

Proskauer Benefits Brief: Bankruptcy Meets Withdrawal Liability: Claims, Challenges, and Recovery

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In the second part of their discussion on bankruptcy and withdrawal liability, Neil Shah and Daniel Desatnik examine what plans can recover on withdrawal liability claims in bankruptcy and how debtors may push back.

Listen as they cover interest, fees and present value calculations, administrative and priority disputes, distressed employer defenses, third-party releases and successor liability risks in asset sales. For multiemployer plans and their advisors, they also highlight how timing, strategy and careful attention to plan terms and court filings can materially affect recovery.

Neil Shah: Welcome to the Proskauer Benefits Brief, Legal Insight on Compensation and Benefits. I'm Neil Shah, senior counsel at Proskauer.

We're continuing our discussion today about all the ways in which withdrawal liability comes up in bankruptcy. I'm rejoined by Danny Desatnik from our Bankruptcy and Restructuring Group. In our prior episode, we gave a high-level overview of what happens in bankruptcy, the impact of the automatic stay, and the importance for plans to file a proof of claim in the bankruptcy.

Today, we're going to continue that discussion and get into what exactly is supposed to be in the proof of claim, and what's in the debtor's toolkit in the event they want to challenge the plan's claim to the withdrawal liability.

Now, we've covered in prior episodes that, outside of bankruptcy, multiemployer pension plans are entitled to collect the withdrawal liability, but in the event of non-payment by an employer, they're also entitled to a whole bunch of other amounts. Now, those amounts include interest, they include liquidated damages, and they include a mandatory award of attorneys' fees and costs. What's the right of a plan to recover any of those amounts in the bankruptcy?

Daniel Desatnik: Thanks, Neil. Obviously, a debtor files for bankruptcy in part because they're seeking relief from debt, and the debtor has a number of tools in its toolkit to deal with the amount of the debts that it has. And so, as the holder of a withdrawal liability claim, you would have certain rights outside of bankruptcy that, when you're inside of bankruptcy, you'll find are no longer enforceable.

To answer your question more directly, I'll answer it with the famous lawyer answer of, it depends. And really, it's about timing, and we talked a little in the last episode about timing. So, amounts that the plan accrues before the filing, like interest, those generally can be included in your proof of claim. But on the other hand, amounts that would arise after the bankruptcy filing, such as interest, fees, and liquidated damages, those are not recoverable from an insolvent estate. In fact, they are expressly precluded by the bankruptcy court.

And like every rule, there are also exceptions to the rule. One that is rare, but that we have encountered, is called the solvent debtor exception. That sometimes happens when there's a company that files for bankruptcy, usually some outside, external, systemic reason causes an otherwise good company to find itself in bankruptcy, and then their fortunes turn for the better during the bankruptcy case, and now the company finds itself able to repay its debts in full.

There are also cases where the existing equity holders want to retain their equity, and to do so, the Code requires them to pay all senior claims in full, which would include the unsecured claim from the fund. So in these two circumstances, courts have required payment of the full contractual or the full statutory amount of those claims. And it's not just what the Bankruptcy Code may otherwise limit the claim to, but now you can actually recover on things like post-petition interest and potentially even liquidated damages.

Neil Shah: Alright, so then other than the exceptional case, it sounds like the plan is not going to see anything other than the withdrawal liability itself. Now, on that front, we've talked before about how withdrawal liability is payable in a lump sum, or in monthly or quarterly payments over time. In the last episode, you also talked about how, in the proof of claim, you would include the current present value of the withdrawal liability. How does that all work out when you're filing a proof of claim?

Daniel Desatnik: So the first thing that I think you should understand is bankruptcy accelerates the claim, and it collapses the installment schedule into a single claim against the estate. Many plans will file for the present value of the remaining installments, rather than a nominal sum of future payments.

The debtor's plan of reorganization or liquidation will dictate the actual distributions on that accelerated claim. So, in other words, the form of consideration and the percent of recoveries that you'll receive. The withdrawal liability schedule outside of bankruptcy no longer continues as such inside the case.

So, a practical point here is to tie the claim amount to the clear actuarial assumptions and plan rules, and reserve your rights to amend it if new facts or additional withdrawals surface.

Neil Shah: Now, we've spent a lot of time talking about what the plan is supposed to do once a bankruptcy case is filed. Let's turn to the debtor's side. What are some of the tools in the debtor's toolkit when they face a proof of claim for withdrawal liability and they believe that the amount is too high, or that it's not owed at all? What exactly are they supposed to be doing here?

Daniel Desatnik: Sure. I'll talk specific things they can do, and then I'll also talk high level. As we mentioned in the past episode, the debtors usually have a home court advantage here if they can get the bankruptcy court to be the venue that is going to decide the ultimate withdrawal liability claim. They may find a judge that is more sympathetic to their cause and looking to help them reduce the size of the claim.

So, simply, you'll find a debtor either dragging their feet and taking a long time to resolve a claim, or even by filing an objection, they're able to use the leverage of the process to try and settle a claim at something of a discount. Now, that's sort of the high-level leverage dynamic that's going on.

A debtor is going to look at the facts that are asserted in the proof of claim, and this is why you really want to make sure that you have expert counsel, whether that's bankruptcy counsel, ERISA counsel, or both, that get your proof of claim to assert all the facts that they need to.

They're going to look at whether withdrawal occurred, they're going to test the fact pattern, the dates, they're going to look at the triggers if there are things in the plan of reorganization, deadlines that you missed, any technical footfalls they will try and use against you. They'll also look to challenge add-ons. So, if you have an administrative expense theory, they're going to push back on that. If you've asserted priority on pre-petition claims, they're going to push back on that.

They're going to look at your calculation of interest, they're going to look at whether you're claiming post-petition interest and liquidated damages, and they're going to push back on that because, as we had previously talked about, those are things that are disallowed by the bankruptcy court.

Finally, so long as it hasn't already been waived, the debtor can assert all different types of challenges that employers assert outside of bankruptcy.

Neil Shah: Alright, so it sounds like, then, there are some unique arguments that debtor's counsel can assert in the bankruptcy, but otherwise, the debtor's counsel is kind of doing the same thing that any employer would do outside of the bankruptcy. They might challenge whether a withdrawal has occurred or not occurred, they might challenge the assumptions that went into the calculation itself. And so long as those have been preserved, there'll be an issue as to whether that's decided by the bankruptcy court or by an arbitrator.

Now, one issue that we haven't talked about yet is one of the exceptions that takes on added prominence in bankruptcy. We're going to have a whole episode dedicated to that exception, and really all the other exceptions that are found throughout the statute. But to give a little bit of flavor of that, it's an exception that is available for distressed employers, both in and outside of bankruptcy, and it takes on added prominence when there actually is a bankruptcy.

What it essentially provides is that if the employer is insolvent, or here the debtor in bankruptcy is insolvent, there is an alternate means of calculating its withdrawal liability that, on the higher end, is capped by whatever the liquidation value is of the company itself. Like I said, we will cover that in much more detail in a later episode.

Before we wrap, one more item that I think we should cover. We've talked about how an employer's commencement of a bankruptcy case doesn't stop the plan from going after the employer's affiliates. So let's say the bankruptcy court approves a plan of liquidation or a reorganization plan. Is it possible that either of those will impact the plan's right to proceed against others, even after the confirmation of the plan?

Daniel Desatnik: So your question hits on a very hot topic in all of restructuring law right now. In fact, it's a subject that was recently dealt with by the Supreme Court in a case of high public interest called *Purdue*. And where I think you're going, Neil, is whether the debtor can use a plan, whether that's a plan of reorganization or a plan of liquidation, to effectively discharge liabilities that the fund may hold against third parties. And we call those third-party releases.

The Supreme Court found that those are not permissible. But creative restructuring lawyers are working hard to find ways around that rule. So the practice point here for our listeners should be that you will still see plans of reorganization or plans of liquidation where they give you the option to opt out of providing a third-party release. And if you are asleep at the switch and you don't affirmatively check the box to opt out, you may find that not only is your claim against the debtor discharged for whatever recovery you're to receive on your unsecured claim, but you may then realize that you can't pursue those third parties that might be liable to you as well.

So generally speaking, the rule is during the case, the automatic stay does not prohibit you from pursuing those entities unless the court takes some affirmative action. But through a plan, if you are not paying attention, you might find yourself having released those claims. So pay attention. If you do see anything that says third-party release, make sure that you opt out.

Neil Shah: That's very helpful. Let's just talk quickly about one last issue. I don't think we're going to have enough time to give it the full attention that it deserves, and like I've said many times during our series so far, we're going to have an episode dedicated exclusively to talking about this in more detail. But let's talk about asset sales in bankruptcy, and specifically successor liability.

So, as part of a liquidation or reorganization, the debtor's estate will sometimes sell its assets to generate cash that can be used to either pay creditors or fund the company that emerges from the reorganization. These sales are generally considered to be free and clear of all existing liabilities, which I imagine is what makes them attractive for purchasers. How does withdrawal liability, or rather, can withdrawal liability still rear its head here for purchasers of assets out of bankruptcy?

Daniel Desatnik: Again, Neil, you're hitting on a very fertile area of the law. Increasingly, we see that purchasers in bankruptcy who are looking to buy substantially all assets of the debtor free and clear will try to protect against the risk of successor liability by including in the proposed order findings of fact that they are not a continuation of the debtor, that they are choosing different locations, different workforce, different branding, different supply chains, whatever the best set of facts may be to show that they are not, in fact, a successor.

And then on top of that, they will seek a legal finding in the sale order that there is no successor liability. Bankruptcy courts are increasingly more likely to agree with those findings and to provide those findings in their orders, mainly because you're trying to get the highest and best price you can for the assets. And if a purchaser is going to be open to successor liability, they're not going to pay as much for the assets than if they can get this free-and-clear finding.

Now, we see in the Seventh Circuit, for example, that not all courts are willing to acknowledge that they have the power to provide a finding of no successor liability. But that said, what you should do as the holder of a withdrawal liability claim is pay careful attention to the sales process and to the proposed order. And if there are successor liability findings in there that would insulate the purchaser from your claim, you should consider speaking to counsel for the creditors' committee to determine if they are going to object to such findings. And if there are no such findings, you may be able to assert your claim against the buyer.

Neil Shah: Great. That's very helpful. Before we wrap, any other issues you want to flag for our listeners?

Daniel Desatnik: I think from the questions and answers that we've gone through on the two podcast episodes, the listeners can certainly appreciate that the intersection of the withdrawal liability question and bankruptcy is very complex. And the value of having experienced counsel can be the difference between you potentially losing your entire claim because you tripped a deadline or had a technical issue, or being in a position to really maximize the amount that you recover on your claim.

So I think hiring counsel that has direct experience with withdrawal liability in the distressed world is so important. And I also think being proactive about exercising your rights. So before a company files for bankruptcy, start looking into doing things that you can to put yourself in the best position. Otherwise, you might find yourself behind the eight ball.

Neil Shah: This was great. Thanks so much for joining us.

Daniel Desatnik: Thank you for having me, Neil.

Neil Shah: That's our episode for today. If you find 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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