Third Circuit Decision Regarding Withdrawal Liability Harmonizes The Purposes Of ERISA, As Amended By The MPPAA, And The Bankruptcy Code

In a case of first impression, the Third Circuit held that a pension fund’s $5.8 million claim against a Chapter 11 debtor for withdrawing from a multi-employer pension plan is entitled to priority payment as an “administrative expense” to the extent the fund’s claim is attributable to work performed by the debtor’s employees during the bankruptcy case. The decision balances the purpose of the Bankruptcy Code to preserve the bankruptcy estate for the benefit of all creditors against the purposes of ERISA, as amended by the MPPAA, to protect the finances of pension plans and to prevent an employer’s withdrawal from negatively affecting the plan and its employee-beneficiaries.

To encourage employees, suppliers, and others to provide goods and services to a company in bankruptcy, the Bankruptcy Code requires the bankruptcy estate to pay for the goods and services in full before general unsecured claims are paid. The burden is on the claimant, however, to demonstrate that the goods and services it provided during the bankruptcy case were necessary and actually benefited the estate. The Code designates these priority payments as “administrative expenses” because they constitute valid expenses of administering the bankruptcy estate. By limiting priority to those expenses that are necessary and beneficial, the Code prevents the estate from being consumed by administrative costs, and preserves the estate for the benefit of all creditors.

When the debtor is an employer that withdraws from a multi-employer pension plan, the Employee Retirement Income Security Act, as amended by the Multiemployer Pension Plan Amendments Act (“MPPAA”), imposes liability on the employer based on the employer’s proportionate share of the shortfall between the plan’s assets and the vested benefits the plan must pay to all employee-beneficiaries.

Marcal Paper Mills, Inc. was a manufacturer and supplier of paper products and a participant in a multi-employer pension plan. After filing for Chapter 11 bankruptcy protection, Marcal continued to operate its business and make contributions to the plan on behalf of its employees until it sold its assets and withdrew from the plan. As a result, the plan filed a $5.8 million withdrawal liability claim against Marcal as an administrative expense.

In a case of first impression, In re Marcal Paper Mills, Inc., No. 09-4574 (3rd Cir. June 16, 2011), the Third Circuit held that the portion of the withdrawal liability claim that is attributable to the post-petition period during which Marcal contributed to the plan while operating in bankruptcy is entitled to priority payment as an administrative expense. The decision was based, in part, on the Court’s concern that the purposes of the MPPAA would be undercut if the pension plan’s entire claim was classified as a general unsecured claim and paid, if at all, only after higher priority claims were paid in full.

The decision will impact strategic bankruptcy planning. In some cases, financially-distressed employers will be incentivized
to withdraw from multi-employer pension plans sooner rather than later to minimize the administrative expense portion of a withdrawal liability claim. In other cases, employers will attempt to reorganize without withdrawing from a plan to avoid incurring the additional administrative expense. The decision will also affect the price that potential purchasers are willing to pay for an employer’s business as a going-concern when, for example, the sale agreement requires the purchaser to assume the administrative expense portion of the employer’s withdrawal liability.

Finally, the decision will impact debtor-in-possession financing, which typically includes loan carve-outs to pay administrative expenses. Calculating the carve-outs will require a methodology for apportioning withdrawal liability between pre-petition and post-petition periods. The Third Circuit, however, was silent on the methodology that should be used and remanded the case to the District Court to address that issue.

A copy of the Third Circuit’s decision is available here.

For more information, please contact the Seyfarth attorney with whom you work, or any Bankruptcy, Workouts & Business Reorganization attorney on our website.