

Buy-Side Briefs

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Coal Bankruptcies: Complications and Risks Associated with Federal Coal Legislation

Introduction

The recent bankruptcy filing of Patriot Coal Corporation and its reporting of “unsustainable” legacy benefit liabilities have raised the profile of other post-employment benefits (OPEBs, *i.e.* non-pension retiree benefits) in the coal industry. Some market participants have assumed that coal industry OPEB liabilities can be discharged through the same bankruptcy processes and procedures as OPEB liabilities in other industries. However, two pieces of federal legislation — the Coal Retiree Health Benefit Act and the Black Lung Benefits Act — create statutory benefit obligations for coal operators and these obligations are significantly more difficult to discharge through the bankruptcy process than “traditional,” voluntary OPEBs. Below is a brief discussion of the statutes and the impact that they may have on the restructuring options of coal operators.

Background

Coal worker health and benefits legislation for retirees primarily takes the form of two statutes, the Coal Industry Retiree Health Benefit Act, 26 U.S.C. § 9701 et seq. (the Coal Act) and the Black Lung Benefits Act, 30 U.S.C. § 901 et. seq. (the Black Lung Act). The Coal Act was established in 1992 to address the underfunding of United Mine Workers of America (UMWA) health plans and to shore up funding for the lifetime health care of coal retirees. The Black Lung Act was passed in 1969 to address chronically high rates of pneumoconiosis (aka black lung disease) among coal workers by providing monthly income maintenance and other benefits to coal miners who were “totally disabled” by black lung disease.

The Coal Act imposes a series of obligations on coal operators who, as of 1992, were or had been signatories to collectively bargained coal wage agreements. Under the Coal Act, such operators are statutorily required to fund individual employer retiree health plans (IEPs). The Coal Act also established two national funds — the “Combined Fund” and the “1992 Fund” — that were designed to provide health benefits to retirees not covered by an IEP. Then-existing UMWA health benefit funds were merged into the Combined Fund. The 1992 Fund was established as a “back-stop” for not-otherwise-covered retirees, as well as those retirees who may in the future be “orphaned” when an operators’ IEP was canceled. Workers who retired after October 1994 are not eligible for the Coal Act funds. Each of the Coal Act funds is financed by per-beneficiary premiums assessed against “assigned” operators or their “related persons.”¹ In addition, because the 1992 Fund must absorb eligible retirees from a canceled IEP, certain operators maintaining an IEP are required to post collateral to the 1992 Fund. In order to cover retirees who are totally orphaned from any operator or related person, the government has begun phasing-in transfer payments from the Abandoned Mine Reclamation Fund to the funds.

The Black Lung Act creates a claims process for miners asserting that they have been disabled by black lung disease. Claims are investigated by the Department of Labor (DOL). If a benefit (in the form of monthly disability, survivor or medical care payments) is awarded to a miner or the heirs of a miner, that benefit is assessed against the “responsible operator” identified by the DOL. If no responsible operator is identified, a national trust funded by coal excise taxes pays the benefit. If the responsible operator is unable to pay, the national trust pays the benefit but the responsible operator is then liable to the trust, with such liability backed by subrogation rights and statutory liens.

Both the Coal Act and the Black Lung Act can have a major impact on the restructuring options of coal mine operators. For example, when Bethlehem Steel (which also had coal operations) was in bankruptcy in 2003, it terminated benefits to 85,000 of its employees and retirees, but excluded from this termination 3,800 individuals covered by its Coal Act IEP. Despite both Bethlehem’s decision to continue to pay for its IEP up until the time of a § 363 sale of its assets and Bethlehem’s negotiation of an settlement with the Coal Act

funds, Bethlehem's estate ultimately incurred \$40 million in allowed claims (including § 503(b)(1) administrative priority claims) by a sureties liable for Coal Act bonds issued on behalf of Bethlehem.²

While the precise impact of coal legislation on a particular case is unique to that case, such legislation generally makes restructuring of coal industry OPEBs more complicated and case-specific than in other industries. These complexities are discussed below.

Limitations on Modifications to Coal Industry OPEBs

Section 1114 of the Bankruptcy Code protects certain "retiree benefits"³ from modification prior to satisfaction of § 1114's significant procedural and substantive requirements.⁴ Despite these protections (and notwithstanding the uncertainty caused by the Third Circuit's opinion in *Visteon*), many debtors assume that, as long as their benefit plans preserve a unilateral right to modification, they can shed OPEB liabilities without resort to § 1114.⁵ This belief is still held by many market participants, but likely does not apply to the legislatively mandated retiree benefits in the coal industry. The statutory nature of certain coal industry benefits makes them very different from OPEBs in other industries.

The claims process under the Black Lung Act has been found to be outside the scope of the automatic stay.⁶ While this does not mean that a debtor must pay its assigned black lung benefit liabilities (the Black Lung Benefits) as they come due, it does mean that most debtors will have little ability to limit the gross amount of such Black Lung Benefits. A decision to stop paying Black Lung Benefits would also create obligations to the Black Lung Disability Trust Fund, which would then pursue payment from the debtor itself, as well as the debtors' insurers, sureties or posted collateral – leading to claims against the operator's bankruptcy estate. Moreover, in some circumstances a coal operator's directors and officers could be personally liable for civil penalties on account of unpaid Black Lung Benefits.⁷

Courts have been hesitant to allow modifications to IEP retiree benefits required by the Coal Act, except in the most dire circumstances.⁸ Such modification would almost certainly have to be carried out via the § 1114 process, which, as noted above, places significant procedural and substantive roadblocks to modification. Premiums due to the Coal Act funds are protected in bankruptcy as "taxes" and can be afforded administrative expense status under § 503(b)(i), if they accrue post-petition.⁹ This can be a major restructuring operating expense because the obligation to pay Coal Act fund premiums continues post-petition, even if the operator ceases coal mining.¹⁰ However, courts have held that coal assets may be sold in a § 363 sale free and clear of the obligation to pay future Coal Act premiums.¹¹

The Coal Act scenarios faced by a debtor coal operator will vary tremendously depending on the nature of the operator's retirees. For instance, attempting to modify benefits to 1992 Fund-eligible retirees covered by an IEP may be futile since the expense of funding the IEP would simply be reasserted as new 1992 Fund premiums (*i.e.* post-petition "taxes" for which the estate was responsible). However, the outcome may be different if canceling or modifying an IEP would not create a large number of new 1992 Fund beneficiaries. Debtors facing significant Combined Fund liabilities may need to pay particular attention to the date those premiums come due.¹² In general, the legal and practical difficulties in modifying Coal Act liabilities means that in a deleveraging (*i.e.* non-operational) restructuring, the prudent course for a debtor is likely to maintain Coal Act benefits in place. On the other hand, to the extent a coal operator is using its bankruptcy to shutter or sell assets, the effect of those actions on the operators' claim pool must be carefully managed.

Of particular importance to any attempted restructuring of coal OPEBs is the broad, ERISA-like control group liability imposed by both the Black Lung Act and the Coal Act. Such provisions have the potential to spread liability under the statutes across corporate families. The Black Lung Act's implementing regulations were drafted to allow the DOL access to a large group of related companies in the event that a responsible operator cannot pay its benefit obligations.¹³ Liabilities under the Black Lung Act can also extend to both successor and prior owners of a mine.¹⁴ Similarly, the Coal Act creates a category of "related persons" (including successor in interest, control group affiliates and joint venture partners) who are jointly and severally liable for certain of an operator's Coal Act premiums.¹⁵ Furthermore, the actual assignment of beneficiaries to an operator (who then must provide an IEP or pay premiums for coverage under one of the funds) will be transferred to "related persons" if the primary operator is no longer in business.¹⁶

The cumulative effect of the wide liability net cast by the Black Lung Act and the Coal Act is that attempts to restructure coal industry OPEB obligations can have a major impact on affiliates, co-debtors, and third parties. In many instances, obligations may simply shift to co-debtors, rendering untenable many benefit restructuring strategies, including a subsidiary-by-subsidary approach. In addition, to the extent impacted third parties assert claims against the debtor, this could have a serious impact on the debtor's general unsecured claims pool.

Conclusion

Despite the protections afforded by § 1114, OPEBs are sometimes considered to be relatively easily managed in bankruptcy. However, the picture is not nearly as clear when dealing with the liabilities imposed by the Coal Act and the Black Lung Act. The reduced ability of a coal operator to modify or discharge its Coal Act and Black Lung Act liabilities through the chapter 11 process, as well as the significant reach of group liability under both statutes, makes restructuring OPEB liabilities more difficult for coal operators than employers in other industries. Managing coal-specific liabilities in bankruptcy is a complicated and fact-specific endeavor, which may involve legal questions that are not fully developed in case law.

Endnotes

¹ As discussed below, the Coal Act's definition of "related persons" is quite broad, and includes prior owners. The sometimes marginal connection between beneficiaries and their "assigned" operators was the subject of considerable controversy after the Coal Act was enacted.

² See *In re: Bethlehem Steel Corporation*, 2004 Bankr. LEXIS 517 (February 9, 2004 Bankr. S.D.N.Y.).

³ "Retiree benefits" for purposes of § 1114 are defined at 11 U.S.C. 1114(a).

⁴ Before a retiree benefit can be modified pursuant to § 1114, the debtor must negotiate with an authorized representative of retirees (who has to refuse "without good cause" the debtors' proposal) and satisfy the bankruptcy court that the modification to retiree benefits is "necessary to permit the reorganization of the debtor." See 11 U.S.C. 1114(g).

⁵ Compare *In re Visteon Corp.*, 612 F.3d 210 (3d Cir. 2010) with *In re Delphi Corp.*, No. 05-44481(RDD), 2009 WL 637315 (Bankr. S.D.N.Y. Mar. 10, 2009). *Delphi* reflects the conventional wisdom, rejected in *Visteon*, that contractually cancelable retiree benefits can be terminated outside of § 1114.

⁶ See *Wolf Creek Collieries v. Ruby Sammons*, Case No. 02-3528 (6th Cir. Jul. 14, 2003) (reinstating black lung appeal after DOL petitioned that debtor Wolf Creek's automatic stay did not apply due to § 362(b)(4)'s "police power" exemption).

⁷ See 20 C.F.R. § 726.300 et. seq.

⁸ See e.g. *In re Horizon Natural Resources Company*, 316 B.R. 268 (Bankr. E.D. KY. 2004). The debtor in *In re: Sunyside Coal Company*, 146 F.3d 1273 (10th Cir. 1998) attempted to modify its IEP under § 1114, but this was rejected by the bankruptcy court and the debtor subsequently converted its case to a Chapter 7 liquidation. See *Id.* at 1276.

⁹ See e.g. *In re: Sunyside Coal Company*, 146 F.3d. 1273 (10th Cir. 1998) (joining 2nd and 4th Circuits in holding that Coal Act fund premiums are taxes to be accorded priority if accruing post-petition and distinguishing case law in other employment contexts that looks at whether post-petition benefit obligation "relates back" to pre-petition event).

¹⁰ Generally, the Coal Act applies to entities that are "in business" and this covers any entity that is managing assets, including chapter 11 debtors. See e.g. *Holland v. Kitchekan Fuel Corp.*, 137 F. Supp. 2d. 681 (S.D.W.V. 2001). But the obligation to pay 1992 Fund premium applies to entities regardless of whether they are "in business," meaning that only dissolution will prevent such liabilities from accruing. See *In re: Sunyside Coal Company*, 146 F.3d. at 1280.

¹¹ See *In re Leckie Smokeless Coal Co.*, 99 F.3d 573 (4th Cir. 1996); see also *In re: WP Steel Venture LLC*, Case No. 12-1161 (Bankr D. Del) (section 363 sale approved August 8, 2012).

¹² Combined Fund premiums are assessed annually, as opposed to the monthly invoicing of 1992 Fund premiums. Whether such assessment is pre- or post-petition could impact the priority of Combined Fund claims.

¹³ See e.g. 20 CFR 725.492, 20 CFR 725.493

¹⁴ See e.g. *C&K Coal Co. v. Taylor*, 165 F.3d 254 (3d Cir. 1999)

¹⁵ See 26 U.S.C. §§ 9701(c)(2), 9704(a).

¹⁶ See 26 U.S.C. § 9706.

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