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Code to Code

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At the Intersection of ERISA and the Bankruptcy Code: Withdrawal-Liability Disputes in Ch. 11 Cases

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Reconciling clashing statutory imperatives is familiar territory for bankruptcy practitioners. Name an area of the law that may conflict with the Bankruptcy Code, and chances are you will find a raft of cases trying to resolve the dispute. Reconciling the Federal Arbitration Act with the Bankruptcy Code in dispute with a debtor over a contract with an arbitration clause? There is a case for that.[1] Foreign privacy law precluding discovery of materials that are ordinarily discoverable in the U.S.? There is a case for that, too.[2] Federal securities laws, state police powers,[3] the list goes on.

Until the recent bankruptcy filing of *Yellow Corp.*,[4] conflicts between the Employee Retirement Income Security Act of 1974 (ERISA) and federal bankruptcy law received far less prominence. However, such conflicts do come up, particularly where a debtor/employer's withdrawal from a multiemployer pension plan causes a withdrawal-liability dispute, which is often complicated by the need to balance competing objectives of ERISA and the Bankruptcy Code. With *Yellow* casting a spotlight on treatment of withdrawal liability, this article analyzes two ERISA/Bankruptcy Code issues that few courts have addressed: (1) When does a withdrawal-liability claim arise; and (2) what happens if withdrawal liability is prorated between pre- and post-petition periods?

Brief Overview of Withdrawal Liability

Congress enacted ERISA "to protect interstate commerce and the interests of participants [and their beneficiaries] in employee-benefit plans."[5] Under ERISA, a multiemployer pension plan (MEPP) is defined as a retirement plan "maintained pursuant to one or more collective-bargaining agreements" where "more than one employer is required to contribute."[6] Pursuant to ERISA, Congress also created the Pension Benefit Guaranty Corp. (PBGC), a nonprofit federal corporation under the Department of Labor that provides termination insurance to MEPPs.[7]

Shortly after ERISA became law, "Congress became concerned that a significant number of MEPPs were experiencing extreme financial hardship" and directed the PBGC to prepare a report analyzing the problem and recommending a solution.[8] The PBGC's report found that ERISA did not adequately protect MEPPs from the adverse consequences of employer withdrawals[9] and recommended new

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1 *See, e.g., In re Anderson*, 884 F.3d 382 (2d Cir. 2018) (denying motion to compel arbitration).

2 *See, e.g., In re Glob. Power Equip. Grp. Inc.*, 418 B.R. 833 (Bankr. D. Del. 2009) (applying federal rules, rather than Hague Evidence Convention, to discovery).

3 *See, e.g., In re Bernard L. Madoff Inv. Sec. LLC*, 12 F.4th 171 (2d Cir. 2021) (using definition of "good faith" under Bankruptcy Code and not federal securities law); *In re Berry Ests. Inc.*, 812 F.2d 67 (2d Cir. 1987) (noting that police-power statutes cannot be abrogated by bankruptcy laws).

4 In *In re Yellow Corp.*, No. 23-11069 (CTG) (Bankr. D. Del.), certain MEPPs filed proofs of claim asserting more than $7 billion in withdrawal liability and other claims against the debtors. Despite receiving $41 billion from the PBGC under the American Rescue Plan Act of 2021 that covers the debtors' withdrawal liability, the MEPPs argue that pursuant to a PBGC regulation, the funds received cannot be counted toward reducing the debtors' withdrawal liability. The debtors objected to the claims, primarily arguing that the regulation exceeds the PBGC's statutory authority and is arbitrary and capricious, because it changes the MPPAA's withdrawal-liability calculation. Cross-motions for summary judgment on this issue were filed by the debtors, the MEPPs and the PBGC and are pending before the bankruptcy court. If the court invalidates the regulation, most of the MEPPs' claims would be disallowed, thus allowing for full recovery to unsecured creditors and a potential recovery for shareholders.

5 29 U.S.C. § 1001(b).

6 29 U.S.C. § 1002(37)(A).

7 29 U.S.C. § 1302(a), (b).

8 *Pension Ben. Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 721 (1984).

9 *See id.* at 721 (noting that original text of ERISA did not require employers withdrawing from MEPPs to pay any amounts for unfunded benefits unless employer contributed within five years of MEPP's termination and that PBGC exercised its discretion to pay benefits on MEPP's termination).

rules imposing withdrawal liability for employers that withdraw from MEPPs.[10]

In response, Congress enacted the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA).[11] As its legislative history reveals, "[t]he primary purpose ... is to protect retirees and workers who are participants in such [multiemployer] plans against the loss of their pensions."[12] In furtherance of this purpose, the MPPAA requires employers withdrawing from MEPPs to pay their proportionate share of any "unfunded vested benefits,"[13] thus functionally creating a fixed "exit fee" chargeable to employers that cease making contributions under MEPPs.[14] This exit fee is referred to as "withdrawal liability."[15]

Withdrawal Liability Issues in Chapter 11 Cases

ERISA and the Bankruptcy Code are premised on competing objectives. ERISA's objectives, as amended by the MPPAA, are to safeguard MEPPs and prevent an employer's withdrawals from negatively impacting MEPPs and its employee beneficiaries. In contrast, the two primary objectives of the Bankruptcy Code are "to grant a fresh start to the honest but unfortunate debtor"[16] and ensure "equality of distribution among [similarly situated] creditors of the debtor."[17] The Code advances these goals in a number of ways, including through the automatic stay, by discharging pre-petition liabilities, and by requiring that creditors with equal priority receive their *pro rata* share of distributions.[18]

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As a result of these competing objectives, conflicts often surface at the intersection of ERISA and the Bankruptcy Code, including in the context of withdrawal-liability disputes when bankruptcy courts are tasked with determining whether such a claim is entitled to administrative-expense priority, the highest priority under the Code's claim priority scheme.

When Does a Claim for Withdrawal Liability Arise?

When a debtor/employer withdraws from a MEPP post-petition, the logical question that follows relates to the treatment of withdrawal liability: Is it a general unsecured pre-petition claim (which is dischargeable), or an administrative-expense claim (which must be satisfied in full to confirm a plan)? Neither the Bankruptcy Code nor ERISA directly answers the question, leading to wide disagreement among courts.

Courts have generally held that because the Bankruptcy Code broadly defines a "claim" to include contingent claims, a claim for withdrawal liability arises from the accumulation of unfunded benefits over a period of time and is only contingent on a debtor/employer's withdrawal from a MEPP.[19] In *Trustees of Amalgamated Ins. Fund v. McFarlin's Inc.*, the Second Circuit found that withdrawal liability arises from the accrual of unfunded vested benefits that "accumulates over a period of years prior to the departure of the withdrawing employer."[20]

In *McFarlin*, the debtor/employer withdrew from the MEPP shortly after filing for chapter 11 in 1982. The Second Circuit explained that the MPPAA provided that for employers withdrawing from MEPPs after Sept. 25, 1980, the withdrawal liability would be attributable to the five years preceding the employer's withdrawal (in this case, 1975-81).[21] Accordingly, the Second Circuit held that the withdrawal-liability claim was not entitled to administrative-expense priority because the liability that accrued "was attributable to the period pre-dating the filing of the Chapter 11 petition."[22] Despite this holding, the court left open the possibility that withdrawal-liability claims may arise post-petition when the accrual of unfunded vested benefits can be attributed to a post-petition period.[23]

Other courts have held that a claim for withdrawal liability does not exist until a debtor/employer withdraws from a MEPP and, therefore, only arises upon actual withdrawal.[24] For example, in *CPT Holdings Inc. v. Indus. & Allied Emps. Union*

10 *Id.* at 722, 723.

11 *See generally* 29 U.S.C. § 1381-1461; *see also* H.R. Rep. No. 96-869(1), at 60 (1980), *reprinted in* 1980 U.S.C.C.A.N. 2918, 2928 (House Report regarding adoption of MPPAA noted that "[t]he current rules for employer liability upon the withdrawal of the employer are inequitable and dysfunctional because: (1) employers who withdraw from [a MEPP] early are rewarded, while employers who remain with [a MEPP] are penalized, and (2) there is no provision for compensation to [a MEPP] for a withdrawal").

12 H.R. Rep. 96869(I)a, *reprinted in* 1980 U.S.C.C.A.N. 2918, 291.

13 *See generally* 29 U.S.C. § 1381.

14 Lee T. Polk, J.D., 3 *ERISA Practice and Litigation* § 12:7 (2021) (characterizing withdrawal liability under MPPAA as "exit fee" that "arises from either a partial or complete withdrawal from [a MEPP]").

15 29 U.S.C. §§ 1381, 1391, 1399. There are circumstances where an employer's exit can trigger a "mass withdrawal" in which withdrawal-liability payments can be made in perpetuity. 29 U.S.C. § 1399(c)(1)(D). Mass withdrawal occurs when all, or substantially all, contributing employers withdraw from a MEPP. 29 C.F.R. § 4001.2.

16 *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007) (citations and internal quotation marks omitted).

17 *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991).

18 11 U.S.C. §§ 362, 727(b), 1123(a)(4); *see also Begier v. IRS*, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal priority should receive pro rata shares of the debtor's property.").

19 *See generally Trs. of Amalgamated Ins. Fund v. McFarlin's Inc.*, 789 F.2d 98 (2d Cir. 1986); *In re Bayly Corp.*, 163 F.3d 1205, 1209 (10th Cir.1998) (holding that withdrawal liability based on "pre-petition labor ... is a pre-petition contingent liability under bankruptcy law"); *In re U.S. Pipe & Foundry Co.*, 32 F.4th 1324, 1334 (11th Cir. 2022) (declining to follow *CPT Holdings* and holding that because claims include contingent claims, debtor's obligations were discharged); *In re CD Realty Partners*, 205 B.R. 651, 656, 657 (Bankr. D. Mass. 1997) (holding that withdrawal liability constituted contingent claim).

20 *McFarlin*, 789 F.2d at 103.

21 *Id.*

22 *Id.* at 103-04.

23 *See In re Marcal Paper Mills Inc.*, 650 F.3d 311, 319-20 (3d Cir. 2011) (noting that Second Circuit's "analysis [in *McFarlin*] clearly supports" that withdrawal liability can be prorated between pre- and post-petition periods).

24 *CPT Holdings Inc. v. Industrial & Allied Emps. Union Pension Plan, Local 73*, 162 F.3d 405, 409 (6th Cir. 1998) (citing *Matter of United Merchs. and Mfrs. Inc.*, 166 B.R. 234, 239 (Bankr. D. Del. 1994)) (holding that MEPP "has no enforceable right to payment for withdrawal liability until an employer actually withdraws, leaving the [MEPP] underfunded"); *see also Board of Trs. of Teamsters Local 863 Pension Fund v. Foodtown Inc.*, 296 F.3d 164, 169 (3d Cir. 2002) (same); *In re Checker Motors Corp.*, 495 B.R. 355, 365 (Bankr. W.D. Mich. 2013) (same).

25 *CPT Holdings*, 162 F.3d at 409.

Pension Plan, the Sixth Circuit found that a claim for withdrawal liability "cannot exist prior to withdrawal" because under ERISA, "withdrawal liability is based on an employer's share of unfunded vested benefits *at withdrawal*."[25] The court emphasized that while the Bankruptcy Code defines "claim" broadly, "the relevant nonbankruptcy law must be examined to see whether a right to payment, even a contingent right, exists."[26] The Sixth Circuit then held that the withdrawal-liability claim arose post-confirmation, at the time of withdrawal, and thus could not be discharged by the debtors' chapter 11 plan.[27]

What Happens if Withdrawal Liability Is Prorated Between Pre- and Post-Petition Periods?

Once a court decides when the withdrawal-liability claim arises, the next question is whether the liability should be prorated between the pre- and post-petition periods and, if so, whether the prorated post-petition claim can qualify for administrative priority.[28] This issue generally turns on whether the prorated post-petition portion provides a benefit to the estate, a prerequisite to administrative-expense priority. Courts apply different weights to this question, resulting in a split on whether the prorated post-petition withdrawal liability can sufficiently benefit the estate to constitute an administrative expense.

In analyzing this issue, some courts require that the benefit to the estate be not only "actual and necessary," but "substantial" and "direct."[29] In *In re HNRC Dissolution Co.*, the Sixth Circuit Bankruptcy Appellate Panel held that withdrawal liability is "not entitled to priority as an administrative expense." Since "the calculation of a plan's unfunded vested benefits, and, consequently, the assessment of withdrawal liability against a particular employer, will *always* be a function of numerous factors that are not, and cannot be, *directly linked* to the post-petition work," it "undercut the assertion that the prorated liability resulted from a 'direct and substantial' benefit to the estate."[30]

Other courts have only required that the benefit be "actual and necessary" to qualify for administrative-expense priority, leading to a different result when analyzing withdrawal-liability disputes.[31] For example, in *Marcal Paper Mills Inc.*, the Third Circuit held that a pension fund's claim against the debtor for withdrawing from an MEPP can be prorated between the pre- and post-petition periods, and found that because "the covered employees were required to perform work post-petition in order to keep the [debtor] in operation," a benefit was "unquestionably" conferred on the estate.[32] The Third Circuit also declined to follow the reasoning by the Sixth Circuit in *HNRC*, finding that while the existence of withdrawal liability "[w]ithout question" is calculated based on a range of factors, only some of which may relate to labor performed post-petition, the debtor/employer assumes this risk by "choosing to use covered employers to perform post-petition work."[33]

In addition, the Third Circuit reasoned that its decision "harmonize[s] the purposes of the Bankruptcy Code and ERISA, as amended by the MPPAA," because "it ensures that workers are provided the full benefit of the bargain promised to them in the continued" collective-bargaining agreement, while at the same time "prevent[s] [the estate] from being devoured by the entire withdrawal liability."[34] Certain lower courts have also held similarly.[35]

Conclusion

In dealing with the treatment of withdrawal liabilities in chapter 11 cases, bankruptcy courts encounter complex and unique challenges that stand at the intersection of ERISA and bankruptcy law. With few bankruptcy courts having addressed these issues and the differing approaches they have adopted, current case law offers little guidance on the proper classification of such claims. Given the substantial impact of these disputes on the ultimate outcome of a debtor/employer's chapter 11 case, these issues are likely to remain critical disputes in the future. abi

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26 *Id.*
27 *Id.*
28 *In re HNRC Dissolution Co.*, 396 B.R. 461, 479 (B.A.P. 6th Cir. 2008) (noting that issue of whether withdrawal liability can be prorated between pre- and post-petition periods is distinct from issue of when such liability arises); *Einhorn v. Dubin Bros. Lumber Co.*, 33 F. Supp. 3d 504, 513 (D.N.J. 2014) (same).
29 *See, e.g., In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987).
30 *HNRC*, 396 B.R. at 480 (emphasis added).
31 *See, e.g., In re O'Brien Envtl. Energy Inc.*, 181 F.3d 527, 532-33 (3d Cir. 1999).
32 *Marcal*, 650 F.3d at 317.
33 *Id.* at 317-18.
34 *Id.* at 321.
35 *See, e.g., In re California-Nevada Methodist Homes*, No. 21-40363 CN, 2023 WL 2903340 (Bankr. N.D. Cal. April 11, 2023); *In re Pulaski Highway Express Inc.*, 57 B.R. 502, 508-09 (Bankr. M.D. Tenn. 1986); *In re Cott Corp.*, 47 B.R. 487, 491-92 (Bankr. D. Conn. 1984).