injury Claims, means that the Debtors' apparent plan – to establish reserves for each type of Claim Category in a plan, and liquidate the claims in each Claim Category at a later date – cannot be accomplished. Any attempt to establish such reserves would require Personal Injury Claims to be reserved at based on their full asserted value, while every other claim category was limited to an estimated value, providing reserves for Personal Injury Claims well in excess of those reserved for any other claim (and, implicitly, that such

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[6] Certain courts recognize a right of a Bankruptcy Court to disallow a personal injury claim based on dispositive legal defenses, such as the statute of limitations. *See In re U.S. Lines, Inc.*, 262 B.R. 223, 234 (S.D.N.Y. 2001), aff'd, 318 F.3d 432 (2d Cir. 2003) (upholding decision to dismiss personal injury claims based on statute of limitations grounds). The Motion, however, does not appear to seek disallowance of the Personal Injury Claims – merely the estimation of the total allowable amount of all claims, which does not fall under this exception. While the Third Circuit permits litigants to create this jurisdiction by consent through filing a claim, responding to an objection, and seeking a favorable ruling, at this stage of these bankruptcy proceedings the Debtors can hardly claim such jurisdiction has been created. *See In re Tribune Media Co*., 902 F.3d 384, 393-95 (3d Cir. 2018) (*pro se* claimant consented to jurisdiction of his personal injury claims by filing a proof of claim, filing a response to an objection, filing a supplemental response, and appearing at a hearing, all without objection to court's jurisdiction).

claims will receive significantly greater *pro rata* distributions than any other litigation claim). An attempt to do so would violate the unfair discrimination test for confirming a plan for any rejecting class (as all other claims would be limited to much lower distributions on account of like claims), and likely violate the "best interests" for any dissenting members of an accepting class. *See* 11 U.S.C. 1129(b)(1) (unfair discrimination test); 1129(a)(7)(A)(ii) (best interests test).

ii. The Estimation Sought in the Motion Would Be Detrimental to the Estates

27. The Debtors, though partly responsible for, and a reprehensible actor in the national opioid crisis who has been accused, and its founder found guilty of, serious criminal charges, are but one of many actors that are responsible for the crisis. In fact, though its criminal conduct was outrageous, the Debtors are a smaller entity when it comes to their prescription numbers and total assets. According to the Debtors, at their peak involvement in the prescription opioid market in 2015, they accounted for only 0.03% of nationwide opioid prescriptions. Motion ¶ 19. On the global scale, reports have estimated that fixing the opioid crises will cost tens to hundreds of billions of dollars.[7]

28. The Debtors expressed three clear objectives they wanted to accomplish in these bankruptcy cases: (i) maximizing the value of their enterprise through exploring sales of their assets and pursuing affirmative causes of action (which can and should be realized for the benefit of the estates through a liquidating trust, rather than by the Debtors themselves); (ii) preserving funds by seeking a stay of burdensome and asset consuming litigation; and (iii) further preserving funds by limiting their time in chapter 11 through estimation of categories of claims

[7] *See*, Alison Frankel, *Government Officials Put Opioid Defendants in a Squeeze Over Confidentiality* March 14, 2019, https://www.reuters.com/article/legal-us-otc-opioids/government-officials-put-opioid-defendants-in-a-squeeze-over-confidentiality-idUSKCN1QV2PF; *see also* Brian Mann, *Opioid-Makers Face Wave of Lawsuits in 2019*, NPR (December 31, 2008, 7:00 AM), https://www.npr.org/2018/12/31/680741170/opioid-makers-face-wave-of-lawsuits-in-2019.

to facilitate confirmation of a plan. The estimation procedure as currently contemplated in the Motion stands in direct contradiction to objectives (ii) and (iii) described above. The procedures will guarantee: (ii) expensive and value destructive litigation that is burdensome and asset consuming and (iii) extending the time in which the Debtors stay in Chapter 11.

29. Though interrelated with the national opioid crises and having committed reprehensible and criminal acts, Insys is a relatively small bankruptcy proceeding that will likely produce a relatively small pool of funds to distribute to creditors after the Debtors complete their sales process. As a result, it makes no economic sense to divert these bankruptcy proceedings straight to costly litigation: there are abundant existing procedures and cases where the various parties will litigate issues relevant to these cases (such as the "Phase 1" MDL trials) and duplicating that existing, expensive litigation is unnecessary.[8] Further, no attempt at consensual allocation discussions between the various creditor groups has been made by the Debtors, and such discussions would be likely to produce a fruitful result at *far less cost* to the estates than the estimation procedure proposed by the Motion.

30. These cases cry out for a reasonable settlement between the various constituencies that (1) enhances, realizes, and preserves the assets of the estates, (2) results in the timely exit of the Debtors from these Chapter 11 cases by way of the creation of a post-confirmation vehicle that will receive and then fairly and equitably distribute those assets and (3) that allows the

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[8] Contemporaneously with the filing of this Objection, there was a hearing in the Opioid MDL on a motion seeking certification of a proposed class of "all United States Cities and Counties" for negotiation purposes. *See* Plaintiffs' Notice of Motion and Motion for Certification of Rule 23(b)(3) Cities/Counties Negotiation Class, *In re: National Prescription Opiate* Litigation, No. 17-md-02804-DAP, Docket No. 1683 (setting hearing for June 25, 2019 at noon). At the hearing, counsel to the Plaintiffs requested additional time to resolve certain objections to the negotiation class that they believed could be resolved through additional negotiation and revisions to the motion. The Plaintiffs proposed that they file an amended motion on July 9, objections be filed by July 23, and a hearing on that amended motion occur on August 6. This request was approved without objection by the Court. This potential negotiation class (if approved) may provide another vehicle to facilitate the resolution of a number of the issues sought to be estimated (at considerable cost) in the Motion through a negotiated process in a consensual manner.

affected stakeholders themselves, rather than the liquidating Debtors (whose interest in the estates' assets has effectively passed to their creditors) the ability to arrive at an allocation on their terms rather than to be forced into an unnecessary, premature, expensive and fiercely litigated estimation process.

31. If the Motion, with its fast track process, is granted, however, settlement will rapidly become impossible. The allocation of value between the various Claim Categories may be viewed as relevant to any future bankruptcies or related settlement discussions. Accordingly, to protect their claims against the other 99.97% of the opioid market, each Claim Category in all likelihood will vigorously litigate the estimation procedure called for under the Motion to the fullest extent, *including* appealing any adverse decision – even if such litigation or such appeal will necessarily cost more than the party could hope to recover in this proceeding. *See Beatrice Co. v. Rusty Jones, Inc.*, 153 B.R. 535, 538 (N.D. Ill. 1993) (recognizing, though not deciding, that estimation of claims may raise collateral estoppel issues).

32. Further, the Debtors have inexplicably sought to make settlement even more difficult if the Motion is granted, by virtually eliminating the possibility of settlement prior to the estimation contemplated under the Motion. The Debtors – who, it should not be forgotten, are wrongdoers with criminally convicted officers and directors who fueled the opioid crisis giving rise to the claims they now seek to estimate – propose to submit their own proposed estimates *five days* after the entry of an order granting the Motion. Motion ¶ 33. The Debtors offer no rationale for injecting themselves in this process in this way, and it is profoundly destructive (and unnecessary). Once such a report is submitted, a party advantaged by that report has every incentive to ensure it is incorporated into an order of this Court, and a party disadvantaged by that report will litigate to ensure it is not; and settlement becomes nearly impossible. Worse,

because the Debtors – who again, are the wrongdoers here – propose to submit this report without the benefit of any party in interest's opportunity to present evidence or argument, the Debtors essentially propose to declare the baseline by fiat without any input from the actual parties in interest.

33. As a result, the Motion offers no practical benefits and imposes significant (and, if the Debtors' report is filed, nearly insurmountable) hurdles to settlement of these cases. Like the case of *In re Dow Corning*, estimation here – as it is not needed to confirm a plan – would simply be "a colossal waste of time and money." *In re Dow Corning*, 211 B.R. at 567.

B. <u>The Debtors' Requested Relief As To Subordination Should Be Denied</u>.

34. By the Motion, the Debtors also ask this Court to "subordinate all claims seeking penalties, consistent with existing precedent, thus maximizing creditors' recoveries for actual and compensatory damages." Motion at ¶ 39. This Court should deny the Debtors' request as inconsistent with the Bankruptcy Code.

i. There Is No Legal Basis For Subordination

35. The Debtors' proposed subordination of litigation claims (though the Motion does not specify exactly what the Debtors propose to subordinate) has no basis in the Bankruptcy Code, and runs directly counter to the priority scheme established by Congress in Section 507.

36. The Debtors rest their argument on Section 726 of the Bankruptcy Code, which provides the priority structure for distribution of property of an estate *under Chapter 7 of the Bankruptcy Code*. It simply does not apply to property of estates that are subject instead to Chapter 11, as is the case here. *See, e.g., In re Hyatt*, 509 B.R. 707,721 (Bankr. D.N.M. 2014) (holding that punitive damages claims may not be categorically subordinated under a Chapter 11 plan because "[i]n Chapter 7, but not in Chapter 11, punitive damages claims are subordinated by

statute. To allow a plan proponent to subordinate punitive damages claims categorically to other unsecured claims would . . . contravene the priority scheme set forth in 11 U.S.C. § 507(a).”); *In re Quigley Co.*, 437 B.R. 102, 144 (Bankr. S.D.N.Y. 2010) (citing *United States v. Reorganized C F & I Fabricators of Utah, Inc.*, 518 U.S. 213, 228-29 (1996)) (“Penalty claims are statutorily subordinated to unsecured claims in chapter 7 . . . but there is no comparable subordination of penalty claims under chapter 11.”); *In re Sheldon Transfer & Storage Co.*, No. 89-40514-JFQ, 1992 WL 415377, at *1 (Bankr. D. Mass. Sept. 15, 1992) (“While the Code explicitly provides for the automatic subordination of penalty claims in a chapter 7, there is no such provision applicable to chapter 11 proceedings. . . . The absence of such provision suggests to me that Congress intended to afford different treatment to penalty claims in a chapter 11.”); *see also In re Manhattan Jeep Chrysler Dodge, Inc.*, No. 18-10657, 2019 WL 2158773, at *5 (Bankr. S.D.N.Y. May 15, 2019) (citing *In re Tribune Co.*, 506 B.R. 613, 617 (Bankr. D. Del. 2013)) (rejecting subordination argument based on Section 726 “because section 726 does not apply in a chapter 11 case”); *In re Tribune Co.*, 506 B.R. 613, 617 (Bankr. D. Del. 2013) (finding that Section 726(a) did not apply in a Chapter 11 case so as to allow a late-filed claim); *In re Xpedior Inc.*, 354 B.R. 210 (Bankr. N.D. Ill. 2006) (holding that claims disallowed in a Chapter 11 case should not instead receive subordinated status pursuant to Section 726 because “Section 726 should only be applied to cases under Chapter 7.”).

37. The Debtors contend that the Chapter 7 subordination scheme is nonetheless categorically applicable to Chapter 11 cases pursuant to Section 1129(a)(7), which establishes that, in order for a plan to be confirmed, each holder of a claim or interest in an impaired class must either (i) accept the plan or (ii) receive an amount equal to or greater than the amount such holder would receive in a case under Chapter 7 (known as the “best interests test”).

38. For this proposition, the Debtors rely on dicta in *Owens Corning v. Credit Suisse First Boston*, 322 B.R. 719, 723-24 (D. Del. 2005). In that case, the court was asked to estimate the value of certain claims as of the petition date, including certain pre-petition verdicts and settlements in connection with litigation by certain asbestos claimants. In the process of estimating that value as of the petition date, the court considered that seven different factors may have "skewed" past litigation results, one of which was that "[t]he dollar amounts of verdicts and settlements pre-bankruptcy included, or may have been impacted by, punitive damages or the threat of such damages." 322 B.R. at 723. That court *was not asked* to subordinate penalty claims, as the Debtors now ask this Court to do, and that court *did not hold* that claims based on punitive damages awards must be so subordinated under Section 726, Section 1129, or any other section of the Bankruptcy Code.

39. Courts that *have* been asked to subordinate penalty claims in a Chapter 11 case based on the purported application of Section 726(a)(4) through the best interests test *have declined to do so*, on the basis that whether the best interests test ever comes to be relevant in a particular case depends upon, among other things, the classification of claims, the degree of acceptance of a plan by creditors, and the value distributed under such plan. *See In re Morande Enters., Inc.*, No. 2:07-cv-498-FtM-29, 2008 WL 4459143, at *5 (M.D. Fla. Sept. 30, 2008) (holding that punitive damages claims could not be subordinated under the best interests test because "[h]ere, each voting holder of an impaired claim approved the plan, and therefore resort to the [best interests test] was not necessary."); *In re Hyatt*, 509 B.R. at 721 (citing the *Owens Corning* court's dicta with respect to the application of Section 726(a)(4) through the best interests test, "[t]he Court rejects the rationale that punitive damages claims may be categorically subordinated under a Chapter 11 plan through separate classification and treatment of claims . . .

.”); *see also In re Adelphia Commc’ns Corp.*, 327 B.R. 143, 170 (Bankr. S.D.N.Y. 2005) (noting that the relevance of Section 726(a)(4) in a Chapter 11 case “would turn on a host of other factors incapable of prediction at this time – most notably the degree of acceptances of a reorganized plan by creditors, and the value to be distributed under any chapter 11 plan.”).

40. In asking this Court to subordinate certain claims under the best interests test, the Debtors are proposing that the Court permanently subordinate claims, based on the potential needs of a hypothetical plan that has not even been described. Subordination of litigation claims based on this purported interplay of Sections 726(a)(4) and 1129(a)(7) is improper because, should a hypothetical plan come to pass where the best interests test was not met, the failure to satisfy Section 1129(a)(7) would result only in the inability to confirm the plan, not in subordination of the MDL Litigants’ claims. *See In re Adelphia Commc’ns Corp.*, 327 B.R. at 170. Subordinating these claims at this point, therefore, would require reaching far beyond the boundaries of the best interests test.

41. Indeed, if the Debtors were correct about the application of the best interests test through Section 726(a), there would effectively be a categorical subordination of penalty claims in *every* Chapter 11 case. Not only is this proposition without any explicit support in the Bankruptcy Code, and in contravention of the priority scheme set forth in Section 507(a), but also runs afoul of Supreme Court precedent on the issue. *See United States v. Reorganized C F & I Fabricators of Utah, Inc.*, 518 U.S. 213, 229 (1996) (“[C]ategorical subordination at the same level of generality assumed by Congress in establishing relative priorities among creditors [is] tantamount to a legislative act . . . .”); *United States v. Noland*, 517 U.S. 535, 541 (1996) (overturning a Court of Appeals decision that “‘postpetition, nonpecuniary loss tax penalty claims’ are ‘susceptible to subordination’ by their very ‘nature’” and holding that such decision

"runs directly counter to Congress's policy judgment"). In drafting two separate priority schemes for Chapter 7 and Chapter 11 cases, Congress has determined that different treatment of similar claims may be appropriate in cases under different chapters of the Bankruptcy Code. In particular, penalty claims are subordinated in Chapter 7 cases, and not in Chapter 11 cases. See 11 U.S.C. §§ 507, 726. The Debtors' proposed backdoor into categorical subordination for penalty claims in Chapter 11 cases is directly in line with the rulings the Supreme Court has overturned. Therefore, the MDL Plaintiffs submit that the Debtors' request for subordination of litigation claims should be denied.

ii. Subordination is Unnecessary for Confirmation of a Plan

42. Even if the Court agreed that penalty claims could be subordinated, such subordination need not, and should not, be determined at this stage in these cases. Any litigation that occurs prior to plan confirmation, whether in the context of an estimation proceeding or otherwise, depletes the Debtors' estates and comes directly at the expense of creditor recoveries. Such litigation is likely to far surpass what would otherwise be appropriate for estates of this size, as these cases will almost certainly serve as a bellwether for the slew of other opioid-related bankruptcy cases to come.

43. The MDL Plaintiffs submit that this expense can be minimized or avoided by delaying any such litigation until after confirmation (which, as described above, could be consensual if the Debtors' value-destructive scheme is curtailed). Should litigation over subordination, or allowance, or any other issue with respect to claims, eventually become necessary in these cases, such litigation could be carried out at a far lesser expense to creditors by a liquidating trust, once the factual background of the opioid cases has been more developed nationally.

44. Further, to the extent it is necessary to bifurcate claims into purported "penalty" components and admitted non-penalty components to confirm a plan under the "best interests" test, such bifurcation can (and must) be done by the plan itself. At that point – if the classification scheme is challenged as improper – the Court will consider and rule upon if the "best interests" test, in these cases, effectively incorporates the subordination provisions of 11 U.S.C. § 726 (and, to the extent necessary, which particular classes of damages would be subordinated – or leave that issue to the stage at which point each claim is liquidated).

45. Therefore, there is no need to waste the Debtors' resources and this Court's time with an estimation process on subordination at this juncture, even if such subordination could be granted (which, as described above, it cannot), and therefore the Debtors' request should be denied.

CONCLUSION

WHEREFORE, for the foregoing reasons, the MDL Plaintiffs respectfully request that the Court: (i) sustain this Objection; (ii) deny the Motion; and (iii) grant the MDL Plaintiffs such other and further relief as is just and proper.

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