ERISA Withdrawal Liability Claims Unlikely to Receive Administrative Expense Priority Status in a Chapter 11 Reorganization

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INTRODUCTION

An employer who withdraws their participation in a multi-employer defined benefits plan is statutorily required to pay the plan a withdrawal liability.⁴ Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA"), provides a number of formulas to assist a multi-employer defined benefits plan’s actuary with calculating the withdrawal liability amount.⁴ Congress imposed withdrawal liability on withdrawing employers “(1) to protect the interests of participants and beneficiaries in financially distressed multiemployer plans, and (2) . . . to ensure benefit security to plan participants.”⁵ An employer’s ability—and willingness—to pay withdrawal liability is compromised when the employer files a Chapter 11 petition. Typically, unsecured, pre-petition debts in a Chapter 11 reorganization are discharged unless the United States Bankruptcy Code grants the debt priority status in repayment.⁴ The Bankruptcy Code does not expressly designate

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withdrawal liability as a non-dischargeable debt, but discharging withdrawal liability would cost the defined benefits plan’s beneficiaries their promised benefits.\textsuperscript{5}

To challenge the dischargeability of withdrawal liability claims, defined benefits plans have argued that withdrawal liability claims deserve administrative expense priority status, as defined in Chapter 5 of the Bankruptcy Code.\textsuperscript{6} Employers rebut that proposition, arguing that withdrawal liability claims are not entitled to administrative expense priority status because the claim amount is calculated using factors that arose in the pre-Chapter 11 filing period.\textsuperscript{7} This memorandum addresses whether withdrawal liability claims are entitled to priority status as administrative expenses. Part I explains the legal standard for classifying a withdrawal liability claim as an administrative expense. Part II examines the specific factors of the legal standard, and how courts apply them differently.

DISCUSSION

I. Withdrawal Liability Claims Face Statutory Challenges to Qualifying for Administrative Expense Priority Status.

Administrative expenses typically arise from labor performed post-petition; but, withdrawal liability claims are calculated with a range of factors–only some, if any, relating to labor performed post-petition. This section will analyze the complex nature of withdrawal liability claims; specifically, how the claims’ composition does not neatly fit within the definition of administrative expenses.

A. Withdrawal Liability Explanation

A multi-employer defined benefits plan is “a pension plan under which an employee receives a set monthly amount upon retirement for his or her life, with the benefit amount

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\item \textsuperscript{5} See 11 U.S.C. § 1141(d)(1); 11 U.S.C. § 523.
\item \textsuperscript{6} See 11 U.S.C. § 503(b); 11 U.S.C. 507(a)(2).
\item \textsuperscript{7} See id.
\end{itemize}
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typically based upon the participant’s wages and length of service."\textsuperscript{8} Employers and employee unions agree to a contribution amount and distribution schedule in a collective bargaining agreement. 29 U.S.C. § § 1103, 1082. Under these agreements, employers are obligated to distribute contributions to a plan administrator who places them in a trust for each employee to withdraw on a monthly basis when he or she retires.\textsuperscript{9}

Employers may completely or partially withdraw from an underfunded plan, but they will be required to pay their proportionate share of the plan’s unfunded vested benefits, or the “difference between the present value of vested benefits and the current value of the plan’s assets.”\textsuperscript{10} The defined benefits plan’s actuary formulates estimates to calculate the present value of vested benefits and the current value of the plan’s assets using assumptions based on (1) the current number of the fund’s employees, (2) the fund’s investment strategy, and (3) the history of benefit payments from the preceding five years.\textsuperscript{11} Additionally, the actuary will only use average values from the last full plan year—not the date of withdrawal—in their calculations.\textsuperscript{12} As discussed later in this memorandum, this calculation method poses an obstacle for benefit plans arguing withdrawal liability claims should receive administrative expense priority status.\textsuperscript{13}

\textbf{B. The Prevailing Understanding of Administrative Expenses}

The Bankruptcy Code expressly designates certain discrete types of unsecured claims, like administrative expenses, to receive priority in distribution, thereby increasing the likelihood that an unsecured creditor will be paid.\textsuperscript{14} Administrative expenses in a Chapter 11

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  \item \textsuperscript{8} \textit{In re Schering Plough Corp.} \textit{ERISA Litig.}, 589 F.3d 585, 589 n. 8 (3d Cir. 2009).
  \item \textsuperscript{9} \textit{See id.}  
  \item \textsuperscript{10} \textit{See PBGC v. R.A. Gray & Co.}, 467 U.S. 717, 725 (1984); 29 U.S.C. §1381(a); 29 U.S.C. § 1391.
  \item \textsuperscript{11} \textit{See In re HNRC Dissolution Co.}, 396 B.R. 461, 472 (B.A.P. 6th Cir. 2008).
  \item \textsuperscript{12} \textit{See 29 U.S.C. § § 1391(2)(A)(ii)--(B)(ii)(II).}
  \item \textsuperscript{13} \textit{See infra Part II(B)(ii).}
  \item \textsuperscript{14} \textit{See U.S.C. 11 §§507(a)(1)--(a)(2).}
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reorganization receive second priority, behind domestic support obligations. When a multi-employer defined benefit plan files for reorganization under Chapter 11, administrative expenses will likely receive first priority in distribution because domestic support obligations rarely arise in this context.

The Bankruptcy Code defines administrative expenses as “the actual, necessary costs and expenses of preserving the estate.” The statute contains a non-exhaustive list of possible administrative expenses, which are generally related to labor performed post-petition, post-judicial proceedings, or after a violation of law. Courts have grappled with the scope of the statute in relation to claims for employment compensation. The Bankruptcy Code expressly allows any payment of retiree benefits to receive administrative expense priority status. But, the Bankruptcy Code and ERISA do not expressly confer administrative expense priority status on withdrawal liability claims, and few courts have addressed this issue. Nonetheless, there is an apparent split on how to classify withdrawal liability claims based upon the timing of when the withdrawal liability arose.

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15 Id.
17 See id.
19 See 11 U.S.C. § 1114(e)(2) (“Any payment for retiree benefits required to be made before a plan confirmed . . . has the status of an allowed administrative expense as provided in section 503 . . . .”).
21 See McFarlin’s, 789 F.2d 98 (finding that withdrawal liability calculated using all pre-petition period data is unable to receive administrative expense priority status); cf. Marcal Paper, 650 F.3d 311 (holding that withdrawal liability can be divided into post-petition and pre-petition portions, and the post-petition portion can receive priority status); but see HNRC, 396 B.R. 461 (ruling that the portion of withdrawal liability arising from post-petition labor cannot receive administrative expense priority because the calculation requires factors from the pre-petition period).
C. The Distinction Between Post-Petition and Pre-Petition Claims

The United States Bankruptcy Code expressly allows for “wages, salaries, or commissions rendered after the commencement of a bankruptcy case.” So, courts cannot confer administrative expense priority status to a claim for employment compensation unless the claim arose after the debtor-employer’s Chapter 11 filing. To determine when the claim arose, courts have applied the Mammoth Mart test, or the benefit-to-the estate test. The test requires a claimant to show (1) the claim arises from a transaction between themselves and the bankruptcy trustee or debtor-in-possession, and (2) the estate—not the claimant—directly and substantially benefitted from the transaction. The Third Circuit allows the second prong of the test to be satisfied by any showing of benefit to the debtor estate.

II. Factors to Consider when Determining Whether a Withdrawal Liability Claim can be Afforded Administrative Expense Priority Status.

A few courts have addressed this issue, and each addressing court has assigned different weight to factors in the legal standard to support their holdings. This section will explore how courts differed when applying the legal standard to determine what portion of a withdrawal liability claim, if any, deserves administrative expense priority status.

A. Withdrawal Liability Arises at Time of Withdrawal

Courts have grappled with the sub-issue of whether a withdrawal liability claim exists at the time of a Chapter 11 plan confirmation. The Bankruptcy Code allows for the

24 See In re Mammoth Mart, Inc., 536 F.2d 950, 954 (1st Cir. 1976); see e.g., McFarlin’s, Inc., 789 F.2d at 101; HNRC, 396 B.R. at 475; Matter of Jartran, Inc., 732 F.2d 584, 586 (7th Cir. 1984); Straus-Duparquet, Inc. v. Local U. No. 3 Int. Bro. of Elec. Wkrs., 386 F.2d 649, 651 (2d Cir. 1967); In re Amarex, 853 F.2d 1526, 1531 (10th Cir. 1988).
26 See CPT Holdings, Inc., 162 F.3d at 409; Hotel 71 Mezz Lender LLC, 2015 WL 1125591, at *11.
dischargeability of contingent claims, or “claim[s] which ha[ve] not yet accrued and [are]
dependent upon some future event that may never happen,” when a Chapter 11 plan is
confirmed.27 Employers have argued that a withdrawal liability claim is a contingent claim at
confirmation because there is a likelihood that an employer may withdraw its participation from
the multi-employer defined benefits plan post-confirmation.28 Consequently, withdrawal
liability would be entitled to discharge as a contingent claim.29

ERISA states that withdrawal liability arises when (1) the benefits plan has unfunded
vested benefits and (2) an employer either completely or partially withdraws from the plan.30
Multi-employer defined benefits plans have argued that employers who withdraw post-petition
are not entitled to discharge of withdrawal liability because the claim did not exist when the plan
was confirmed.31

Courts have held that ERISA, not the Bankruptcy Code, is the guiding law on this sub-
issue because the right to payment does not arise until the employer officially withdraws.32 So,
withdrawal liability claims arising post-petition cannot be classified as contingent claims eligible
for discharge. But, when an employer withdraws from a benefits plan pre-petition, most—if not
all—of the withdrawal liability will be discharged because it will be considered a contingent claim
under the Bankruptcy Code.33

B. Administrative Expense Definition

28 See CPT Holdings, Inc., 162 F.3d at 406 (explaining that employer filed a motion for summary judgment on
withdrawal liability payments because the benefits plan had “a contingent claim” under the Code against the
employer at the time of Chapter 11 confirmation).
29 See id.
31 See CPT Holdings, Inc., 162 F.3d at 408.
32 See Id. at 409; Hotel 71 Mezz Lender LLC, 2015 WL 1125591, at *11.
33 See Pulaski Highway, 57 B.R. at 504–08 (discharging all withdrawal liability that arose pre-petition); Art Shirt, 93
B.R. 333 (same); Silver Wheel, 47 B.R. at 479 (same).
Withdrawal liability claims cannot be unequivocally classified as an administrative expense because courts disagree on whether it falls under the administrative expense definition. Courts disagree on whether withdrawal liability is an “actual, necessary cost and expense[] of preserving the [debtor] estate,” and if so, whether withdrawal liability is based on these post-petition expenditures.\textsuperscript{34}

Courts have expressly held, or implied, that withdrawal liability is an “actual, necessary cost and expense of preserving the estate” notwithstanding other factors that may affect its priority status.\textsuperscript{35} In the Third Circuit, pension benefits are a necessary consideration for post-petition work that helps the continued operation of the business post-confirmation.\textsuperscript{36} Therefore, withdrawal liability arising post-petition is an actual, necessary cost of preserving the debtor estate.\textsuperscript{37} The Sixth Circuit, in analyzing the issue, applied the \textit{Mammoth Mart}, benefit-to-the-estate test, and held that claims for liabilities directly related to the post-petition work of the debtor’s employees are administrative expenses because the labor “unquestionably benefitted the estate.”\textsuperscript{38} The court, however, determined that withdrawal liability claims are not administrative expenses because the amount is calculated using factors \textit{indirectly} related to post-petition labor.\textsuperscript{39} This case highlights the inextricable link between a court’s classification of withdrawal liability as an administrative expense and the liberalness of a court’s view on what can be considered “actual and necessary” post-petition costs.

\textit{i. The Pre-Petition and Post-Petition Divide}

\textsuperscript{35} See \textit{Marcal Paper}, 650 F.3d at 311; \textit{HNRC}, 396 B.R. at 461; \textit{Pulaski}, 57 B.R. at 502; \textit{CPT Holdings, Inc.}, 162 F.3d at 405; \textit{Hotel 71}, 2015 WL 1125591; \textit{In re Great Ne. Lumber & Millwork Corp.}, 64 B.R. at 428; \textit{In re Cott Corp.}, 47 B.R. at 495.
\textsuperscript{36} See \textit{Marcal Paper}, 650 F.3d at 319.
\textsuperscript{37} See \textit{id}.
\textsuperscript{38} See \textit{HNRC}, 396 B.R. at 476.
\textsuperscript{39} See \textit{id}.
Only post-petition costs and expenses can receive administrative expense priority status, but courts disagree on how to determine whether withdrawal liability arose post-petition. Some courts classify the entirety of a withdrawal liability claim as a pre-petition, unsecured claim without providing explanation. The Sixth Circuit’s holding in *HNRC* suggests that withdrawal liability claims cannot be said to arise from post-petition labor because the amount is calculated using pre-petition data.

Some courts do not consider the calculation method a reason to render the entirety of a withdrawal liability claim a pre-petition expense, so they allow such claim to be carved into pre-petition and post-petition portions. The *Cott Corp.* court reasoned that an employer’s underfunding of the benefit plan continued post-petition, so that portion should be afforded priority status as an administrative expense. The Third Circuit views the debtor employees’ post-petition labor in exchange for the debtor’s promise to provide pension benefits as a sufficient reason to allow the post-petition claim to receive priority status.

**C. Legislative Purpose of ERISA**

ERISA, as amended by the MPPAA, imposed withdrawal liability on employers who withdraw from a defined benefits plan “to insure that before leaving a plan an employer would pay his proportionate share of the plan’s liability for vested but unfunded benefits attributable to work already performed.” Generally, a court’s willingness to carve withdrawal liability into

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41 See *Silver Wheel*, 47 B.R. at 479; *Art Shirt Ltd., Inc.*, 93 B.R. 333.
42 See 396 B.R. at 476–77.
43 See *Marcal Paper*, 650 F.3d at 319; cf. *McFarlin’s*, 789 F.2d 9 at 103 (“Since withdrawal liability is based on the withdrawing employers contributions to the Plan prior to the year before the employer withdraws . . . [it] is attributable to the period pre-dating the filing of the Chapter 11 petition.”).
44 See 47 B.R. at 494.
45 See *Marcal Paper*, 650 F.3d at 321 (stating that holding otherwise would negatively affect[] the plan and its employee beneficiaries.”); *Great Ne. Lumber.*, 64 B.R. at 428 (“[T]o the extent that withdrawal liability is attributable to post[-]petition employment, the claim would be entitled to administrative status.”).
46 *McFarlin’s*, 789 F.2d at 103 (internal quotations omitted).
pre-petition and post-petition claims depends on how the court weighs the broader legislative purpose of ERISA, as amended by the MPPAA, in their analysis. Nonetheless, a court cannot invoke ERISA’s purpose if the employer withdrew from the plan pre-petition because the entirety of the claim would be based on pre-petition labor.

CONCLUSION

Courts seemingly agree that withdrawal liability claims can only be afforded priority status as an administrative expense if the claimant can prove that they arose from post-petition labor. The nature of withdrawal liability claims makes this task difficult because actuaries must calculate factors using data from the pre-petition period. Consequently, most courts have found that withdrawal liability claims are not administrative expenses, but the Third Circuit overlooked the calculation method to allow multi-employer defined benefits plans to recover some portion of withdrawal liability.

Caselaw suggests that the Third Circuit may be an outlier on this issue. However, the share of defined benefits plans facing likely insolvency is growing as a result of increased longevity and the decline of employers who offer pensions to their employees. So, as more employee’s benefits become vulnerable to a loss of benefits, it is possible that courts could side with the Third Circuit.

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47 See Marcal Paper, 650 F.3d at 319 (“The legislative history of the MPPAA emphasizes that absent withdrawal liability, the employees are harmed” (citation omitted)); cf. HNRC, 396 B.R. at 470–73 (discussing the purpose of withdrawal liability and how it is calculated under ERISA, but not discussing its practical implications).
48 See McFarlin’s, 789 F.2d at 103.