COMMENT

SPLITTING THE BABY: WHETHER ERISA-IMPOSED WITHDRAWAL LIABILITY CLAIMS SHOULD BE PRORATED AND GRANTED ADMINISTRATIVE PRIORITY IN BANKRUPTCY PROCEEDINGS

INTRODUCTION

Congress's passage of the Employee Retirement Income Security Act of 1974 (ERISA) created new liability for employers seeking to terminate their involvement with pension plans.[1] Specifically, passage of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) imposed withdrawal liability on employers terminating their involvement with multiemployer plans.[2] Over the years, courts have come to a myriad of different decisions on how to treat this liability in the course of an employer's bankruptcy. The recent increase in business bankruptcy filings combined with the practice of companies unloading their burdensome pension plans in bankruptcy has again brought this issue to light. Recently, two courts considered this controversy and came to opposite conclusions. This article will address the historical treatment of withdrawal liability, the different approaches courts have taken, and the correct approach to upholding the congressional purpose of both the Bankruptcy Code and ERISA.

Before jumping into the complicated issues that arise at the intersection of federal bankruptcy law and ERISA, it is useful to first examine some of the background for these bodies of law. As both ERISA and federal bankruptcy law are sufficient-

[1] Employee Retirement Income Security Act of 1974, § 1, 29 U.S.C. § 1001 (2006).

[2] Multiemployer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, 94 Stat. 1208 (codified at 29 U.S.C. §§ 1381-1461).

ly complex to warrant entire treatises on their own, this article will merely attempt to introduce the aspects of these bodies of law relevant to this issue.

I. THE HISTORY AND SCOPE OF ERISA

Congress enacted ERISA in response to findings that the then-existing minimum standards for employee benefit plans were inadequate to secure the plans' soundness and stability, the plans were regularly insufficiently funded to pay accumulated benefits, and the plans often terminated before requisite funds had accumulated—thus depriving the beneficiaries of their anticipated benefits.[3] Congress also found employee benefit plans to substantially affect interstate commerce, federal tax revenues, the national public interest, and that "the continued well-being and security of millions of employees, retirees, and their dependents are directly affected by multiemployer pension plans."[4] Congress intended for ERISA to function as a comprehensive scheme, providing a uniform federal standard of regulation for most private employee benefit programs.

Congress's primary purpose in drafting ERISA was "the protection of individual pension rights,"[5] "to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information."[6] Congress implemented this policy by "establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for ap-

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[3] 29 U.S.C. § 1001(a).

[4] *Id.* § 1001a(a)(3).

[5] H.R. REP. NO. 93-533, at 1 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639.

[6] 29 U.S.C. § 1001(b). *See also* Boggs v. Boggs, 520 U.S. 833, 839 (1997) ("ERISA is designed to ensure the proper administration of pension and welfare plans, both during the years of the employee's active service and in his or her retirement years."); Crown Cork & Seal Co. v. Cent. States Se. & Sw. Areas Pension Fund, 982 F.2d 857, 861 (3d Cir. 1992) ("ERISA's central purpose is to protect the security of employee pension plans and to insure that benefits which have vested are paid to employees.") (citing Pension Benefit Guar. Corp. v. R.A. Gray & Co., 467 U.S. 717 (1984)); Richard A. Ippolito, *A Study of the Regulatory Effect of the Employee Retirement Income Security Act*, 31 J.L. & ECON. 85, 87 (1988) ("Defined benefit pension plans are the primary focus of ERISA . . . .").

propriate remedies, sanctions, and ready access to the Federal courts."[7] Congress also designed ERISA:

> to protect interstate commerce, the Federal taxing power, and the interests of participants in private pension plans and their beneficiaries by improving the equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.[8]

Through ERISA, Congress also created the Pension Benefit Guarantee Corporation (PBGC), a private government corporation within the Department of Labor, to encourage continuation and maintenance of private pension plans, provide for timely payment of pension benefits, and maintain pension insurance premiums at the lowest level consistent with its legal obligations.[9]

Under ERISA, pensions are typically categorized into two types: "defined benefit" plans and "defined contribution" plans. Defined benefit plans typically provide retired employees with an income that is based on factors such as the employee's salary and years of service.[10] On the other hand, in defined contribution plans, the employer contributes a portion of the employee's wages into a separate account, and the employee is entitled to the balance of this account upon retirement.[11] ERISA further divides defined benefit plans into single and multiemployer plans. Multiemployer plans are those maintained by one or more employee organizations pursuant to a collective bargaining agreement (CBA), and to which more than one employer is required to contribute.[12] ERISA uses a "catch-

[7] 29 U.S.C. § 1001(b).
[8] 29 U.S.C. § 1001(c).
[9] 29 U.S.C. § 1302(a).
[10] *See* 29 U.S.C. § 1002(35).
[11] *See* 29 U.S.C. § 1002(34).
[12] 29 U.S.C. § 1002(37)(A).

all" definition for single employer plans: "an employee benefit plan other than a multiemployer plan."[13]

A. The Multiemployer Pension Plan Amendment Act of 1980

Shortly after the passage of ERISA, Congress became aware of problems relating to the treatment of multiemployer plans.[14] Congress amended ERISA through the MPPAA to provide additional protections to these multiemployer plans. Congress's primary purpose in enacting the MPPAA was to "protect retirees and workers who are participants in such [multiemployer] plans against the loss of their pensions."[15]

As originally enacted, ERISA did not require employers withdrawing from a multiemployer plan to pay any compensation for unfunded benefits to the plan.[16] Thus, the result of an employer's withdrawal was to shift the funding burden to the remaining employers in the plan.[17] Liability would only be imposed on a withdrawing employer if the plan terminated within five years, and then only to the extent of thirty percent of the employer's net worth.[18] As a result, Congress found the then-existing rules for withdrawal liability to be "inequitable and disfunctional [sic]."[19] Specifically, Congress found these rules to reward employers who withdrew early from a financially troubled plan, while penalizing the remaining employers.[20] As part of the remedy to this inequity and dysfunction, Congress imposed an obligation on employers to pay pension plans a

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[13] 29 U.S.C. § 1002(41).

[14] H.R. REP. NO. 96-869, pt. 1, at 51 (1980), *reprinted in* 1980 U.S.C.C.A.N. 2918, 2919.

[15] *Id.* at 51, *reprinted in* 1980 U.S.C.C.A.N. 2918, 2919.

[16] *Id.* at 60, *reprinted in* 1980 U.S.C.C.A.N. 2918, 2928.

[17] *Id.*

[18] *Id.* at 60-61, *reprinted in* 1980 U.S.C.C.A.N. 2918, 2928-29 ("Termination liability for the unfunded benefits guaranteed by the [PBCG] is imposed on employers who contributed to the plan within 5 years of its termination."). Liability could also be imposed if the withdrawing employer was classified as a "substantial contributor," but even in that case the employer was merely required to provide some type of security to the PBGC for the potential termination liability. *Id.* at 60, *reprinted in* 1980 U.S.C.C.A.N. 2918, 2928.

[19] *Id.* at 60, *reprinted in* 1980 U.S.C.C.A.N. 2918, 2928.

[20] *Id.*

withdrawal liability for any unfunded vested benefits (UVB) attributable to the withdrawing employer.[21]

B. Withdrawal Liability

When an employer withdraws from a multiemployer plan, ERISA, as amended by the MPPAA, imposes an obligation on the employer to pay its proportional share of the plan's UVB.[22] For a complete withdrawal, the employer is deemed to have withdrawn on the date that the employer permanently ceases covered operations or is permanently removed of any obligations to contribute to the plan.[23]

Calculating a withdrawing employer's liability is a two-step process.[24] First, the plan calculates the amount of UVB for the entire plan.[25] The MPPAA defines "unfunded vested benefits" as the difference between the present value of the nonforfeitable benefits and the current value of the plan's assets.[26] In the second step, the plan calculates the withdrawing employer's share of the UVB.[27] ERISA sets forth four different methods of calculating the portion of UVB attributable to the withdrawing employer.[28] Three of the four methods (presumptive, modified presumptive, and rolling-5) base withdrawal liability on the proportion of total employer contributions made by the withdrawing employer during the previous five years, end-

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[21] *See* Multiemployer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, §§ 4201, 4203, & 4211 (codified as amended at 29 U.S.C. §§ 1381, 1383, & 1391 (2006)).

[22] CPT Holdings, Inc. v. Indus. & Allied Employees Union Pension Plan, Local 73, 162 F.3d 405, 407 (6th Cir. 1998) (citing 29 U.S.C. §§ 1381, 1391; Concrete Pipe & Prod. v. Const. Laborers Pension Trust, 508 U.S. 602, 608 (1993)).

[23] 29 U.S.C. § 1383(a).

[24] *See* Milwaukee Brewery Workers' Pension Plan v. Jos. Schlitz Brewing Co., 513 U.S. 414, 417 (1995); 29 U.S.C. § 1391.

[25] *See Milwaukee Brewery*, 513 U.S. at 417; 29 U.S.C. § 1391.

[26] 29 U.S.C. § 1393(c) ("For purposes of this part, the term "unfunded vested benefits" means with respect to a plan, an amount equal to—(A) the value of nonforfeitable benefits under the plan, less (B) the value of the assets of the plan.").

[27] *See Milwaukee Brewery*, 513 U.S. at 417; 29 U.S.C. § 1391; *see also* Trs. of Amalgamated Ins. Fund v. McFarlin's, Inc., 789 F.2d 98, 103 (2d Cir. 1986) (stating that withdrawal liability is the employer's "proportionate share of the plan's liability for vested but unfunded benefits attributable to work already performed").

[28] *See* 29 U.S.C. § 1391.

ing with the year before the employer's withdrawal.[29] Under the fourth method (direct attribution), the employer is only liable for the UVB directly attributable to it; therefore, the plan must maintain separate records for each employer that participates in the plan.[30] The presumptive method is most commonly used to calculate withdrawal liability.[31]

II. THE BANKRUPTCY CODE

The Supreme Court has long held that "[t]he principle purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'"[32] The Bankruptcy Code operates under two central tenets: an equal distribution of assets,[33] and a fresh start for the debtor upon discharge.[34] For the purposes of this discussion, this article will focus primarily on the process of reorganization in bankruptcy. The Bankruptcy Code allows businesses to reorganize and continue operating while undergoing a restructuring of their debts. Chapter 11 of the Bankruptcy Code permits businesses to take advantage of provisions to restructure equity interests and debts. The Supreme Court has stated "[t]he fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."[35]

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[29] *See* 29 U.S.C. §§ 1391(c)(2)-(3) (2006).

[30] *See* 29 U.S.C. § 1391(c)(4).

[31] 29 C.F.R. § 4211.1(a) (2009) ("With the minor exceptions . . . a plan determines the amount of unfunded vested benefits allocable to a withdrawing employer in accordance with the presumptive method . . . .").

[32] Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 286-87 (1991)); *see also* 1 COLLIER ON BANKRUPTCY ¶ 1.01 (16th ed. 2009).

[33] Union Bank v. Wolas, 502 U.S. 151, 161 (1991) ("[T]he preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor.") (quoting H.R. REP. NO. 95-595, at 177-78 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138).

[34] *Marrama*, 549 U.S. at 367.

[35] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984); *see also* United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983) ("By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners. Congress presumed that the assets of

While it is obvious that the bankruptcy process benefits the debtor, it also provides benefits to creditors. Creditors benefit from an orderly and centralized liquidation, or in the case of reorganization creditors of equal priority receive pro-rata and equitable distributions from the debtor. In order for a debtor to qualify for reorganization, the debtor must pay the creditors at least as much as they would have received in a liquidation.[36] By allowing a business that is worth more as an operating entity than the sum of its liquidated parts to continue operating, the Bankruptcy Code preserves the "going concern" value of the debtor and avoids unnecessary economic waste. Reorganization provides benefits to society in such forms as continued wages and benefits for workers and tax revenues for governments.

A. Administrative Priority

Section 507 of the Bankruptcy Code provides the order and priority by which certain claims and expenses are paid from the assets of the bankruptcy estate.[37] The statute grants first[38] priority to certain administrative expenses incurred after the filing of the bankruptcy petition.[39] Having a first priority simply gives the party the right to be paid before anyone else. In order to qualify as an administrative expense, the claim must arise from "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, and commissions for services rendered after the commencement of the case."[40] The purpose of this provision is to encourage third parties to provide the debtor with goods and services necessary for the debtor to continue operating to the benefit of all creditors.[41] While

the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'") (internal citation omitted).

[36] 11 U.S.C. §§ 1129(a)(7), 1225(a)(4), 1325(a)(4) (2006).

[37] *See* 11 U.S.C. § 507 (Supp. 2010).

[38] While § 507(a)(1) gives first priority to claims for domestic support obligations, business Chapter 11 proceedings do not typically involve DSO's; therefore, administrative expenses have a virtual first priority. *See* 11 U.S.C. § 507.

[39] 11 U.S.C. § 507(a)(2).

[40] 11 U.S.C. § 503(b)(1) (2006).

[41] *See* 4 COLLIER ON BANKRUPTCY ¶ 503.06[2] (16th ed. 2009); *see also In re* Jartan, Inc., 732 F.2d 584, 588 (7th Cir. 1984) ("[A]dministrative priority is granted to post-

this provision may be necessary to encourage others to engage in business with the debtor, courts have generally construed section 503(b) priorities narrowly to protect the interests of all creditors in the bankruptcy estate.[42] The test devised to determine whether a claim qualifies for administrative priority is commonly referred to as the "benefit to the estate" test. Under this test, a debt qualifies only if (1) it arises from a transaction with the bankruptcy estate and (2) it provided a direct and substantial benefit to the estate.[43]

III. THE PROBLEM

Having introduced the background material necessary to frame the issue, this article will now introduce the problem as it arises in the context of a Chapter 11 proceeding. When a company that participates in a multiemployer plan withdraws from the plan during the course of a Chapter 11 reorganization, ERISA, as amended by the MPPAA, imposes withdrawal liability for the portion of UVB attributable to the employer. The question for the courts in these cases is what treatment to give the plan's claim for the withdrawal liability. Specifically, whether the withdrawal liability, or a portion thereof, should be treated as an administrative expense and granted priority. As the following cases illustrate, courts often vary on the correct treatment of these claims.

A. In re *HNRC Dissolution Co.*

In November of 2008, the Bankruptcy Appellate Panel for the Sixth Circuit decided the case *In re* HNRC Dissolution

petition expenses so that third parties will be moved to provide the goods and services necessary for a successful reorganization.").

42 *See In re* HNRC Dissolution Co., 396 B.R. 461, 475 (B.A.P. 6th Cir. 2008) ("Because 'priority claims reduce the funds available for creditors and other claimants,' it is well established that '[c]laims for administrative expenses under § 503(b) are strictly construed.'") (quoting City of White Plains, N.Y. v. A & S Galleria Real Estate, Inc. (*In re* Federated Dept. Stores, Inc.), 270 F.3d 994, 1000 (6th Cir. 2001)); *see also* 4 COLLIER ON BANKRUPTCY ¶ 503.06[2] (16th ed. 2009).

43 *See, e.g.*, *In re* Eagle-Picher Indus., Inc., 447 F.3d 461, 464 (6th Cir. 2006); *In re* DAK Indus., Inc., 66 F.3d 1091, 1094 (9th Cir. 1995); *In re* Jartan, 732 F.2d 584, 587 (7th Cir. 1984).

Co.[44] The debtors in *HNRC* were parties to collective bargaining agreements (CBAs) with the United Mine Workers of America (UMWA).[45] Under these agreements, the debtors were required to participate in "the 1974 plan," a multiemployer defined benefit pension plan.[46] Under the 1974 plan, the debtors' employees accrued pension benefits for every hour they worked.[47] In November of 2002, the debtors filed a voluntary petition for bankruptcy under Chapter 11 and subsequently operated as debtors-in-possession for approximately two years.[48] During the postpetition period, the debtors employed over 1000 UMWA-represented employees, working a combined total of 2,976,962 hours.[49] In 2004, after an unsuccessful attempt to reorganize, the debtors amended their Chapter 11 plans and sold substantially all of their assets.[50] On September 30, 2004, the Chapter 11 plans became effective, resulting in the debtors' rejection of the CBAs and dissolution of the debtors.[51]

The 1974 plan then asserted a claim for withdrawal liability, stating that the debtors' cessation of operations constituted a complete withdrawal from the plan.[52] In calculating the withdrawing employer's liability, the 1974 plan added a third step to the process.[53] After calculating the total UVB in the plan and the portion attributable to the withdrawing employers,[54] the plan determined what portion of the debtors' total

[44] *In re* HNRC Dissolution Co., 396 B.R. 461 (B.A.P. 6th Cir. 2008).

[45] *Id.* at 465.

[46] *Id.*

[47] *Id.*

[48] *Id.* at 466.

[49] *Id.*

[50] *Id.*

[51] *Id.* at 467.

[52] *Id.* ERISA states, "complete withdrawal from a multiemployer plan occurs when an employer—(1) permanently ceases to have an obligation to contribute under the plan, or (2) permanently ceases all covered operations under the plan." 29 U.S.C. § 1383(a) (2006).

[53] *HNRC*, 396 B.R. at 467.

[54] To calculate the withdrawal liability, the plan used a modified version of the rolling-5 method. The plan first calculated the total amount of UVB at the time of the debtors' withdrawal. The plan then divided the hours worked by the debtors' employees during the previous five years by the total hours worked by all plan participant em-

withdrawal liability was attributable to postpetition work.[55] To do this, the plan divided the number of postpetition hours worked by the debtors' employees by the total number of hours worked by the debtors' employees in the five years before the withdrawal.[56] The plan then claimed that the portion of the withdrawal liability they attributed to postpetition services should be entitled to administrative priority.[57] After considering briefs on the matter, the bankruptcy court disallowed the 1974 plan's claim for administrative priority holding that the plan failed to demonstrate that the liability on which the claim was based had directly and substantially benefitted the bankruptcy estate.[58]

Considering the appeal, the BAP found "the central, and ultimately dispositive" issue to be whether the prorated portion of the debtors' withdrawal liability directly and substantially benefited the bankruptcy estate.[59] Analyzing the issue, the BAP conceded the obvious benefit of the employees' postpetition work and recognized the common application of administrative priority to wages and pension plan minimum funding contributions earned through postpetition services.[60] The BAP

ployees during the same period. This percentage was then multiplied by the total UVB. The 1974 plan claimed a total withdrawal liability of $224,986,733 as of June 30, 2004. *Id.*

[55] *Id.*

[56] *Id.* ("This calculation resulted in approximately 8.7% of the total withdrawal liability being allocated to the postpetition period.").

[57] *Id.* Lexington Coal, one of the purchasers of the debtors' assets, objected to the 1974 plan's claim, asserting that "the withdrawal liability did not directly and substantially benefit the Debtors' estate." *Id.* at 467-68.

[58] *Id.* at 469. A change in the plan's interest rate assumptions led it to amend its claim for administrative expense. This change in interest rate decreased the total amount of withdrawal liability from $224,986,773 to $138,354,090. *Id.* at 468. However, in the amendment the plan also asserted that the original calculation used an incorrect withdrawal date excluding an entire year. *Id.* The plan asserted the correct percentage of withdrawal liability attributable to postpetition work was not 8.7%, but 26.2%. *Id.* Therefore, the plan increased the administrative expense claim amount from $19,580,146 to $36,248,771. *Id.* The bankruptcy court's determination was based in part on its view that because the interest rate change reduced the amount of withdrawal liability, no additional indebtedness was created during the administration of the debtor's estate. *Id.*

[59] *Id.* at 475.

[60] *Id.* at 476.

even went so far as to state that where Sixth Circuit precedent grants administrative priority to minimum funding contributions, "it seems appropriate to assert that claims for withdrawal liability relating to postpetition work by a debtor's employees should also be entitled to priority status."[61] However, the BAP quickly retreated from this position stating that, under the Sixth Circuit's *CPT Holdings* decision, a claim for withdrawal liability cannot arise prior to the debtor's actual withdrawal from its pension plan.[62] The BAP ultimately concluded that the major issue in the postpetition portion of the withdrawal liability assessed against the debtor "is *always* dependent upon factors that are not directly related to the postpetition work of a debtor's employees."[63]

Based on the influence of these outside factors, the BAP concluded, as a matter of law, that withdrawal liability claims do not have the "requisite causal relationship" to the postpetition work performed by the debtors' employees necessary to be eligible for administrative priority.[64]

B. Trucking Employees of North Jersey Welfare Fund, Inc. v. Marcal Paper Mills, Inc.

One year after the *HNRC* decision, the U.S. District Court for the District of New Jersey heard a very similar appeal and came to a very different conclusion.[65] Like *HNRC*, *Trucking Employees of N. Jersey Welfare Fund, Inc., v. Marcal* involved an employer withdrawing from a multiemployer plan in the process of Chapter 11.[66] Marcal employed truck drivers represented by the Teamsters Union Local 560, and under the CBAs between the parties Marcal was obligated to pay monthly

[61] *Id.* at 477. *But see* discussion *infra* Part IV.C.

[62] *Id.* at 478-79 (citing CPT Holdings, Inc. v. Indus. & Allied Employees Union Pension Plan, Local 73, 162 F.3d 405, 409 (6th Cir. 1998).

[63] *Id.* at 479. The court goes on to list the sources of UVB as a "myriad of factors including interest rate assumptions, the performance of a plan's investments, and other actuarial methods utilized by the plan's sponsors." *Id.*

[64] *Id.* 480-81.

[65] Trucking Employees of N. Jersey Welfare Fund, Inc. v. Marcal Paper Mills, Inc., No. 09-1863 (SRC), 2009 U.S. Dist. LEXIS 101695 (D.N.J. Nov. 2, 2009).

[66] *Id.* at *3-*5.

contributions to the pension plan on behalf of the drivers.[67] Marcal commenced Chapter 11 proceedings in November of 2006 and eventually sold its assets and dissolved in May of 2008.[68] Like the debtors in *HNRC*, Marcal made required contributions during the period it operated in Chapter 11, and upon dissolution all parties agreed that Marcal had no remaining obligation to contribute to the plan.[69]

Upon Marcal's withdrawal, the TENJ Pension Fund calculated Marcal's withdrawal liability to be $5,980,128 and filed an administrative priority claim for the portion they attributed to postpetition work.[70] The bankruptcy court, relying on *HNRC*, reclassified the claim as a general unsecured claim, not eligible for administrative priority.[71]

On appeal, the district court addressed the issue of whether the court should separate the withdrawal liability attributable to postpetition services from the prepetition liability and grant the former administrative priority.[72] Analyzing the issue, the district court noted it was one of first impression for the Third Circuit.[73] After conducting an analysis of the existing law, the court concluded that the Sixth Circuit BAP "miss[ed] the mark by focusing on the manner in which the assessment is computed rather than on the nature of the obligation itself."[74] The court viewed the withdrawal liability as "an acceleration of the employer's obligation to contribute towards the funding of pension benefits accrued by employees pursuant to agreement."[75] Essentially, the court viewed withdrawal liability as

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[67] *Id.* at *3-*4. Marcal did not enter into a new CBA after filing for Chapter 11, but entered into a Memorandum of Understanding with the Local 560 continuing the terms of the CBA pending negotiation of a new contract. *Id.* at *4.

[68] *Id.* at *3-*4.

[69] *Id.* at *4.

[70] *Id.* at *5. TENJ Pension Fund originally asserted a claim for the entire amount as an administrative expense, but after Marcal objected to administrative status, the fund countered by seeking only the portion attributable to postpetition services. *Id.* at *5-*6.

[71] *Id.* at *8.

[72] *Id.* at *7.

[73] *Id.*

[74] *Id.* at *22.

[75] *Id.* at *22-*23.

bridging the gap between the value of the benefits earned and the amount the employer had previously contributed. Countering the Sixth Circuit BAP's opposition to outside factors affecting the calculus, the district court held, based on the accelerated nature of the obligation, the law's concern with underfunded pensions, and the formula used to calculate the liability, outside factors will of course have some influence.[76] The court reiterated that this is not the dispositive issue, rather it is the character of the withdrawing employer's debt to the fund—"that is, incurred in return for the employees' service to the employer post-petition."[77] The court characterized the withdrawal liability incurred postpetition as nothing more than deferred compensation and stated that to deny administrative priority for these claims, "would in essence give the debtor a free ride on the labor of its employees."[78] The court found this result to be inequitable and "precisely opposite to what the MPPAA intended."[79] Therefore, the court granted administrative priority to the portion attributable to postpetition services, but remanded the case to the bankruptcy court to determine a method of apportioning the liability.[80]

IV. DISCUSSION

These two cases, decided just a year apart clearly illustrate the confusion courts experience when attempting to determine the treatment of withdrawal liability in bankruptcy. This issue has been frequently litigated after the passage of the MPPAA with surprisingly little progression. Attempting to resolve this issue, this article has analyzed the relevant case law along with the statutory text and legislative history. What this article attempts to do in this section is explain the clear legislative intent and the only workable solution for this issue.

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[76] *Id.* at *23.

[77] *Id.* at *24.

[78] *Id.*

[79] *Id.* at *25.

[80] *Id.* at *27. All parties agreed that there is no settled method of apportioning withdrawal liability. *Id.*

A. Is a Plan's Claim for Withdrawal Liability a "Claim" for Bankruptcy Purposes?

In looking at a plan's claim for withdrawal liability, one of the first and most important questions to answer is whether it is a claim for bankruptcy purposes, and if so, when it arises. At least one court has held that in some circumstances it is not a claim.[81] In *CPT Holdings*, the Sixth Circuit held, on somewhat different facts from the above cases, that where the withdrawal occurs eighteen months after confirmation of the Chapter 11 case and had not been contemplated by the employer during the Chapter 11 proceedings, the withdrawal liability is not a "claim" and is not discharged upon confirmation.[82] When an employer has terminated participation in a multiemployer plan prior to or at confirmation of the Chapter 11 plan, courts have virtually always considered the plan's withdrawal liability to be a "claim" for bankruptcy purposes.[83]

B. Can the Claim be Partitioned?

The next consideration is whether it is proper, or even possible, to partition a withdrawal liability claim into portions attributable to post and prepetition services. While several courts have recognized the appeal of portioning the claim, few have actually done so.[84]

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[81] *See* CPT Holdings, Inc. v. Indus. & Allied Employees Union Pension Plan, Local 73, 162 F.3d 405, 409 (6th Cir. 1998). In this case, during reorganization, the debtor-in-possession assumed the CBA and thereafter entered into a new CBA with the union. *Id.* at 406. Acknowledging the Bankruptcy Code's broad definition of a "claim," the court nonetheless held that an employer must completely withdraw from a plan prior to confirmation in order to discharge the claim. *Id.* at 409 ("They cannot remain a part of the plan and simultaneously have their withdrawal liability forgiven should they ever decide to withdraw.").

[82] *See id.* at 406, 409.

[83] *See, e.g.*, Trs. of the Amalgamated Ins. Fund v. McFarlin's, Inc., 789 F.2d 98 (2d Cir. 1986); *In re* Pulaski Highway Express, Inc., 57 B.R. 502 (Bankr. M.D. Tenn. 1986); *In re* United Dep't. Stores, Inc., 49 B.R. 462 (Bankr. S.D.N.Y. 1985).

[84] *Compare In re* Cott Corp., 47 B.R. 487, 495 (Bankr. D. Conn. 1984) (dividing the withdrawal claim into prepetition and postpetition amounts, and granting administrative priority to the postpetition amount), *and* Trucking Employees of N. Jersey Welfare Fund, Inc. v. Marcal Paper Mills, Inc., No. 09-1863 (SRC), 2009 U.S. Dist. LEXIS 101695 at *27 (D.N.J. Nov. 2, 2009) (prorating withdrawal liability claim and granting

In drafting ERISA and the MPPAA, Congress never hinted that withdrawal liability is capable of being partitioned or prorated, and as a result no statutory method of partitioning the claim exists.[85] Where courts have allowed a claim to be prorated, the calculation has typically been done as follows: once the employer's withdrawal liability has been determined using one of the methods provided in ERISA,[86] that amount is multiplied by the number of hours the debtor's employees worked postpetition divided by the total hours worked by the debtor's employees in the previous five years.[87] For example, if the debtor's withdrawal liability is determined to be $1,000,000, and the debtor's employees worked 10,000 hours postpetition and 50,000 hours in the previous five years, then one fifth ($200,000) of the withdrawal liability would be attributable to work done postpetition (10,000/50,000 = .2 x $1,000,000 = $200,000). While on its face this formula may have some appeal, it has no basis in law.

C. The Missing Link: The Internal Revenue Code

Understanding the standards governing an employer's obligation to pay minimum funding contributions is central to understanding the correct treatment of the withdrawal liability claims in bankruptcy. These standards are found in the Internal Revenue Code (IRC).[88] Through the IRC Congress created an incentive to entice employers to participate in employee pension and welfare plans. Congress accomplished this by giving employers a tax deduction for funds contributed to these types of plans. Because these benefits are not taxable to the employee, employers are enticed to use benefits as wage substitutes. Since the IRC excludes these benefits from an employee's

administrative priority to the postpetition amount), *with Pulaski*, 57 B.R. at 508, 510 (recognizing the equity of prorating the withdrawal liability claim, but declining to do so on the record before it).

[85] *See Pulaski* at 510-11 n.17 (noting the ERISA provides four methods of calculating withdrawal liability, none of which were designed to partition the withdrawal liability claim).

[86] *See supra* note 28 and accompanying text.

[87] *See, e.g.*, *In re* HNRC Dissolution Co., 396 B.R. 461, 467 (B.A.P. 6th Cir. 2008).

[88] 26 U.S.C. § 412 (Supp. 2010).

income tax, typically employees would rather receive nine dollars in benefits than ten dollars in income. As a result, these "tax subsidies" on fringe benefits can greatly reduce wage costs for employers. However, to qualify for these lucrative benefits employers must meet the obligations stated in the IRC.

Section 412 of the IRC sets forth the minimum funding standards for multiemployer plans.[89] The IRC divides the minimum funding contributions into two parts: the amount necessary to pay for benefits that are presently accruing, and an additional amount to amortize unfunded liabilities that accrued in the past.[90] Essentially, employers are required, on an ongoing basis, to contribute to the pension plan an amount that covers all presently accruing employee benefits and plan expenses and an amortized amount of previously occurring underfunding.[91] While withdrawal liability and minimum funding requirements may seem similar, it is important to recognize the distinction between the two. Withdrawal liability represents the difference between the plan's UVB and the present value of its assets, in a sense requiring withdrawing employers to settle up.[92] On the other hand, the minimum funding requirements ensure that employers fund both presently accruing benefits and past liabilities as they occur, forcing them to pay as they go.[93] It is also important to note that unlike the minimum funding requirements,[94] withdrawal liabil-

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[89] *Id.*

[90] *See* 26 U.S.C. §§ 412, 431. Although Congress has amended the funding standards many times, the basic structure of the funding requirements is substantially the same as when ERISA was originally passed.

[91] *See* 26 U.S.C. §§ 412, 431; *see also* H.R. REP. NO. 96-869, at 59 (1980), *reprinted in* 1980 U.S.C.C.A.N. 2918, 2927 ("Generally the minimum funding standards require that contributions to a plan each year be adequate to pay for benefits accrued in that year (normal cost) plus an amount necessary to amortize unfunded liabilities spread over specified periods of time.").

[92] *See supra* notes 22-31 and accompanying text.

[93] *See supra* notes 89-91 and accompanying text.

[94] *In re* HNRC Dissolution Co., 396 B.R. 461, 465 (B.A.P. 6th Cir. 2008) ("The periodic contribution rates are established through collective bargaining . . . ."); *see also In re* United Dep't. Stores, Inc., 49 B.R. 462, 462 (Bankr. S.D.N.Y. 1985).

ity does not derive from the collective bargaining agreements; it "is a product of the MPPAA."[95]

Now that all the pieces of the puzzle have been collected, it is possible to analyze how withdrawal liability claims should be treated in bankruptcy. As the dispositive question rests on whether the claims qualify for administrative priority, this article will analyze the claims under the administrative priority standard.

As employers typically continue to make the required contributions up to the point of their withdrawal from the plan,[96] the first step in this analysis is to classify the minimum funding contributions. Since contributions to pension plans are typically seen as wage substitutes and are certainly part of the collective bargaining agreement, there is usually no objection to the employer making these contributions while operating postpetition. Even if an employer does not make these contributions, the Bankruptcy Code has a specific provision granting administrative priority to such a claim.[97] However, a Sixth Circuit case applying this provision held that only the portion of the minimum funding contributions attributable to pension benefits earned postpetition—as opposed to the amortized portion for past underfunding—is eligible for administrative expense priority.[98] Understanding the purpose of administrative priorities and the nature of minimum funding contributions, it is logical that the Bankruptcy Code would grant priority in such a case.

Viewing pensions as wage substitutes, it follows that allowing priority for contributions does in fact encourage parties to work with the debtor postpetition and provide a direct and

[95] CPT Holdings, Inc. v. Indus. & Allied Employees Union Pension Plan, Local 73, 162 F.3d 405, 407 (6th Cir. 1998); *see also* Trs. of the Amalgamated Ins. Fund v. McFarlin's Inc., 789 F.2d 98, 104 n.2 (2d Cir. 1986).

[96] *See, e.g.*, *HNRC*, 396 B.R. at 466; Trucking Employees of N. Jersey Welfare Fund, Inc. v. Marcal Paper Mills, Inc., No. 09-1863 (SRC), 2009 U.S. Dist. LEXIS 101695, at *4 (D.N.J. Nov. 2, 2009); *In re* United Dep't Stores, Inc. 49 B.R. at 463.

[97] 11 U.S.C. § 507(a)(5) (Supp. 2010).

[98] *In re* Sunarhauserman, Inc., 126 F.3d 811, 819 (6th Cir. 1997); *see also* Columbia Packing Co. v. PBGC, 81 B.R. 205, 210-11 (D. Mass. 1988) (finding debtor's obligation to make periodic contributions to the pension plan was entitled to administrative priority to the extent it arises from services performed postpetition).

substantial benefit to the estate in the exact manner as paying regular cash wages. But if administrative priority for minimum funding contribution is sufficient to encourage parties to work with the debtor, we are left with this question: what purpose is served by granting administrative priority to withdrawal liability claims?

The only logical reason for granting an administrative priority to *any* portion of a withdrawal liability claim is to encourage employees to continue working for the debtor by granting priority to the pension benefits they are earning postpetition. The obvious flaw in this reasoning is that the minimum funding requirements have already fulfilled this purpose. By granting administrative priority to the funding contributions, Congress has both encouraged and protected the employees to the full extent necessary to fulfill the purposes of both the Bankruptcy Code and ERISA. Viewing these intersecting bodies of law in their entirety, it is clear that granting an administrative priority to withdrawal liability claims is inconsistent with congressional intent.

D. *Congress's Intent*

Viewing the legislative history of the MPPAA with an eye towards its implications on bankruptcy sheds additional light on this discussion. In the MPPAA, Congress ordered the PBGC to create a voluntary supplemental insurance program to reimburse multiemployer plans for withdrawal liability claims "which are *uncollectible* because of bankruptcy or similar proceedings involving the employer."[99] Characterizing withdrawal liability as "uncollectable because of bankruptcy" goes a long way in describing Congress's view of the correct treatment of these claims in bankruptcy. It would be inconsistent for Congress to order the PBGC to create a separate plan to allow multiemployer plans to insure against uncollectable withdrawal liability claims if Congress intended for these claims to receive administrative priority. Perhaps a counter argument might be

[99] H.R. REP. 96-869, pt. 2, at 31 (1980) (emphasis added), *reprinted in* 1980 U.S.C.C.A.N. 2993, 3020.

that Congress merely intended to insure against the portion attributable to prepetition services, but this argument fails because Congress never even discussed partitioning withdrawal liability claims and certainly specified no method for doing so. Yet another example is ERISA's provision lowering the amount of withdrawal liability imposed on "insolvent employer[s] undergoing liquidation or dissolution."[100]

The message appears to be consistent; while Congress is using withdrawal liability to discourage participating employers from withdrawing from multiemployer plans, the imposition of withdrawal liability is not universal. It seems clear that Congress designed withdrawal liability as a means of encouragement for employers, and not an entitlement for plans. Anticipating uncollectible withdrawal liability claims, Congress created the supplemental program. By making the supplement program voluntary, Congress gave plans a choice: participate in the program or self-insure against uncollectible withdrawal liability.

Looking at this legislative history and the bankruptcy related provisions, it is clear that Congress did not envision an administrative priority for withdrawal liability claims. Even if Congress had envisioned such treatment, we would not expect to find the priority written into ERISA. As administrative expense priority is a bankruptcy created doctrine, when Congress decides to grant such a privilege it does so by amending the Bankruptcy Code. For example, in 2005, Congress amended section 503(b)(1)(A) of the Bankruptcy Code to provide an administrative expense for certain back pay awards.[101]

Taking a close look at what Congress has done in the Bankruptcy Code with regard to pension related claims further illuminates the issue. As discussed, section 507 gives a first[102]

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[100] MPPAA, § 4225(b), 94 Stat. 1208, 1242 (1980) (current version at 29 U.S.C. § 1405(b) (2006)). Congress limited the withdrawal liability for these employers to no more than the sum of fifty percent of the UVB allocable to the employer and the portion of that fifty percent that does not exceed the liquidation or dissolution value of the employer at the commencement of the liquidation or dissolution and after reducing the liquidation or dissolution value by the original fifty percent. *Id.*

[101] Pub. L. No. 109-8, § 329, 119 Stat. 23, 101 (2005).

[102] *See supra* note 38.

priority to administrative expenses, as defined by section 503.[103] While section 503 makes no specific mention of employee benefit plan contributions or pension obligations, section 507 gives a fifth priority to claims for a limited amount of prepetition contributions to employee benefit plans.[104] Given Congress's explicit mention of pension related claims, one would expect any intended administrative priority for withdrawal liability to show up in either section 503 or 507.

Because administrative expense priority is generally narrowly construed, a claim of administrative priority for withdrawal liability must pass a very high bar.[105] While it does seem appropriate that employees should be entitled to an administrative priority for the pension benefits they earn postpetition, where courts have erred is in using administrative priority to give the plans through withdrawal liability what has already been given through the required minimum contributions. Allowing pension plans to receive the employer's required minimum contributions *in addition* to granting administrative priority to a portion of the withdrawal liability claim creates no additional incentive for parties to work with the debtor—the very purpose of administrative priority—and thereby hijacks the bankruptcy process. Decisions like *Marcal* frustrate the Bankruptcy Code's purposes of effecting a successful reorganization and an equitable distribution of assets. Because administrative expenses must be paid before a plan can be approved, this additional expense could keep many large companies from successfully reorganizing. Therefore, allowing the plans to receive this windfall imposes an impermissibly high cost on society.

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[103] 11 U.S.C. § 507(a)(2) (Supp. 2010).

[104] 11 U.S.C. § 507(a)(5). This priority is limited to claims "arising from services rendered within 180 days before the date of the filing of the [bankruptcy] petition or the date of the cessation of the debtor's business, whichever occurs first," and is limited to an amount equal to $10,950 multiplied by the number of employees less the aggregate amount paid to the employees under the 507(a)(4) fourth priority for wages, salaries, commissions, including vacation, severance and sick leave pay earned within 180 days of the filing of the petition, plus the aggregate amount paid by the estate on behalf of the employees to any other employee benefit plan. 11 U.S.C. §§ 507(a)(4)–(5).

[105] *See supra* note 43 and accompanying text.

CONCLUSION

Congress enacted the MPPAA just two years after enacting the Bankruptcy Code.[106] It is hard to believe that Congress could have overlooked the obvious collision course of withdrawal liability and bankruptcy. Viewing the MPPAA and its legislative history, it is clear Congress fully anticipated this collision and went to great lengths to minimize the impact that bankruptcy and employer insolvencies would have on multiemployer pension plans. Foreseeing that withdrawal liability would become uncollectable through bankruptcy, Congress ordered the PBGC to create a supplemental program to reimburse plans that suffer such uncollectible withdrawal liabilities. Participation in the supplemental program was voluntary, giving plan fiduciaries the choice of whether to participate, or whether to self-insure. Had the program been mandatory, one wonders if we would still have an issue to discuss.

The privilege of administrative expense priority falls neatly within the province of bankruptcy law. Its purpose is simple: to encourage others to engage in business transactions with the debtor. Such a provision is unquestionably necessary to provide an effective means to reorganize a debtor. The Bankruptcy Code narrowly construes administrative priorities in order to preserve the value of the estate for all creditors, limiting its use to the actual, necessary costs and expenses of preserving the estate. This priority is limited to expenses arising from a transaction with the estate that directly and substantially benefited the estate. This standard is indeed met by employees earning pension benefits while working for the debtor postpetition, and the employees' claims are fully satisfied by the employer's payment of the minimum required contributions.

Any assertion of administrative priority for a withdrawal liability claim fails for three principal reasons: (1) the calculation has no relation to the amount of benefits the employees earn postpetition, (2) there is no statutorily provided method of partitioning withdrawal liability into prepetition and postpetition amounts, and (3) any claim for the employees' postpetition-

[106] *See* MPPAA of 1980 and Bankruptcy Code of 1978.

earned benefits is properly satisfied through the minimum funding requirements.

Contrary to the *Marcal* court's statement, if courts allow pension plans to receive administrative priority *on top* of the minimum funding contributions, it is the plans that get the free ride, and they are riding on the backs of the creditors.

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