ARTICLES

Employee Benefits Issues Prominent in Restructuring and Bankruptcy Cases

By Israel Goldowitz[*]

INTRODUCTION

With a recession overdue, employee benefits practitioners should be ready when employers face financial distress and should understand how employee benefits are treated in bankruptcy. Recent developments involving executive compensation, pension funding, and withdrawal liability give a glimpse of what to expect.

EXECUTIVE COMPENSATION DISPUTE IN PURDUE PHARMA

Pay equity is a major issue in corporate bankruptcies. The Bankruptcy Code provides for allowance of administrative expense claims, including wages and salaries for services rendered after the commencement of the case.[1] Retention bonuses for insiders, however, are limited to those that are ''essential'' to retain an individual whose services are ''essential to the survival of the business.'' Severance bonuses for insiders are restricted to those that are part of a program generally applicable to all full-time employees. Neither a retention or severance payment can exceed 10 times the mean payment of that type to non-management employees during the calendar year.[2]

The debtor must keep faith with rank-and-file workers, who have often endured rounds of headcount reductions and concessions before bankruptcy. At the same time, the debtor must retain executive talent, eliminate redundancies, and attract new talent to lead the turnaround.

The U.S. Trustee and the Official Committee of Unsecured Creditors often object to executive pay arrangements, as do major creditors. In *Purdue Pharma*,[1] objectors included states who brought claims against Purdue for opiod-related damages and had not settled those claims.

The bankruptcy court mainly approved the bonuses, accepting the debtor's argument that, for most of the 700 employees affected, the bonuses were essentially part of their salary.[3]

The Creditors' Committee dropped its objection only after negotiating a deal in which $10 million was cut, mainly for top executives, as were bonuses based on pre-2018 performance. In addition, under that deal, payments will be deferred and in some cases will be subject to clawback to encourage employees to stay with the company.

The states particularly objected to a $1.3 million bonus for the CEO, as he had been named as a defendant in several suits brought by both states and private parties, based on his role in the company's opioid marketing. The court was mainly concerned with a $6 million pre-bankruptcy advance on retention payments that were originally not due until 2020 and 2022. The court concluded that the issue required more development and urged the parties to discuss the issue.

MCCLATCHY'S FUNDING WOES

ERISA requires annual minimum funding contributions by the sponsor of a single-employer pension plan and the members of its controlled group (80% commonly owned businesses). The annual contribution is due in quarterly installments fifteen days after the end of each quarter, with a catch-up payment 8½ months after year end. If a payment is not made when due, a lien arises, enforceable by PBGC for the benefit of the plan. The lien has the status of a federal tax lien.[4]

The McClatchy Company's November 13, 2019, 10-Q[5] states:

> 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 ap-

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[1] 11 U.S.C. §503(b)(1)(A)(i).

[2] 11 U.S.C. §503(c)(1), §503(c)(2).

[1] *In re Purdue Pharma, L.P.*, No. 19-23649 (Bankr. S.D.N.Y Dec. 9, 2019).

[3] *See* Supplemental Final Order Authorizing (1) Debtors to Pay Prepetition Wages, Salaries, Employee Benefits, and other Benefit Programs and Pay Related Administrative Obligations. . ., available at https://aboutblaw.com/NA2.

[4] 29 U.S.C. §1082(b), §1083(a), §1083(j), §1083(k).

[5] Available at https://investors.mcclatchy.com/sec-filings.

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> proximately $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.

McClatchy has apparently used pre-funding balances in lieu of cash contributions,[6] and those balances are nearly exhausted.[7] Cash flow demands will then spike up sharply.

The 10-Q continues:

> . . . [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.

The IRS may grant a funding waiver to a controlled group undergoing ''temporary substantial business hardship'' in consultation with PBGC. A funding waiver allows the controlled group to defer the annual contribution, with additional amortization charges and usually with a grant of security.[8] While the IRS may grant waivers for three years out of 15,[9] it does not grant multi-year waivers based on a single application.

Continuing, the 10-Q states that McClatchy has:

> 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.

A controlled group may terminate an underfunded plan in a distress termination if it ''demonstrates to the satisfaction of the [PBGC]'' that each member ''cannot pay its debts when due and will be unable to continue in business'' unless the plan is terminated.[10] Typically, this requires an analysis of projected revenues and expenses, including pension contributions. PBGC's financial, legal, and actuarial staff will take a hard look at the data and projections.

Finally, the 10-Q states:

> 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.

A controlled group in bankruptcy may terminate a plan if the bankruptcy court finds that it ''will be unable to pay its debts under a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process'' and approves the termination. PBGC is entitled to notice and to be heard on any such motion.[11] As with the non-bankruptcy distress test, this requires analysis of projected cash flows and may require analysis of whether any lender will provide exit financing.[12]

If an underfunded plan is terminated, PBGC has a claim against the controlled group for the unfunded benefit liabilities, the difference between the value of plan liabilities and of plan assets.[13] Liabilities are valued under PBGC regulations, using surveys of annuity prices. Assets are valued at fair market value.[14]

Debtors or creditors committees often contest this claim, asserting that use of the annuity marketplace inflates the claim, to the detriment of other unsecured creditors. 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. In *In re U.S. Airways Group*,[15] the court agreed with the PBGC. Since then, PBGC has invariably succeeded, and settlements rarely discount the claim except by a small percentage.

PBGC may also have a claim for any unpaid minimum funding contributions. If there is a funding lien and PBGC perfects it before bankruptcy, it would be indefeasible.[16] Unpaid contributions also have priority, up to $10,000 (indexed) per employee for services rendered during the 180 days before the bankruptcy petition, but only arguably for the post-petition-period.[17]

DEAN FOODS' MULTIEMPLOYER PENSION OVERHANG

A controlled group withdraws from a multiemployer plan when it ceases to have covered operations or to have an obligation to contribute to the plan.[18] Withdrawal often occurs in bankruptcy, as the debtor

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[6] *See* 29 U.S.C. §1083(f).

[7] *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.

[8] 29 U.S.C. §1082(c), §1083(e).

[9] 29 U.S.C. §1082(c)(1)(A).

[10] 29 U.S.C. §1341(c)(2)(B)(iii).

[11] 29 U.S.C. §1341(c)(2)(B)(ii).

[12] *In re Philip Services*, 310 B.R. 802 (Bankr. S.D. Tex. 2004).

[13] 29 U.S.C. §1362(a), §1362(c).

[14] 29 U.S.C. §1301(a)(18);29 CFR pt. 4044 *et seq*.

[15] 303 B.R. 784 (Bankr. E.D. Va. 2003)

[16] 11 U.S.C. §545.

[17] 11 U.S.C. §503(b), §507(a)(5).

[18] 29 U.S.C. §1383(a).

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may modify or reject its collective bargaining agreement on a showing of necessity.[19]

Withdrawal lability is the withdrawn employer's allocable share of the plan's underfunding, usually measured by its historical percentage of all contributions.[20]

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.[21] 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.[22]

Many employers are therefore seeking to exit Central States. Asset purchasers are reluctant to take on an obligation to Central States, unless they can negotiate an appropriate purchase price adjustment.

Withdrawal liability is stated as a lump sum, but is payable in installments.[23] The installments are capped at 20 years' worth. But if the plan terminates in a mass withdrawal, the 20-year cap does not apply, and all unallocated underfunding (e.g., attributable to employers who have already gone bankrupt) is allocated among remaining employers.[24] The $722 million estimated claim in Dean Foods may represent the uncapped amount if not the mass withdrawal liability exposure.

There are arguments for priority, but courts gently treat withdrawal liability as a general unsecured claim, as it mainly represents pre-petition service liabilities.[25]

In a bankruptcy, a purchaser can acquire assets free and clear of claims.[26] It may be that Dean Foods will sell assets free and clear of withdrawal lability claims, leaving claims to be paid in fractional dollars from a liquidating estate.

THE NEED FOR EXPERTISE

As this summary suggests, employees benefits issues are often prominent in bankruptcies or out-of-court restructurings. Employers, lenders, executives, 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.

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[19] 11 U.S.C. §1113(b).

[20] 29 U.S.C. §1391(c).

[21] *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://aboutblaw.com/NA7.

[22] *See* 29 U.S.C. §1085(e)(9).

[23] 29 U.S.C. §1399(c)(1).

[24] 29 U.S.C. §1399(c)(1)(B), §1399(c)(1)(D).

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

[26] 11 U.S.C. §363(f).

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