

## Third Circuit Holds that a Portion of Post-Petition Withdrawal Liability in Bankruptcy Is Entitled to Priority Over General Unsecured Claims

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Recently, the Third Circuit held that withdrawal liability triggered after a bankruptcy filing date may be apportioned to pre- and post-petition service for the debtor, and that the withdrawal liability attributable to post-petition service may be entitled to priority over general unsecured claims under the Bankruptcy Code. Employers that participate in a multiemployer pension plan should determine the claims impact of withdrawal in light of this court decision and also assess whether filing for bankruptcy protection outside of the Third Circuit is appropriate.

The U.S. Court of Appeals for the Third Circuit recently held in *In re Marcal Papers Mills, Inc.* that withdrawal liability triggered after the bankruptcy filing date may be apportioned to pre- and post-petition liabilities attributable to pre- and post-petition service with the amount of withdrawal liability attributable to post-petition service treated as an administrative expense entitled to priority over general unsecured claims under the Bankruptcy Code.

### Background

The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) created “withdrawal liability” to ensure that employers were required to fully fund promised pension benefits in the event of withdrawal from a multiemployer pension plan. Under MPPAA, if an employer withdraws from a multiemployer pension plan, then such employer is liable for its proportionate share of the unfunded vested benefits, which is generally the difference between the present value of vested benefits under the plan and the current value of the plan’s assets.

At issue in *Marcal* was how withdrawal liability under MPPAA should be treated in the context of a Chapter 11 bankruptcy proceeding. Under the Bankruptcy Code, claims against a debtor’s estate are given priority based on how they are classified in the proceeding. In a Chapter 11 bankruptcy proceeding, “administrative expenses,” which are the actual and necessary costs and expenses of preserving the estate after the bankruptcy is filed, are entitled to priority over the claims of general unsecured creditors because they allow for the continued functioning of the debtor and the preservation of the estate for creditors. In *Marcal*, the Third Circuit was faced with an issue of first impression regarding whether the portion of a bankrupt employer’s withdrawal liability attributable to the post-petition service constituted an administrative expense or a general unsecured claim.

## Third Circuit Decision

In *Marcal*, an employer entered into a collective bargaining agreement under which it was required to participate in a multiemployer pension plan on behalf of certain collectively bargained employees. After filing a Chapter 11 bankruptcy petition, the employer operated as a debtor-in-possession and continued to employ such employees pursuant to the terms of a collective bargaining agreement (including a memorandum of understanding continuing the terms of such collective bargaining agreement upon its expiration) until the employer's assets were sold to another entity 18 months later. The administrator of the multiemployer pension plan determined the employer had withdrawn from the plan on account of the sale of its assets, assessed withdrawal liability and filed a claim for such withdrawal liability to be classified as an administrative expense in the employer's Chapter 11 bankruptcy proceeding. In objecting to the plan's claim, the employer argued that the total withdrawal liability amount should be reclassified as a general unsecured claim. In response, the administrator altered its claim to seek administrative priority only for the portion of withdrawal liability attributable to the post-petition services provided by the employees. The Bankruptcy Court found for the employer and declined to characterize any portion of the withdrawal liability claim as an administrative expense. However, the District Court reversed, holding that the portion of the withdrawal liability attributable to post-petition service with the employer constituted an administrative expense and, thus, was entitled to priority over general unsecured claims.

The Third Circuit affirmed, holding that, in order to harmonize the purposes of the Bankruptcy Code and ERISA, as amended by MPPAA, withdrawal liability "should be and can be apportioned" between pre- and post-petition service and that the portion attributable to post-petition service can be classified as an administrative expense. The court determined that the employer could not have continued operation without the post-petition service of the covered employees, and that continued operation of the employer conferred a clear benefit to the estate. Further, the court found that in exchange for these services, the employer promised to provide pension benefits through the plan and that employees would continue to accrue new vested pension benefits as a result of their post-petition service. Accordingly, the court concluded that such promised pension benefits were akin to direct compensation (such as wages, salaries and commissions, which are treated as "administrative expenses" under the Bankruptcy Code) provided in exchange for post-petition services, and that because post-petition direct compensation was undisputedly an administrative expense, the costs of providing other post-petition employee benefits should likewise be classified as an administrative expense. The court highlighted precedent for apportioning other types of employee benefits based on pre- and post-petition service as additional support for its decision. However, the court remanded the case to the district court to determine the appropriate method for apportioning the withdrawal liability.

## Impact on Employers Participating in a Multiemployer Pension Plan

*Marcal* is the first time a federal Circuit Court of Appeals has ruled that a portion of post-petition withdrawal liability is an administrative expense. Presumably, any withdrawal liability that could be attributed to the 180-day period prior to a bankruptcy filing may now be regarded as a priority claim (similar to wages and other benefit contributions during the 180-day period prior to a bankruptcy filing) under the logic of the *Marcal* court. Employers that participate in multiemployer pension plans should determine the claims impact of withdrawal in light of the new case law. Also, *Marcal*, coupled with the Third Circuit's decision last year in *In re Visteon Corp.* (holding that Section 1114 of the Bankruptcy Code applies to the modification or termination of unvested retiree benefits that a debtor in possession could otherwise unilaterally amend or terminate), may prompt employers to reconsider whether to file for bankruptcy protection outside of the Third Circuit (which covers Delaware, New Jersey and Pennsylvania).

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