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The Coal Industry

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Coal Industry Series – Legacy Liabilities: Related Restructuring and Bankruptcy Part II

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- Collective Bargaining Agreement, Pension and OPEB modifications that may be possible in Bankruptcy that are not available absent an agreement of all parties.

A. The Law

- Section 1113 of the Bankruptcy Code provides, in relevant part, that a debtor in possession may assume or reject a collective bargaining agreement if:
  - subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession ... shall –
  - (A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
  - (B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.
- 11 U.S.C. § 1113(a), (b)(1).

Modification of CBAs in Bankruptcy

- The Bankruptcy Code further requires that the debtor "meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement." 11 U.S.C. § 1113(b)(2) (2012). Section 1113(c) provides that:
  - [t]he court shall approve an application for rejection of a collective bargaining agreement only if the court finds that--
    - (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1);
    - (2) the authorized representative of the employees has refused to accept such proposal without good cause; and
    - (3) the balance of the equities clearly favors rejection of such agreement.
- 11 U.S.C. § 1113(c).

Modification of OPEBs in Bankruptcy

- Section 1114(e) of the Bankruptcy Code provides in relevant part that:
  - notwithstanding any other provision of this title, the [debtor] shall timely pay and shall not modify any retiree benefits” unless the court, on the motion of the [debtor] or authorized representative of the retirees, orders, or the debtor and the authorized representative agree to, the modification of such benefits. 11 U.S.C. § 1114(e) (2012).
  - Section 1114(b) defines the “authorized representative” as the person designated by a labor organization as the authorized representative of persons “receiving any retiree benefits covered by a collective bargaining agreement.” 11 U.S.C. § 1114(b) (2012).

OPEB Modification (cont.)

- For purposes of Section 1114, "retiree benefits" are defined as:
  - payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise) maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under this title.
- 11 U.S.C. § 1114(a) (2012).

OPEB Modification (cont.)

- Section 1114(f)(1) provides that a debtor, after filing the bankruptcy petition but prior to filling a motion to modify retiree benefits, shall:
  - (A) make a proposal to the authorized representative of the retirees, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the retiree benefits that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
  - (B) provide, subject to subsection (k)(3), the representative of the retirees with such relevant information as is necessary to evaluate the proposal.
- 11 U.S.C. § 1114(f)(1).
- The debtor is also required to meet with the authorized representative of the union at reasonable times to confer in good faith in an attempt to “reach mutually satisfactory modifications to such retiree benefits.” 11 U.S.C. § 1114(f)(2).

OPEB Modification (cont.)

- Pursuant to Section 1114(g), a court shall enter an order that permits the modification of retiree benefits if the court finds that:
  - (1) the [debtor] has, prior to the hearing, made a proposal that fulfills the requirements of subsection (f);
  - (2) the authorized representative of the retirees has refused to accept such proposal without good cause; and
  - (3) such modification is necessary to permit the reorganization of the debtor and assures that all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and is clearly favored by the balance of the equities.
- 11 U.S.C. § 1114(g).

Checklist for CBA and OPEB Modifications in Bankruptcy

- For court approval of a motion to reject and modify a CBA under Section 1113 or to modify retiree benefits under Section 1114, the debtor must meet the following requirements:
  - The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement.
  - The proposal must be based on the most complete and reliable information available at the time of the proposal.
  - The proposed modifications must be necessary to permit the reorganization of the debtor.
  - The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.
  - The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal.
  - Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union.
  - At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.
  - The Union must have refused to accept the proposal without good cause.
  - The balance of the equities must clearly favor rejection of the collective bargaining agreement.

Section 1113 and 1114

- Debtors must meet the requirements of Section 1113 and 1114 by a preponderance of the evidence.
- As a practical matter, once the debtors have made their prima facie case, the burden shifts to the union to show that the debtor did not supply sufficient information, that the debtor did not bargain in good faith, in addition to demonstrating that the union had good cause to refuse the proposal.
- Failure to meet any of these requirements is sufficient for the court to deny a debtors' motion to reject the CBA and/or to modify retiree benefits.

Peabody Coal/Patriot Coal:

Peabody Coal – S.D. West Virginia (Judge Goodwin)

Patriot Coal – Bankr. E.D. Missouri (Judge Surratt-States)

Organizational History

- Prior to October 31, 2007, Debtor Patriot Coal Corporation and a number of its subsidiaries were wholly-owned subsidiaries of Peabody, the world's largest private-sector coal company.
- On October 31, 2007, Patriot was spun-off from Peabody through a dividend of all of its outstanding shares.
- In exchange for stock in Debtor Patriot Coal Corporation, Peabody contributed subsidiary companies (assets and liabilities) to Debtor Patriot Coal Corporation, together with the retiree health care liabilities associated with those operations.
- As a result of the spin-off, Debtor Patriot Coal Corporation became a separate, public company. Following the spin-off, Debtor Patriot Coal Corporation became the independent parent of 64 subsidiaries.
- Peabody Holding agreed to pay liabilities that Patriot incurred for the provision of health care benefits for 3,100 retired miners (hereinafter the "Peabody-Assumed Group").

Peabody Coal/Patriot Coal:

The Patriot Coal 2008 Acquisition Of Magnum Coal Company

- In 2005, Arch Coal sold 100% of the stock of three Arch subsidiaries to Magnum Coal Company (hereinafter "Magnum"). This transaction allowed Arch to assign to Magnum less than 15% of its assets but more than 90% of Arch's retiree health care liabilities.
- In 2008, Patriot Coal announced that it signed an agreement to purchase Magnum. At the time of its acquisition by Patriot Coal, Magnum was one of the largest coal producers in Appalachia. A substantial portion of those mining operations were operated by UMWA-represented labor.
- The acquisition of Magnum caused Patriot Coal to assume Magnum's liabilities for health care benefits to current and former employees of Magnum and other entities associated with Arch.
- Following the Magnum acquisition, over 90% of the health care beneficiaries who received post-retirement benefits from Patriot were former employees or dependents of former employees of Peabody, Arch or their subsidiaries that were acquired by Patriot.
- As of February 2013, Patriot paid for or administered retiree health care benefits to approximately 21,000 individuals.
- In 2012, Patriot spent approximately $83 million dollars on retiree health and financed benefits administered pursuant to the Coal Act for more than 2,300 retirees and dependents, and other benefits for approximately 1,200 non-union retirees and dependents.
- Patriot spent approximately $20.8 million dollars in 2012 on contributions to the 1974 Pension Plan.

Peabody Coal/Patriot Coal:

<u>Patriot 1113/1114 Motion</u>

- Patriot proposed to make various modifications to the CBAs to divest the Debtors of the responsibility to provide Retiree Benefits and pensions.

Peabody Coal/Patriot Coal:

Patriot Coal Opinion (May 29, 2013):

The **Bankruptcy Court Found:**

- There is no dispute that for Debtors' survival, concessions are necessary.
- Patriot's obligations for Retiree Benefits consume double its revenue in relation to competitors.
- Patriot also faced considerable expense and roadblocks to its productivity if the current CBAs remain in place such that Patriot would not be competitive in the coal market.
- The **Bankruptcy Court Held**:
  - granted the Motion to Reject Collective Bargaining Agreements and to Modify Retiree Benefits;
  - authorized Patriot to terminate retiree benefits for certain of its current retirees pursuant to Section 1114 of the Bankruptcy Code; and
  - transition the retiree health care to the UMWA Retiree Healthcare Trust, to be structured as a Voluntary Employee Beneficiary Association (VEBA)

Peabody Coal/Patriot Coal:

Peabody Coal

A lawsuit was filed on behalf of more than 10,000 retirees and active workers whose health care and pension benefits were transferred to Patriot Coal by Peabody Energy and Arch Coal. Pursuant to the lawsuit, the two spinoffs then merged, resulting into a Patriot Coal that had large legacy obligations and below-market coal contracts.

- The miners and UMWA sued Peabody and Arch for violating ERISA, saying the companies should be held accountable for the retirement obligations to 10,000 retired miners following Patriot's July 2012 bankruptcy filing.
- Patriot cited dropping prices and demand for coal, as well as “unsustainable labor-related legacy liabilities,” among its reasons for declaring bankruptcy.

Peabody Coal/Patriot Coal:

The Complaint by the miners and the UMWA, had claimed Peabody and Arch spun off some of their subsidiaries, which eventually combined into Patriot, specifically to shed their burdensome retirement liabilities. “In view of the realities of the transaction and the cyclical nature of the price of coal, it was inevitable that Patriot would eventually fail under the weight of its retiree health care and other legacy obligations.”

Peabody and Arch asserted the miners’ eligibility for benefits remained the same before and after the spinoffs under ERISA.

Peabody Coal/Patriot Coal:

Peabody Court Holding:

Agreeing with Peabody and Arch, Judge Goodwin reflected that the miners remained eligible to qualify for and collect benefits for several years after the spinoff:

- "The change in sponsorship of the fund does not interfere with the employees' ability to attain Benefits."
- The "employees were still entitled to the same welfare benefits after the transactions as before."
- "ERISA only guards the individual rights of employees to obtain benefits, not the financial security of a pension plan as a whole."
- "Rather than being a decision made by an employer that impacts the employee in the immediate future, Peabody and Arch made decisions as shareholders of the companies employing the plaintiffs, and these decisions did not impact the employees' access to their benefits until many years later."

Peabody Coal/Patriot Coal:

- Eventually Peabody and Patriot entered into a settlement with the UMW by agreeing to fund a VEBA (health care trust fund).
- Patriot is no longer a public company but is a owed by Private Equity funds.

Control Group Liability under ERISA

ERISA imposes certain liabilities and obligations on all (1) — trades or businesses (2) included in a controlled group. These include:

- Withdrawal Liability: Companies that leave multiemployer pension plans must pay their share of liabilities.
- PBGC Termination Liability: Unfunded liabilities must be satisfied when a plan is terminated.
- Liability for Minimum Annual Contributions: Pension plans must be funded at certain minimum levels.
- Other Statutory Requirements: Certain coverage and nondiscrimination tests and reporting requirements for tax-qualified retirement plans are applied on a —controlled group‖ basis.
- Reporting Requirements: Sponsors of underfunded plans must file certain reports with the PBGC.

ERISA defines —controlled group by reference to IRC Sections 414(b) and (c).

- ERISA 4001(a)(14): [I]n the case of a single-employer plan (A) —controlled group means, in connection with any person, a group consisting of such person and all other persons under common control with such person; (B) the determination of whether two or more persons are under —common control shall be made under regulations of the [PBGC] which are consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under subsections (b) and (c) of section 414 of the IRC.
- ERISA 4001(b)(1): With respect to multiemployer pension plan withdrawal liability, under regulations prescribed by the PBGC, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer. The regulations prescribed under the preceding sentence shall be consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under section 414(c) of the IRC.

ERISA Lien on Controlled Group Assets

Liens: An ERISA lien can arise upon all assets in a controlled group in case of a plan termination or a failure to make over $1 million of required contributions.

Can a PE Fund be liable for Controlled Group Liability

In Sun Capital Partners III LP v. New England Teamsters & Trucking Industry Pension Fund, No 12-2312 (1st Cir. July 24, 2013):

- Scott Brass was an employer participating in a Multi-employer Pension Plan (MEPP).
- Sun Trust - a PE company – through various investment funds (one Fund 70%/ one Fund 30%), were the owners of Scott Brass.
- In 2008, an involuntary was filed against Scott Brass.
- The MEPP was underfunded
- The MEPP Plan Administrator demanded payment of Scott Brass' proportionate share of the MEPP's unfunded liability and the withdrawal liability from Scott Brass and the Sun Trust Funds.

PE as part of Controlled Group

The Sun Trust Funds sought a Declaratory Judgment Ruling that the Funds did not meet the “common control” requirement and were not “Trade or businesses.”

The Court of Appeals for the First Circuit held:

- under some circumstances, a PE Fund could be regarded as a —trade or business for ERISA controlled group purposes; and
- did not rule on whether any of the three co-investing Sun Capital funds was in fact a member of an ERISA controlled group of trades or businesses together with the bankrupt portfolio company.

Sun Trust filed:

- Writ of Certiorari with the United States Supreme Court on issue of whether a PE Fund could be regarded as a —trade or business for ERISA controlled group purposes
  - Writ denied (March 2014)
- Motion for Summary Judgment on issue of whether any of the three co-investing Sun Capital funds was in fact a member of an ERISA controlled group of trades or businesses together with the bankrupt portfolio company.
  - Motion is Pending.

Need to Comply with 1114 not just 1113 for OPEB Modification

American Airlines – Court held that American Airlines could not Modify OPEBs

The former AMR Corp. (American Airlines) filed suit in July 2012 against an *official retirees' committee* seeking termination of medical and life insurance benefits for union and non-union retirees.

- Bankruptcy law required appointment of an official committee to oppose the airline's effort to end retirement benefits.
- AMR contended it reserved the unilateral right to terminate health and insurance benefits for retirees at any time.

American Airlines – OPEB Mofidication needs to comply with 1114

AMR argued there were no disputed issues of fact.

The *Bankruptcy Judge disagreed*:

- Finding - the governing documents “lack language categorically reserving the Airline’s right to terminate their contributions to retiree benefits” for 46,930 retirees at the outset of bankruptcy in November 2011.
- Holding - there must be a trial to determine whether the Airline reserved the unilateral right to end health and life-insurance benefits for most retirees.

American Airlines – OPEB Mofidication needs to comply with 1114

Since most retiree benefits were laid out in pre-bankruptcy union contracts, AMR contended that the termination or rejection of those contracts during AMR’s bankruptcy automatically ended the obligation to continue retirees’ benefits.

The *Bankruptcy Court again disagreed*:

- While the union contracts were ended under Section 1113 Proceeding, AMR must undergo a separate process under Section 1114 to end retiree benefits.
- Since the retirees did not participate in the 1113 process, it would be unfair, the Bankruptcy Judge said, to end their benefits through procedures where they were not parties.

What does the Benefits Contract say regarding modification or termination

The Bankruptcy Judge found

- Several AMR documents containing “lifetime language” sufficient so that he might decide at trial that AMR lost the right of unilateral termination – language that could “be reasonably interpreted as a promise of lifetime benefits.”
- reserving the right to modify benefits is not equivalent to keeping the ability to terminate entirely and language in retirement-plan documents giving the right to terminate cannot control union contracts that may imply lifetime benefits.
  - For some non-union participants in a so-called prefunded plan and a 1960 non-union retirement plan, the Bankruptcy Judge said the documents were unambiguous and give AMR unilateral termination rights.
  - For other union and non-union workers, the Bankruptcy Judge said there must be a trial to decide contested issue of fact and determine if the airline has unilateral termination rights.

What is effect of confirmation of Ch 11 Plan on post-confirmation OPEB Modification

While the Opinion was filed in April, the Court entered the Order on May 28, 2014, so as of last week, no appeal was filed.

If AMR must go to trial, it must prove the modification or termination is "necessary to permit the reorganization."

Now that AMR has emerged from bankruptcy without modifying benefits and is operating profitably, the reorganized airline could have difficulty making the required showing.

Termination Premiums

- Both AMR and Patriot sought to modify their OPEBs but did not seek to terminate their pensions.
- Pension “Termination Premiums” were enacted in 2005 to prevent companies from “easily shedding their legacy costs in bankruptcy and coming out reorganized without those legacy costs.”
- In 2009, the Court of Appeals for the Second Circuit ruled that the Termination Premiums could not be discharged in bankruptcy and the statute itself reads as the Termination Premium accrues after confirmation of a chapter 11 Plan.
- It may be that AMR and Patriot did not seek distress terminations because of the cost of the Termination Premiums - $1250 per employee per year for 3 years.

The Bankruptcy Fairness and Employee Benefits Protection Act (S. 2418) (Proposed June 3, 2014),

The Bankruptcy Fairness and Employee Benefits Protection Act (S. 2418), "would limit the ability of companies to reduce or terminate benefits for employees and retirees under the federal Bankruptcy Code, and entitle retirees to the continuation of healthcare benefits for at least two years following the restructuring of their former employer" even if a court rules that a company can eventually halt benefits.

Bill Features: According to the legislative release, the proposed bill would:

- Prohibit companies from using the bankruptcy system to reduce pay and benefits for employees and retirees, unless they can prove that the benefits cuts they have proposed are absolutely necessary to prevent the company's liquidation;
- Require companies in bankruptcy to pay for retiree health care benefits for at least two years following the company's restructuring;
- Establish rights for municipal employees and retirees that are similar to those in corporate bankruptcy cases;
- Require companies to continue making payments to pension plans while bankruptcy proceedings are ongoing;
- Require companies to provide specific information to employees about the duration of their retiree health care benefits;
- Create a legal presumption that promised health care benefits cannot be reduced after the employee retires; and
- Commission a study by the Government Accountability Office (GAO) on strategies some companies use to avoid paying promised benefits to their employees and retirees."

Questions?

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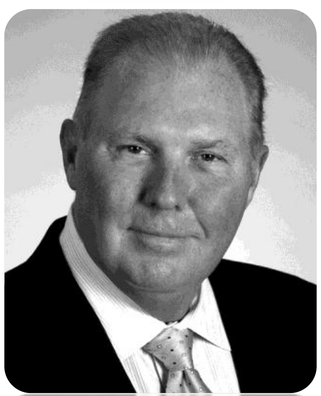

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THANK YOU!