Proskauer Benefits Brief: Bankruptcy Meets Withdrawal Liability

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In this first episode of a two-part conversation, senior counsel Neil Shah is joined by partner Daniel Destnik from Proskauer's Bankruptcy and Restructuring Group to examine how withdrawal liability claims change when bankruptcy enters the picture. Together, they discuss the automatic stay, arbitration versus bankruptcy court, proof of claim strategy, priority and administrative expense issues, and the practical steps plans should take to protect their rights. They also highlight strategic considerations and edge cases that can significantly affect recovery.

Neil Shah: Welcome to the Proskauer Benefits Brief, Legal Insight on Compensation and Benefits. I'm Neil Shah, Senior Counsel at Proskauer. This is the sixth episode in our series on withdrawal liability. Today, we're talking about all the ways in which withdrawal liability comes up in bankruptcy. I'm joined today by Danny Desatnik from our Bankruptcy and Restructuring Group. Danny, welcome. Why don't you tell us what you do here at Proskauer and how withdrawal liability comes up in your practice?

Daniel Desatnik: Thanks, Neil, for the introduction and for having me on as a guest. As you said, I'm a partner here at Proskauer's restructuring group. In my practice, I've encountered issues relating to withdrawal liability in several ways. And this will likely be unsurprising to your viewers, because one of the reasons a company may withdraw from a fund is precisely because they're experiencing financial distress or they're undergoing a restructuring. Most directly, I've represented plans in their capacity as creditors seeking to recover withdrawal liability that's owed to them. And my goal in that respect is to put them in the strongest position to ensure their claim is timely filed, that it gets allowed, and that they obtain the maximum recovery.

Now, a large part of my practice today also involves representing unsecured creditor committees in Chapter 11. We often see that plans want to sit on these committees because their withdrawal liability claims tend to be large in size, and they bring a unique perspective to the Chapter 11 cases. So for those not immersed in the restructuring world, an unsecured creditors committee is required in every large Chapter 11 case. And the committee will typically consist of creditors that are representative of the larger creditor constituency and that hold the largest claims. The committee is there to act as a fiduciary for all unsecured creditors. They get to retain legal counsel and financial advisors that are paid for by the debtor's estates, and they typically function as a powerful check or a counterweight to actions by debtors or secured creditors that may be contrary to the interests of unsecured creditors.

Neil Shah: Thanks for that overview. So, before we kind of dig into all the way withdrawal liability comes up in bankruptcy, why don't you give us a high-level overview of what exactly happens once a bankruptcy case is actually filed?

Daniel Desatnik: Of course. There are many players in every bankruptcy case, but to keep things simple, I'm going to focus on the debtor and the creditors in the Chapter 11 context or the reorganization context. That's mainly the context that I deal with it and that I think many of our listeners will be approaching bankruptcy from. So, a company that files a petition for Chapter 11 becomes a debtor, and it has numerous responsibility as a debtor in possession. The debtor will file a petition that lists its 30 largest unsecured claims, and they're also required to file schedules of their assets and liabilities and statements of their financial affairs. These schedules and statements should list the assets and liabilities at each of the debtor entities. And so, one of the first things you'll want to do if you hold a withdrawal liability claim is to see if your claim is on that schedule.

Upon filing, the debtor receives the benefit of something they call an “automatic stay.” And while they receive this stay, they continue to operate the businesses, but they’re given a breathing spell to work through a restructuring and formulate a plan of reorganization. The debtor will need to make a decision during the case as to whether and how to keep contributing under any CBA to avoid triggering withdrawal. Now as a creditor, you will want to ensure that you are receiving regular notices from the bankruptcy court that could impact your rights. It’s best to work with experienced bankruptcy counsel to review the motions that are filed, especially the ones that are filed on the first day, since these are usually granted on an emergency basis and before a creditors committee, which I mentioned beforehand, is there in place to protect your interests.

Eventually, the core will set a bar date, which is a deadline by which you must submit your proof of claim, or you risk losing that claim entirely. My recommendation is you file a proof of claim, even if the debtors have added your claim on their schedules and you agree with the schedule amount, and I’ll go into why a little bit later. You should also begin getting all relevant documentation in order. If you are in an arbitration on your withdrawal liability claim, that will typically be stayed by the automatic stay, and you will need to either get consent from the debtors to proceed with that arbitration or seek stay relief from the bankruptcy court. Now, it’s my experience that at the initial stages of a case, a court and a debtor would rather focus on stabilizing the business and figuring out their global restructuring before using limited resources to resolve one-off claims.

That said, when the appropriate time comes, the court will often enforce the arbitration requirement for withdrawal liability. Now if the fund withdraws pre-petition, the arbitration clock is running and bankruptcy does not automatically toll ERISA arbitration deadlines. So, if the debtor fails to arbitrate, then their withdrawal liability may be fixed as assessed. If withdrawal liability occurs post-petition, the portion that’s attributable to your post-petition services may be argued as having administrative expense priority, and that’s a good thing because that means your claim will likely get paid in full for that portion of the claim. Courts often allocate the withdrawal liability between the pre- and post-petition periods.

Neil Shah: Alright, so let's unpack some of what you went through now. At the start of the bankruptcy case, there's an automatic stay. And I think it's pretty straightforward that everything, as a result of the automatic stay, everything kind of gets funneled through the bankruptcy court. Are there exceptions to that? Are there instances where a plan can keep going after the underlying withdrawal liability without violating the automatic stay?

Daniel Desatnik: So, the automatic stay is really a key protection that a bankruptcy debtor is provided. And as a creditor, you want to be very sensitive to the fact that that is a key protection for them. So, when the debtor files for bankruptcy, what the automatic state does is it's going to prevent any creditor from continuing their litigation that was in place, including the arbitration that was potentially occurring, or any efforts to collect on the claim. And what that has the effect of doing is it funnels all claims that may be against the debtor from all claimants into one forum, the bankruptcy case, so that there's one place where all these claims get resolved.

And you should understand and appreciate the automatic stay is interpreted very broadly. So, when they say any act to collect is considered a violation, that could be something as simple as sending a letter or a notice of default. Now, there is a big caveat, I think, as you were indicating, Neil, that the stay only applies to the entity that filed for bankruptcy. So, if there are controlled group members, alter egos, single employers and successors that are not part of the bankruptcy, they are not protected by the stay, and they do remain fair game. Now, of course, for every exception, there's another exception, and we often see that a debtor will come in and ask for the state to be extended to some of these players or seek a specific injunction because they'll make the argument that there's overlapping issues with those players, and therefore they all need to be brought under the stay. But unless and until that happens, they are fair game and not protected by the stay.

Neil Shah: Now, we've talked in some prior episodes about the "pay now, dispute later" scheme that applies to withdrawal liability, which is that the employer has to pay while pursuing all disputes in arbitration. We talked just a couple minutes ago about how the automatic stay may or may not impact the deadline to arbitrate. So, let's just say that a bankruptcy case has been filed, the plan files a proof of claim for some amount of withdrawal liability, and the debtor wants to assert some type of a dispute to that calculation. In your experience, does this mean that the debtor needs to commence arbitration, or is the bankruptcy court just going to stand in the shoes of an arbitrator and just decide the issues?

Daniel Desatnik: Yeah, thanks, Neil. I think it's a great question. And it's one where I really think that where the dispute gets decided could have an outsized impact into how the dispute is resolved. So, what we tend to find is that bankruptcy courts are debtor-friendly, and the debtor is the one that chooses where they get to file the venue, the forum, and often try to do it in certain ways so that they can even steer the case towards a preferred judge, specifically because that judge is debtor-friendly. So, what I would anticipate you'll find in many cases is that the debtor would have a preference to have the claim resolved with the bankruptcy court as the finder of fact. Now, that said, the ERISA statute requires arbitration, and there is a significant amount of case law out there which will say that the bankruptcy court, even though it's a creature of federal law, has to respect the intervening, countervailing federal statute in ERISA.

And so, because of the strong presumption towards arbitration there, the correct forum for resolving this claim should be arbitration. And because there are arbitrators that have the expertise resolving these precise kind of claims, this is the better finder of fact. While I wish I could give the viewers a definitive answer on this, the reality is that it's going to depend. We've seen bankruptcy courts go both ways on the correct venue and forum for deciding these claims. I think if the claims are very large and material to the case overall, a bankruptcy court is going to try to find a way to keep themselves as the determiner of fact because they don't want to potentially let an arbitration be what could steer the restructuring in one way or the other.

Neil Shah: Right, so that, that's helpful. Now let's say — we've talked about the automatic stay already. Once a bankruptcy case has been filed, what is the plan supposed to do to preserve its rights to collect the withdrawal liability? The automatic stay obviously prevents any further collection efforts from the debtor itself, but what does the plan actually have to do to preserve its rights so that the debtor's assets, the assets of the bankruptcy estate, are used to pay its claims, and that there's no waiver of its claims?

Daniel Desatnik: Of course, and that's a big part of what, you know, an experienced bankruptcy counsel can assist you with. I would say as a preliminary matter, if you get the sense that a company is distressed and heading towards a bankruptcy, you're always best off trying to do things like commence arbitration before the bankruptcy filing happens so that the clock is running. Now, if you get beaten to the punch by a company and they file for bankruptcy before you've been able to do that, then again, I can't stress this enough, it's all about making sure that you file a proof of claim and you do it before the deadline to file the claim. So, what you'll see in a bankruptcy is they'll set something called a "bar date." And that is the drop-dead date by which, if you fail to file your proof of claim, you lose it. Doesn't matter how meritorious your claim is, how large and significant your claim is, and how much prejudice there might be to you by losing that claim. The deadline is the deadline.

There are certain situations where if you miss it, you can try to speak with debtor's counsel and get a stipulation to have your claim treated as timely, but you never want to find yourself in that position. So, make sure you are monitoring the case, getting alerts, and that you file your proof of claim. When you file your proof of claim, there are three key components that you want to focus on. Number one is the amount of the claim. So you'll need to present value your remaining installments using clean math and assumptions. The second is the priority of the claim. Plans that had the withdrawal liability occur before the bankruptcy filing generally hold unsecured claims. But if the occurrence of the withdrawal happens post-petition, then you might be able to assert that some of it is an administrative expense claim, as I mentioned before, which would be entitled to priority and are required to be paid in full for that portion of it if the debtor wants to confirm a plan.

And then the third thing, which most people do not include in their proof of claims, but which is so critical and has really saved the day for our clients time and time again, is to have a reservation of rights section, a very expansive reservation of rights section where you are preserving your ability to amend the claim for additional withdrawals, recalculate it if there's an error, include interest, include liquidated damages, other potential claims that you may not have been aware about when you filed your claim. This is so important because usually during the arc of these cases, something will come up and you don't want to amend it afterwards and face an argument that that amendment occurred after the bar date and therefore the original proof of claim supersedes.

Neil Shah: Thanks, Danny. That's very helpful, and I think something that all plans should keep in mind in a situation where they need to file a proof of claim in the bankruptcy, either for withdrawal liability, delinquent contributions, or any other amounts. Why don't we end it here? And we'll resume next time to talk a little bit more about what exactly are the amounts that the plan can actually recover in the bankruptcy, and what is kind of in the debtor's toolkit to not pay any of those amounts?

Daniel Desatnik: That sounds great, Neil. Thanks for having me on, and I'm happy to cover those topics in the next episode.

Neil Shah: That's our episode for today. If you found this useful, be sure to follow us and subscribe on Apple Podcasts, Spotify, and YouTube so you don't miss the next episode. If you liked what you heard or want to know more, drop us a line at wl@proskauer.com. I'm Neil Shah. Today's discussion is for general information and is not legal advice. Thanks for listening to the Proskauer Benefits Brief.

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