



THE WAGNER
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Employee Benefits in Bankruptcy

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Presented by

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Introductory Comments

Agenda for today

- ◆ Context for the current environment.
- ◆ Why bankruptcy? Over leveraged, industry failure/decline, poor management, external catastrophe (health crisis, force majeure, political risk), conscious decision to preserve or maximize value; deal with labor issues.
- ◆ Fresh start, provide debt discharge and in a Chapter 11 give debtor time to restructure balance sheet; save the business; save jobs.
- ◆ Equalize to some extent the playing field for creditors .
- ◆ Benefits issues may involve pensions, 401(k) plans, executive compensation, other benefits.
- ◆ Debtor v creditor: competition for every dollar.
- ◆ ERISA and benefits are a specialized subset of bankruptcy law and process.

Bankruptcy a Timely Issue

- ◆ Dean Foods filed bankruptcy last fall. Its largest creditor is Central States Pension Fund, also failing.
- ◆ McClatchy filed bankruptcy in February, citing efforts with IRS and PBGC to address funding of single-employer defined benefit plan.
- ◆ White-collar bonuses, major concern for unions and often public stakeholders, were contested in Purdue Pharma and Bumble Bee.
- ◆ Recession is expected, and along with it more bankruptcies large and small.
- ◆ In last recession, business bankruptcy filings spiked to about 70,000 in 2010. Filings dropped to about 20,000 in 2019.
- ◆ Comparable figures for personal bankruptcy filings were 1,600,000 and 770,000.

Pensions Can Survive Bankruptcy

- ◆ In 2002 and 2008 recessions, some pensions were terminated in bankruptcy (Delphi) but others rode through with haircuts (e.g., American Airlines: plans frozen; lump sums curtailed).
- ◆ Factors include labor, lender, and general creditor demands, affordability, media attention, and strategic use of bankruptcy law and procedure.
- ◆ Private equity and other alternative financing often leads to asset sales, leaving legacy costs such as pensions behind.
- ◆ In personal bankruptcies, pensions and other retirement income are generally protected from creditor claims.

PBGC Basics

◆ Single-Employer Plans

- Minimum funding is main protection for earned benefits.
- PBGC Early Warning Program polices against undue risk taking.
- PBGC's guaranty is ~\$70,000/yr., with reductions for age and payment form.
- Fully funded plan may be terminated in standard termination.
- PBGC may terminate an underfunded plan or accept an employer's distress termination.
- CARES Act provides longer runway, by deferring 2020 contributions to January 2021.
- Controlled group (employer and affiliates) is liable to PBGC on plan termination for unfunded benefits, unpaid contributions, and termination premium.

PBGC Basics (continued)

◆ Multiemployer Plans

- Funding standards more lax than for singles.
- Withdrawal liability meant to protect plan's cash flow and balance sheet.
- Benefit adjustments/suspensions permitted.
- PBGC's guaranty more stingy than for singles, and insurance fund failing.
- Plan merger and partition offer some relief.

Bankruptcy Basics

◆ Parties:

- U.S. Trustee
- Debtor; Debtor in Possession
- Ch. 7 and Ch. 13 Trustees
- Lenders
- Trade Creditors, Unions, Employees, Retiree, Employee Benefit Plans
- Creditors, Bondholders, and Equity Committees
- Ch. 11 Petition, Debtor-in-Possession Financing, Wages/Fringes and Other First-Day Motions, and Formation of Creditors' Committee
- Pre-arranged and Prepackaged Ch. 11 cases
- Property of the Estate, Avoidance Powers, and Automatic Stay
- Rejection of Executory Contracts and Modification of CBAs (under Section 1113) and Retiree Medical Benefits (under Section 1114)
- Ch. 11 Plan of Reorganization and Disclosure Statement
- Objections, Voting, and Confirmation
- Assertion and Allowance of Claims
- Discharge
- Asset sales (under Section 363); compared to “true reorganizations”

“Small Business” Bankruptcies

- ◆ The Small Business Reorganization Act of 2019 took effect in February. Before SBRA, small businesses often couldn't afford the time and expense of Chapter 11. Their only choices were to liquidate in Chapter 7, in state court, or out of court.
- ◆ Small businesses (with less than \$2.7 million in debts) can now proceed under subchapter V of Chapter 11. Subchapter V has shorter timeframes, provides more leeway in negotiating a reorganization plan, and provides for a private trustee to work with the Debtor and creditors to develop a consensual plan.
 - ◆ CARES Act (COVID-19 emergency relief act) increased threshold to \$7.5 million for one year (through February 2021).

“Small Business” Bankruptcies (continued)

- ◆ A small business owner can now reorganize and keep control of company without the complexity or cost of regular Chapter 11:
 - No creditors committee unless the court orders it.
 - No disclosure statement.
 - No need to pay claims in full to retain equity. Plan must simply not “discriminate unfairly” and be “fair and equitable.”
 - Plan must simply provide for distribution of all projected disposable income for three to five years.
 - No competing plans.

Key Points for Small Business

- ◆ The debtor may be individual or entity - \$2,725,625 limit.
 - CARES ACT increase for one year to \$7,500,000.
 - No creditors committees without court order, so Debtor and Trustee work in concert.
 - Fast track – must file Chapter 11 plan within 90 days of petition filing.
 - No disclosure statements.
 - Discharge immediate with consensual plan; within three years if all payments are made with nonconsensual plan.
 - Administrative claims may be paid over time.
 - No Absolute Priority Rule.

Priority of Claims

- ◆ Secured Claims
- ◆ Administrative Expense claims
- ◆ Priority Claims
 - Alimony and Child Support
 - Wages and Related Amounts
 - Employee Benefit Plan Contributions
 - Taxes
 - General Unsecured Claims

PBGC Concerns in Bankruptcy

- ◆ Seeks prompt notice, to be heard on first-day motions, and Creditors' Committee appointment.
- ◆ Court may permit unwarranted termination.
- ◆ Claims may be misclassified.
- ◆ Claim objections may lead to smaller recovery.
- ◆ Substantive consolidation may defeat controlled group liability.
- ◆ Non-Debtor releases may defeat controlled group and fiduciary liability.
- ◆ Unions and retiree groups share some of these concerns.

Creditor Bankruptcy Strategies

- ◆ Object to first-day motions (e.g., Purdue Pharma bonuses).
- ◆ Seek Creditors' Committee membership.
- ◆ Form alliances with other creditors.
- ◆ Know that 1113 and 1114 motions are in the wings, and prepare for negotiations.
- ◆ Similarly, prepare for pension termination motion, contingent on 1113 proceedings.
- ◆ Know that a 363 motion may control negotiations, and prepare accordingly.

Debtor/Lender Bankruptcy Strategies

- ◆ Control agenda and case timing.
- ◆ Seek support of Creditors Committee on employee benefits issues.
- ◆ Modify CBA, if applicable, to permit pension plan termination.
- ◆ Seek distress termination ruling.
- ◆ Object to PBCG claims.
- ◆ Reject CBA under Bankruptcy Code Section 1113.
- ◆ Object to priority of withdrawal liability claims.
- ◆ If necessary, moot these issues through Section 363 asset sale.

Possible Outcomes

- ◆ Pensions ride through bankruptcy.
- ◆ Ride-through with concessions, e.g., freeze.
- ◆ Assumption by asset purchaser, with or without concessions.
- ◆ Spinoff or mirror plan for actives in asset purchase.
- ◆ Distress/involuntary termination or withdrawal.
- ◆ New pension or retirement arrangement.

Goals

- ◆ Employer seeks to preserve workforce but often with more affordable benefit package.
- ◆ Lender/Buyer seeks to cut overhead.
- ◆ Union seeks to preserve jobs, wages, work rules, and benefits to the extent possible.
- ◆ “PBGC wins a case when a DB plan continues,” and so do retirees.
- ◆ Actives need reasonable accruals, posing an inter-generational issue.
- ◆ Retirees seek to preserve benefits, both PBGC-insured and non-insured.
- ◆ New models emerging for actives, the unpensioned, and gig workers.

Defined Contribution Plans

- ◆ Employers can usually terminate DC plans at will, unless limited by a CBA or other contract. No PBGC coverage.
- ◆ In personal bankruptcy, DC accounts are not property of the estate.
- ◆ In addition, debtor may exempt retirement income from the estate under either federal or state exemptions.
 - Federal exemptions extend to retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.
 - Requires IRS determination letter or showing that plan is substantial compliance or debtor or not at fault for noncompliance.
 - State exemptions may include valid “spendthrift” trusts, e.g., one that “contains language substantially to the effect that it restrains both voluntary and involuntary transfers of a beneficiary's interest.” (W. Va. Code §44D-5-502(a)).
- ◆ Exception where debtor uses a DC account or IRA to defraud creditors, e.g., by making outsized contributions on eve of bankruptcy.

Fiduciary Issues

- ◆ No statutory guidance in ERISA or Bankruptcy Code for plan fiduciary.
- ◆ Fiduciary landscape may differ in Chapter 7 liquidation v Chapter 11 reorganization.
- ◆ Who are the fiduciaries? What duties apply?
- ◆ Which plans are ERISA governed? Which employee benefits are non-ERISA?
- ◆ Pre-filing concerns? Unpaid contributions?
- ◆ What is role of the Debtor in Chapter 7 – Bankruptcy Code 704?
- ◆ Appoint an Independent Fiduciary?
- ◆ Employer securities? ERISA duty v securities law requirements.
- ◆ Settlor v Fiduciary? Decision to enter into a bankruptcy?
- ◆ Disclosure?
- ◆ Need for independent legal counsel.

Who are the fiduciaries?

- ◆ To the extent manage assets, renders investment advice for a fee, or discretion over administration of plan
- ◆ Settlor v. fiduciary activity
- ◆ Named fiduciary, trustee, committee, directed trustee, functional fiduciary
- ◆ Personal liability
- ◆ Officers and directors
- ◆ Plan administrator/debtor – Section 704
- ◆ Appointment of an Independent Fiduciary
- ◆ Co-fiduciary liability

ERISA Plans

- ◆ Employee Benefit Plans: pension and welfare
- ◆ Solo plans? Voluntary benefit plans?
- ◆ Top Hat Plans? Unfunded Excess Benefit Plans?
- ◆ Fiduciary exposure to lawsuit by participants where plan is harmed
- ◆ Will bankruptcy cut-off benefits of the plan?

Bankruptcy Code 704

- ◆ Key court cases
 - The Robert Plan
 - In re NSCO, Inc.
 - Mid States Express

Independent Fiduciary Appointment

- ◆ File Motion for Order to Amend Plan/Appoint an Independent Fiduciary.
- ◆ Section 704: trustee is personally acting rather than as trustee? DOL view
- ◆ Inherent conflict.
- ◆ Solution: appoint Independent Fiduciary via plan amendment.

Employer Securities

- ◆ Settlor v. fiduciary conflict
- ◆ ERISA duty v. duty to protect non-public information
- ◆ Valuation issues, especially closely held

QUESTIONS?



Further Reading

Israel Goldowitz, et al., *The PBGC Wins a Case Whenever the Debtor Keeps its Pension Plan*, 16 Marq. Ben. & Soc. Welfare L. Rev. 257 (2015), <https://scholarship.law.marquette.edu/benefits/vol16/iss2/2/>

Israel Goldowitz, *Employee Benefits Issues Prominent in Restructuring and Bankruptcy Cases*, 48 Compensation Planning Journal 3 (January 3, 2020)

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