DEFINED BENEFIT PENSION ISSUES EXPECTED IN THE NEXT WAVE OF BANKRUPTCIES[1,2]

ISRAEL GOLDOWITZ
The Wagner Law Group

INTRODUCTION

In the last recession, corporate bankruptcy filings spiked, to about 60,000 per year in 2008-2010 and more than 40,000 per year in 2011 and 2012.[3] Among the debtors were sponsors of traditional defined benefit pension plans, including American Airlines, General Motors, and Nortel. Others participated in multiemployer defined benefit plans, such as A&P, Hostess, and Patriot Coal.

In some cases, the pensions rode through bankruptcy and were continued by the reorganized company. In others, however, the pension plan was terminated, or the debtor withdrew from the plan, and the resulting claims were resolved in the bankruptcy.

As this article is written, the economy is reeling from the effects of the COVID-19 virus. Unemployment is at levels not seen since 2008, the stock market is well off its highs, and several major companies have filed or are planning for bankruptcy. Bankruptcy treatment often influences out-of-court restructurings. So, it's important for insolvency and restructuring professionals to understand defined benefit pension issues in business bankruptcies.

OVERVIEW OF FEDERAL PENSION LAW

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), governs private-sector employee benefit plans.[4] ERISA sets minimum standards for participation, vesting, benefit accrual, funding, fiduciary conduct, and reporting and disclosure. ERISA also established the Pension Benefit Guaranty Corporation ("PBGC") to insure benefits under failed defined benefit plans.[5]

A defined benefit plan is one that promises a lifetime benefit based on a formula.[6] For salaried employees, the benefit is usually expressed as a percentage of pay times service, e.g., 1.25% of "high-three" pay per year of service (or $37,500 per year if an employee's highest three years' pay averaged $150,000 and she had 20 years of service). For hourly employees, the benefit is often a flat amount per year of service or a percentage of career-long contributions.

A pension is typically payable at a stated retirement age, e.g., 62. It may be paid earlier, with or without a reduction for actuarial equivalency. For instance, if an employee has 70 age and service points, he may be paid the same amount at age 55 as at age 62. In that case, the early retirement benefit is "subsidized."

A defined benefit plan promises a fixed benefit regardless of market performance. Thus, investment risk is on the employer. But Congress did not require employers to fully fund benefits. So the employee has the default risk.[7]

History of Federal Regulation

Pensions were originally a workforce management tool.[8] Pay increases as workers advance, and workers wear out as they age, especially in industrial jobs. By giving older workers an incentive to retire and new hires an incentive to stay, pensions help to manage turnover.

State courts initially saw pensions as gratuities, and unenforceable.[9] A few courts saw a pension promise as an offer of a unilateral contract to a class of persons. For example, if an employer promises anyone who works 20 years and reaches age 65 a pension of one-third of her final pay for life, any member of the class who meets these conditions would have a contractual right to a pension.[10]

But judge-made law was a patchwork, and worker rights mainly developed in other forums. For instance, the Internal Revenue Service ("IRS") took the view that employees would vest in plan assets when a plan

1 The McClatchy Company filed for Chapter 11 bankruptcy on February 13, 2020. Mr. Goldowitz represents a retiree association in that case. The views expressed are his own. Public filings are used for illustrative purposes.

2 An abbreviated version of this article appeared as "Employee Benefits Issues Prominent in Restructuring and Bankruptcy Cases," in BloombergBNA Compensation Planning Journal, January 3, 2020. Other portions appeared in "Funding of Public Sector Pension Plans: What Can be Learned from the Private Sector?," 23 University of Connecticut Insurance Law Journal 143 (2017).

3 https://www.uscourts.gov/news/2013/02/04/bankruptcy-filings-decline-calendar-year-2012 (published February 4, 2013). Since 2015, filings have declined from 26,000 to 22,000. https://www.uscourts.gov/news/2019/04/22/bankruptcy-filings-continue-decline (published April 22, 2019).

4 29 U.S.C. §§ 1001-1453.

5 **29 U.S.C. §§ 1301-1453.**

6 **29 USC § 1002(35).**

7 *See, e.g., Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-40 (1999).

8 Lawrence A. Frolik and Kathryn L. Moore, *Law of Employee Pension and Welfare Benefits* 7 (3d ed. 2012) (citing Merton C. Bernstein, *The Future of Private Pensions* 10 (1964)).

9 *E.g., McNevin v. Solvay Process Co.,* 32 A.D. 610 (N.Y. App. Div. 1898), *aff'd per curiam*, 60 N.E. 1115 (N.Y. 1901).

10 *See Wickstrom v. Vern E. Alden Co.*, 240 N.E. 2d 401 (Ill. App. Ct. 1968) (early retirement offer), cited in 1-3 Corbin on Contracts § 3.16 (2006). An example well known to lawyers is *Carlill v. Carbolic Smoke Ball Company,* 1 QB 256 (1893). A vendor put an ad in a newspaper saying that anyone who bought this contraption and inhaled its vapors and still contracted the flu would be paid 100 pounds. The court held that this was an offer to a class and that any member of the class who met the conditions had accepted the offer and held an enforceable right to payment.

terminates (or when a major downsizing is deemed a termination for affected employees).[11] In 1948, the National Labor Relations Board held that pensions are among the terms and conditions of employment and therefore a mandatory subject of collective bargaining.[12]

The Labor-Management Relations Act, 1947, required collectively bargained multiemployer plans' assets to be held in trust by joint labor-management boards, leading to limited judicial review.[13] In 1958, Congress enacted the Welfare and Pension Plans Disclosure Act,[14] which required all employee benefit plans to file an annual report with the Department of Labor. But there was no comprehensive federal law until ERISA.

ERISA's Minimum Standards

ERISA's minimum standards codify an understanding that pensions are deferred compensation for services rendered.[15] Among other things, ERISA:

- requires that benefits vest within a reasonable period;
- provides that accrued benefits generally cannot be reduced;
- requires that defined benefit plans be responsibly funded;
- imposes minimum standards of prudence and loyalty on plan fiduciaries;
- provides for federal insurance of defined benefit pension plans; and
- broadly preempts State law as it relates to employee benefit plans.[16]

MINIMUM FUNDING STANDARDS

ERISA does not require that benefits be fully funded. Rather, it allows a funding shortfall to be amortized over a period of years. ERISA's minimum standards are found in the Labor title of the U.S. Code (Title 29) and in the Internal Revenue Code (Title 26). Treasury/IRS has primary authority over the funding rules.[17]

Single-Employer Plans

A plan sponsor must make an annual contribution. The plan actuary will first calculate the "funding target," or the present value of plan benefits at the beginning of the year. From the funding target, she will subtract the value of plan assets, to derive the "shortfall." Next, she will set up a schedule to amortize the shortfall over seven years, netting out unamortized charges from prior years, to derive the "shortfall amortization charge."

The actuary will also calculate "normal cost," the present value of benefits expected to be earned in the year plus the year's estimated expenses.[18]

Finally, the actuary will add the shortfall amortization charge and normal cost. The sum is the year's required contribution.

Actuarial present value is highly dependent on the interest and mortality assumptions. The interest assumption is based on an average of yields on high-quality corporate bonds, using a yield curve (or segments of the curve) to fit maturity to expected benefit payments. Mortality is to be prescribed by the Treasury Department at least once every ten years.[19] Mortality is currently based on the RP-2014 table (with improvements).[20]

Contributions are generally due in quarterly installments, 15 days after the close of the quarter. Any deficiency must be paid off in a "catch-up" payment no later than 8-1/2 months after the close of the year. For instance, contributions for the 2019 year are due April 15, July 15, and October 15, 2019, and January 15, 2020, with the catch-up payment due September 15, 2020.[21]

A plan sponsor may elect to create a prefunding balance if it contributes more than the minimum required. It may then apply the prefunding balance in lieu of cash contributions.[22]

11 Isidore Goodman, *Developing Pension and Profit-Sharing Requisites*, 13 Santa Clara L. Rev. 1, 20-21 (1972). *See In re Gulf Pension Litig.*, 764 F. Supp. 1149 (S.D. Tex. 1991).

12 *Inland Steel Co. v. NLRB,* 170 F.2d 247 (7th Cir. 1948); *see* 29 U.S.C § 158(a)(5).

13 29 U.S.C. § 186(c)(5); *see Danti v. Lewis,* 312 F.2d 345, 348 n.3 (D.C. Cir. 1962) ("[the] authorities are divided as to whether an applicant for a pension has a contractual interest in the Fund as a third party beneficiary to the Wage Agreement, or whether his interest is merely equitable and conditioned on meeting the eligibility requirements reasonably established by the Trustees.").

14 Pub. L. No. 85-836, 72 Stat. 997 (1958).

15 29 U.S.C. §§ 1001(a), 1001(b) (". . .the continued well-being and security of millions of employees and their dependents are directly affected by [employee benefit] plans . . . .[ERISA's declared policy is to] protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries . . . .").

16 29 U.S.C. §§ 1053-54, 1082-85, 1104, 1114(a).

17 Reorganization Plan No. 4 of 1978, *reprinted* in 43 Fed. Reg. 47,713 (Oct. 17, 1978).

18 26 U.S.C. § 430(a)-(c). *See* 29 U.S.C. §§ 1133-1135; Lynn A. Cook & James E. Holland, Jr., 371-6TH U.S. Income: Employee Plans—Deductions, Contributions and Funding, Tax Mgmt. Port. at A-113-75 (2015).

19 26 U.S.C. § 430(h)(2), (3).

20 Notice 2018-02, *Updated Mortality Improvement Rates and Static Mortality Tables for Defined Benefit Pension Plans for 2019*, https://www.irs.gov/pub/irs-drop/n-18-02.pdf.

21 26 U.S.C. § 430(j). The Coronavirus Aid, Relief, and Economic Security Act permits employers to defer contributions due in 2020 until January 1, 2021. Pub. No. 116-136, § 3608, 116 Stat. ___,___ (2021).

22 26 U.S.C. § 430(f)(3).

Continued from p.47

A sponsor experiencing "temporary substantial business hardship" may apply to IRS for a waiver of the year's contribution. The waived amount then becomes an additional amortization charge in the next five years. IRS may require that security be given to the plan, enforceable by PBGC.[23]

Additional funding is required if a plan is "at risk," less than 80% funded. At-risk plans cannot increase benefits; they must make the most conservative assumptions about early retirement and benefit form; and their funding is subject to a 4% surcharge. A pre-funding balance cannot be used instead of cash contributions if the plan is at risk.[24]

A liquidity shortfall contribution is required to the extent a plan's liquid assets do not equal three times its annual disbursements.[25]

If the annual contribution is not made by the catch-up date, an "accumulated funding deficiency" results, and an excise tax of 10% of the deficiency is imposed. The tax increases to 100% if the deficiency is not timely corrected.[26]

If the unpaid balance exceeds one million dollars, a lien arises in favor of the plan on all property of the controlled group.[27] PBGC has sole authority to perfect and enforce the lien.[28]

Multiemployer Plans

Contributions are set by collective bargaining agreements, usually at an hourly rate. The hourly rate is calibrated so that, when multiplied by an estimate of hours, shifts, or other agreed units, contributions will meet the statutory minimum.

The minimum is set by a "funding standard account," to which specified charges and credits are made each year. If the total charges are greater than the total credits (including contributions), there is a funding deficiency. In computing the charges and credits, the plan's actuary must use assumptions that are individually reasonable and that in combination represent her best estimate of future experience.[29]

A plan can seek a funding waiver if 10% of the employers would otherwise suffer substantial business hardship, with the waived amount amortized over 15 years. A plan can also seek an extension of the amortization period from 15 to 20 years if it has adopted a funding improvement plan (see below), or to 25 years if necessary to avoid plan termination or a substantial benefit curtailment.[30]

Multiemployer plans in endangered or critical status (less than 80% or 65% funded, respectively) must also adopt funding improvement plans ("FIP") or rehabilitation plans ("RP"). An endangered or "yellow zone" plan's FIP must project a one-third funding improvement over ten years. The FIP typically contains a negotiated schedule of contribution increases and a default schedule if no agreement is reached. The default schedule typically requires decreases in benefit accruals as well.[31]

A critical or "red zone" plan's RP must project emergence from the red zone in ten years. Red zone plans generally may suspend early retirement subsidies and disability benefits not yet in pay status and other "adjustable benefits"and restrict lump sums, in addition to reducing future accruals. If emergence is not possible, a red zone plan must at least take reasonable measures to forestall insolvency.[32]

A "critical and declining" plan—generally one that is projected to be insolvent within 20 years—may permanently reduce benefits, even those in pay status, except for people who are older than 80 or are disabled. The reductions must be approved by the Treasury Department, in consultation with the Labor Department and PBGC, and the plan may not reduce benefits below 110% of the PBGC guaranteed level.[33]

PENSION INSURANCE UNDER ERISA

When the Studebaker Company liquidated in 1963, 4,000 vested employees between ages 40 and 60 got only 15% of promised benefits, and 2,900 under age forty got nothing.[34] That squarely presented the problem of default risk.[35] Federal insurance, through the PBGC, became the solution.

PBGC was largely modeled on the Federal Deposit Insurance Corporation.[36] Thus, for example, pension insurance is mandatory for covered plans.[37] And there are limits that serve as a form of co-insurance.[38]

23 26 U.S.C §§ 412(c), 430(a)(1)(c), (e).

24 26 U.S.C § 430(i). Even stricter limits apply to plans less than 60% funded or whose sponsors are in bankruptcy. Id. § 436.

25 26 U.S.C. § 430(j)(4).

26 26 U.S.C. § 4971.

27 ERISA makes all 80% commonly owned corporations or unincorporated businesses (a "controlled group") jointly and severally liable for pension contributions. 26 U.S.C. §§ 412(b)(2), 414(b), (c), 26 C.F.R. §§ 1.414(b)(1), 1.414(c)-1-(c)-5. The controlled group is also liable to PBGC for the obligations described at [7-8], and to multiemployer plans for those described at [8]. 29 U.S.C. §§ 1301(a)(14), 1301(b)(1), 1362(a), 1381, 29 C.F.R. § 4001.2.

28 26 U.S.C. § 430(k) (2012). The lien has the status of a federal tax lien. Thus, for example, it may become senior to advances under a revolving credit arrangement after 45 days or notice to the lender, whichever occurs first. 26 U.S.C. § 6323, incorporated by reference in 26 U.S.C. § 430(k)(4)(C) (2012) and 29 U.S.C. § 1368(c)(1) (2012).

29 26 U.S.C. § 431(a), (c)(3).

30 26 U.S.C. §§ 412(c), 431(d).

31 26 U.S.C. § 432(c).

32 26 U.S.C. § 432(e).

33 26 U.S.C. § 432(b), (e). The PBGC guaranty is discussed in n. 39.

34 James A. Wooten *"The Most Glorious Story Of Failure In The Business": The Studebaker-Packard Corporation And The Origins Of ERISA*, 49 Buff. L. R. 683, 731 (2001).

35 *Id.*

36 120 Cong. Rec. S29950 (daily ed. Aug 22, 1974) (statement of Sen. Bentsen).

37 29 U.S.C. § 1306(a), (c) (2016). Covered plans exclude those of governmental units, church affiliates, and certain other entities. 29 U.S.C. § 1321(b).

38 Richard A. Ippolito, *The Economics of Pension Insurance* 21-24, 37-38 (1989).

PBGC guarantees benefits under single-employer plans and multiemployer plans.[39] The insurable event for a single-employer plan is plan termination.[40]

Single-Employer Plans

To terminate an underfunded single-employer plan, the sponsor and its controlled group must satisfy the requirements for a distress termination.[41] Each member must meet a distress test, most commonly:[42]

- A petition to liquidate is filed;[43]
- A petition seeking reorganization is filed, and the sponsor establishes to the court's satisfaction that it "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside . . . the reorganization process," unless the plan is terminated;[44]
- PBGC determines that the sponsor "will be unable to pay [its] debts when due and will be unable to continue in business," unless the pension plan is terminated.[45]

PBGC may not proceed with a distress termination "if the termination would violate the terms and conditions of an existing collective bargaining agreement."[46] PBGC defers to the arbitrator, the NLRB, or other competent authority when there is a dispute about a potential contract bar to termination.[47]

PBGC can initiate termination in what's usually called an involuntary termination.[48] The grounds for an involuntary termination include:

- the plan's failure to meet the IRC's minimum funding standard;
- its inability to pay benefits when due; or that
- PBGC's possible long-run loss "may reasonably be expected to increase unreasonably if the plan is not terminated."[49]

On termination of an underfunded plan, PBGC becomes trustee, taking over the plan's assets and its obligations. The sponsor and its controlled group is liable to PBGC for the difference between the plan's benefit liabilities and its assets, the "unfunded benefit liabilities."[50] Liability for unfunded benefit liabilities is meant to keep plan sponsors from promising benefits they cannot afford, thereby shifting the financial burden to the insurance program and to other sponsors whose premiums support the program.[51]

PBGC has issued regulations prescribing the mortality and interest assumptions to be used when calculating the amount of benefit liabilities.[52] They are designed to replicate the market price for closeout annuities.[53] The regulation uses a constant mortality factor, so the higher the surveyed price the lower the interest factor.[54]

The plan sponsor and members of its controlled group are also jointly and severally liable to PBGC:

- for unpaid minimum funding contributions;[55]
- for unpaid insurance premiums;[56] and
- for a termination premium, in three annual installments of $1,250 per plan participant.[57]

Multiemployer Plans

Multiemployer plans can terminate, by mass withdrawal or by plan amendment.[58] The insurable event, however, is insolvency, the inability to pay benefits when due.[59] PBGC doesn't become trustee of multiemployer plans, but provides them with financial assistance to pay benefits at the guaranteed level.[60]

Multiemployer plans spread the risk of business failure. When an employer withdraws, by going non-union or ceasing business, it incurs withdrawal liability for its share of the plan's unfunded vested benefits.[61] The present value of benefits is based on actuarial assumption, often the same as the plan's funding assumptions, but sometimes more conservative.[62]

An employer pays withdrawal liability in installments designed to approximate its contributions at their highest point.[63] Those payments are ordinarily capped at 20 years' worth. If the plan terminates by mass withdrawal, then all employers who withdrew during the preceding three years are presumptively liable for a share of remaining "orphan" liabilities, and the 20-year cap does not apply.[64]

39 For single-employer plans, the maximum guaranteed amount is about $65,000 per year at age 65. For multiemployer plans, the maximum guarantee is a function of the participant's service and the benefit accrual rate under the plan, e.g., about $13,000 per year with 30 years of service, $8,600 per year with 20 years of service, and so on. The guaranty of benefit increases less than five years old is phased in for single-employer plans, but not guaranteed at all for multiemployer plans. 29 U.S.C. §§ 1322(b)(1), (3), (7), 1322A(b), (c).

40 29 U.S.C. § 1361.

41 29 U.S.C. § 1341(c).

42 *Id.* § 1341(c)(2)(B)-(C).

43 *Id*. § 1341(c)(2)(B)(i).

44 *Id*. § 1341(c)(2)(B)(ii).

45 *Id*. § 1341(c)(2)(B)(iii)(I).

46 29 U.S.C. § 1341(a)(1).

47 29 CFR § 4041.7

48 29 U.S.C. § 1342.

49 *Id.* § 1342(a)(4).

50 29 U.S.C. §§ 1301(a)(18), 1362(c).

51 S. Rep. No, 93-383, at 87 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4971.

52 29 C.F.R. §§ 4044.52-.53 (2014); 29 C.F.R. pt. 4044 App. B.

53 *Derivation of Interest Factors for PBGC's Liability Valuation Methodology*, (Sept. 6, 2013), *https://www.pbgc.gov › documents › LiabilityValuation-20130906.*

54 29 C.F.R. §§ 4044.41-.75 (2016); 70 Fed. Reg. 72,205 (Dec. 2, 2005) (*codified* as 29 C.F.R. pt. 4044).

55 29 U.S.C. § 1342(d)(1)(B)(ii).

56 *Id.* § 1307(e).

57 *Id*. § 1306(a)(7)(A).

58 29 U.S.C. § 1341A.

59 29 U.S.C.§§ 1361, 1426.

60 29 U.S.C. § 1322A, 1431.

61 29 U.S.C. § 1381, 1383(a).

62 Compare *Manhattan Ford Lincoln, Inc. v. UAW Local 259 Pension Fund*, 331 F.Supp.3d 365 (D. N.J. 2018) (upholding a discount rate that blends funding and closeout interest factors), with *New York Times Company v. Newspaper and Mail Deliverers' Publishers' Pension Fund*, 303 F.Supp.3d 236 (S.D. N.Y.2018) (overturning such a blended rate).

63 29 U.S.C. § 1399(c)(1).

64 29 U.S.C. § 1399(a)(1)(A) - (D).

Continued from p.49

Withdrawal liability is meant to neutralize incentives to withdraw, to shore up plans affected by withdrawals, and to keep faith with remaining employers. But many multiemployer plans have not recovered from investment losses suffered in the Great Recession or from continued erosion of their contribution base. In addition, the 20-year cap has limited withdrawal liability where contributions were not increased to keep pace with the funding gap. Consequently, PBGC's multiemployer insurance fund is expected to become insolvent by 2026.[65]

CURRENT CASES ILLUSTRATE IMPACT OF DEFINED BENEFIT PLANS ON RESTRUCTURING

McClatchy's Funding Woes

The McClatchy Company filed for bankruptcy on February 13, 2020.[66] The petition reflects a PBGC claim of $530 million, the largest general unsecured claim.[67] Soon after that, McClatchy filed a motion to terminate its pension plan in a distress termination.[68]

The company's Nov 13, 2019 10-Q set the stage:

> We made no cash contributions to the Pension Plan during the first nine months of 2019 or all of 2018. In October 2019, we made a required pension contribution under ERISA of $3.1 million, and we expect to have material contributions in the future. Minimum required contributions for fiscal year 2020 are estimated to be approximately $124.2 million, which would be paid in quarterly installments beginning in January 2020 with the bulk of those payments due in September 2020 or afterwards.[69]

McClatchy had apparently used pre-funding balances in lieu of cash contributions, and those balances were nearly exhausted.[70] As it typical in such cases, cash flow demands would then spike up sharply.

The 10-Q continued:

> . . . [I]n June 2019 we filed an application for a waiver of the minimum required contributions under the Pension Plan for the 2019, 2020 and 2021 plan years with the IRS. In early November 2019, the IRS declined to grant us our three-year waiver request.

While IRS may grant waivers for three years out of fifteen, 29 U.S.C. § 1082(c)(1)(A), it does not grant multi-year waivers based on a single application.[71]

Continuing, the 10-Q said that McClatchy had:

> . . . consulted with the PBGC to discuss measures allowed under existing regulations to provide a more permanent solution, such as a distress termination of the Pension Plan. A distress termination would allow us to continue to operate and relieve the current liquidity pressures of the minimum required contributions under ERISA.
>
> * * *
>
> If we are unable to obtain pension relief and/or a restructuring of our outstanding debt obligations, we may need to seek protection under Chapter 11 of the U.S Bankruptcy Code to protect shareholder value.

Distress termination motions in bankruptcy may require an evidentiary hearing. At a minimum, they require declarations and documentary evidence. The debtor must show that its projected cash flow will be inadequate to support projected minimum funding contributions. Relevant factors include whether the debtor has explored feasible alternatives.[72]

Distress terminations can also turn on the debtor's ability to obtain exit financing. For example, where a debtor would have to devotee its entire free cash flow to pension funding, it could not plausibly attract financing.[73] By contrast, where an investor asserts that will not close unless the plan is terminated, the "existential financial realities" may or may not support that assertion.[74]

Debtors or creditors committees often contest the unfunded benefit liabilities claim, asserting that use of the annuity marketplace inflates the claim, and that an earnings rate based on modern portfolio theory should be used to discount future benefits. PBGC responds that the regulation has the force of law and is reasonable, as the annuity marketplace is the best measure of the cost of satisfying pension liabilities.[75] Based on the Supreme Court's decision in Raleigh v. Illinois Department of Revenue, that "[c]reditors' entitlements in bankruptcy arise in the first instance from the underlying substantive

65 2019 PBGC Ann Rep., at 21, https://www.pbgc.gov/about/annual-reports/pbgc-annual-report-2019.

66 No. 20-10418-(MEW) (Bankruptcy S.D.NY. (docket available at http://www.kccllc.net/McClatchy).

67 Voluntary Petition, docket no. 23 (Feb. 13, 2020), at 16.

68 Motion for an Order (A) Determining that the Financial Requirements for a Distress Termination are Satisfied and (B) Approving a Distress Termination of The McClatchy Company Retirement Plan, docket no. 54 (Feb. 26, 2020).

69 https://investors.mcclatchy.com/sec-filings.

70 See The McClatchy Company Retirement Plan Form 5500, Schedule SB (2018), available at https://freeerisa.benefitspro.com/5500/InstantView.aspx?dln=20191014235302P030081263687001&year=2018&ein=522080478.

71 IRS has not formalized this position. But a waiver application must be filed within 2-1/2 months after the close of the plan year, 26 U.S.C. § 412)(c)(5)(A), and IRS is apparently unwilling to permit multiple-year, advance filings.

72 *In re U.S. Airways Group., Inc.*, 296 B,R, 734, 745 (Bankr. E.D. Va. 2003).

73 *In re Wire Rope Corp.*, 287 B.R. 771, 780-81 (Bankr. W.D. Mo. 2002).

74 *In re Philip Servs. Corp.*, 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004).

75 See *PBGC v. Belfance (In re CSC Indus., Inc.)*, 232 F.3d 505, 508-09 (6th Cir. 2000); *PBGC v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 150 F.3d 1293, 1300-01 (10th Cir. 1998).

law creating the debtor's obligation," PBGC has generally prevailed on the issue.[76]

The controlled group rule may result in additional leverage for the PBGC. Often, subsidiaries have no substantial debt ahead of PBGC's joint and several claims. In such cases, PBGC would assert that its claimsare structurally superior to claims against only the parent or one or more of the top-level subsidiaries.

Though arguments for priority of the unfunded benefit liabilities claim are possible, courts have generally rejected them.[77]

A perfected minimum funding lien would be indefeasible in bankruptcy.[78] But it would be behind any prior perfected liens and might be further behind any debtor in possession borrowings.[79]

Generally, the courts grant priority only to the "normal cost" portion of each contribution that becomes payable postpetition, as only post-petition service benefits the estate.[80] The argument for limiting priority of prepetition contributions is even stronger, as they must "aris[e] from services rendered within the 180 days before the date of the filing of the petition."[81]

Unpaid premiums may be entitled to administrative expense or tax priority, but there is a dearth of case law. So too with termination premiums, except that in a true reorganization, that obligation may not be a dischargeable bankruptcy "claim." Rather, the Second Circuit has held it "does not even arise until the bankruptcy itself is terminated."[82]

Dairy Giants' Multiemployer Pension Overhang

Dean Foods' bankruptcy petition lists the Central States Pension Fund as its largest general unsecured creditor, with an estimated withdrawal liability claim of $722 million.[83] Similarly, Borden Foods' petition lists Central States withdrawal liability claim at $33 million, also the largest general unsecured claim.[84]

Central States, with the largest benefits payroll of any multiemployer plan, is projected to become insolvent in the next five years. As a "critical and declining" plan, it is effectively in an orderly wind-down mode.

As noted, withdrawal liability is stated as a lump sum but is payable in installments, capped at 20 years' worth. But in a mass withdrawal, the 20-year cap does not apply, and all remaining underfunding is reallocated.[85] The figure given in the Dean petition may represent the capped payments, the uncapped payments, or the mass withdrawal liability exposure.[86] The figure given in the Borden petition apparently represents agreed payments for a withdrawal that occurred in 2014.[87]

There are arguments for priority, but courts generally treat withdrawal liability as a general unsecured claim, as it mainly represents pre-petition service liabilities.[88]

In bankruptcy, withdrawal may occur through modification or rejection of the collective bargaining agreement.[89] Or a purchaser may acquire assets free and clear of claims, leaving the claim behind with a liquidating debtor.[90] And withdrawal liability may not be incurred if the debtor reorganizes and does not modify its labor agreements. [91]

CONCLUSION

As this summary suggests, employee benefits issues are often prominent in bankruptcies. Employers, lenders, unions, and other parties in interest should be conversant with the legal principles that govern these issues, and should seek expert legal, financial, and actuarial advice to maximize their leverage both in bankruptcy and in pre-bankruptcy planning and negotiations.

ABOUT THE AUTHOR

Israel Goldowitz
The Wagner Law Group

Israel Goldowitz is a partner with The Wagner Law Group. He is on the Board of Governors of the American College of Employee Benefits Counsel; served on the Labor and Benefits Advisory Committee to the American Bankruptcy Institute's Chapter 11 Reform Commission; and is a contributing author of Norton Bankruptcy Law and Practice. He earned his J.D. from George Washington University and his B.A. from Boston University.

76 E.g., *Dugan v. PBGC (In re Rhodes, Inc.)*, 382 B.R. 550 (Bankr. N.D. Ga. 2008); *In re High Voltage Eng'g,* No. 05-10787 (Bankr. D. Mass. July 26, 2006); *In re UAL Corp.*, No. 02-48191 (Bankr. N.D. Ill. Dec. 16, 2005); *In re US Airways Group, Inc.*, 303 B.R. 784 (Bankr. E.D. Va. 2003); see *Raleigh v. Illinois. Dept. of Revenue*, 530 U.S. 15, 20 (2000).

77 *PBGC v. Skeen (In re Bayly Corp.)*, 163 F.3d 1205 (10th Cir. 1998), *aff'g* No. Civ. A. 95 N 901, 90-18983 SBB, 1997 WL 33484011(D. Colo. Feb. 12, 1997).

78 See 11 U.S.C. § 545.

79 See 11 U.S.C. § 364.

80 *PBGC v. Belfance (In re CSC Indus., Inc.)*, 232 F.3d 505, 510 (6th Cir. 2000); *PBGC v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 150 F.3d 1293, 1296-1300 (10th Cir. 1998); *PBGC v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811, 814-19 (6th Cir. 1997).

81 11 U.S.C. § 507(a)(5).

82 *PBGC v. Oneida, Ltd (In re Oneida)*, 562 F.3d 154, 157 (2d Cir. 2009).

83 *In re Southern Foods Group, LLC d/b/a Dean Foods*, No. 19-36313, Voluntary Petition (Bankr. S.D. Tex. Nov. 12, 2019), available at https://dm.epiq11.com/case/SouthernFoods/dockets.

84 *In re Borden Dairy Company*, No. 20-10010, Voluntary Petition (Bankr. D. Del.), available at https://dr201.s3.amazonaws.com/bdc/VoluntaryPetitions/20-10010.pdf.

85 29 U.S.C. § 1399(c)(1)(B), (D).

86 Withdrawal liability need not be disclosed on the financial statements unless it is probable of occurrence. See ASC 450, https://asc.fasb.org/section&trid=2127173.

87 New Chapter 11 Bankruptcy Filing - Borden Dairy Company, https://www.petition11.com/cases.

88 See *In re Marcal Paper Mills*, 650 F.3d 311 (3d Cir. 2011).

89 See 11 U.S.C. § 1113.

90 See 11 U.S.C. § 1113(b); 11 U.S.C. § 363(f).

91 **Dean Foods has given notice of the rejection of its collective bargaining agreements. Docket no. 1867 (April 30, 2020).**