Pre-Petition Settlement Agreement Not an Assumable, Assignable, Executory Contract

Employee Benefits & Executive Compensation on **October 18, 2023**

In *Svenhard's Swedish Bakery v. United States Bakery*, Bk. No. 19-15277, 2023 WL 5541420 (9th Cir. Aug. 29, 2023), the Ninth Circuit held that a settlement agreement that resolved an employer's withdrawal liability to a multiemployer pension fund was not an executory contract that could be assumed and assigned to a third-party when that employer subsequently filed for bankruptcy. The decision is instructive for multiemployer funds and employers that negotiate settlement agreements to resolve these types of liabilities.

Background

Svenhard's Swedish Bakery ("Svenhard's") entered into a settlement agreement (the "Settlement") to make $3 million in monthly payments over 20 years to resolve almost $50 million in withdrawal liability it owed to the Confectionery Union and Industrial Pension Fund (the "Fund"). Under the terms of the settlement agreement, if Svenhard's failed to make those payments, the Fund retained the right to declare Svenhard's in default and accelerate the original $50 million in withdrawal liability pursuant to ERISA § 4219(c)(5)(A). In exchange, the Fund agreed that, once all $3 million in payments were received, it would release its claim for the remaining $47 million.

Six months later, Svenhard's ceased making payments, and the Fund declared it in default and accelerated the entire outstanding balance of $50 million in withdrawal liability. Days later, Svenhard's filed a chapter 11 petition for reorganization. The Fund filed a proof of claim in the bankruptcy for the balance of the $50 million in withdrawal liability and filed suit in federal district court against United States Bakery ("USB") to hold it jointly and severally liable for that amount as Svenhard's successor.

USB and Svenhard’s sought to limit the Fund’s recovery to the $3 million provided in the Settlement, rather than the original $50 million in withdrawal liability assessed by the Fund. To do so, they undertook a strategy whereby: (i) the bankruptcy estate would deem the Settlement an “executory contract” and assume Svenhard’s obligations to pay $3 million to the Fund; (ii) USB would pay $3 million into the bankruptcy estate, which the estate would pay to the Fund; (iii) the payment would cure the Settlement default, thereby extinguishing the Fund’s claim to collect the remaining $47 million in withdrawal liability; and (iv) Svenhard’s would assign its release under the Settlement to USB, thereby defeating the Fund’s successor liability action against USB.

The Ninth Circuit’s Ruling

The employers’ strategy failed, however, because the bankruptcy court held that the Settlement was not an executory contract that could be assumed and assigned in the first place. In affirming, the Ninth Circuit held that under the “Countryman test,” an executory contract exists only if both parties have material obligations under the agreement as of the petition date that, if breached, would excuse their counterparty’s performance obligations. The Ninth Circuit held that the bankruptcy estate could not satisfy this standard. It explained that the Fund could not have materially breached the settlement agreement as of the petition date because the Fund’s only obligation under the agreement (*i.e.*, to provide a release) was contingent on Svenhard’s first satisfying its obligations (*i.e.*, making $3 million in payments). Because Svenhard’s never made those payments, the Fund’s obligation to provide the release never arose.

The Ninth Circuit also questioned whether the Fund’s failure to provide a release would have in any event constituted a material breach. If Svenhard’s had made the required payments, the settlement agreement and the fact that payment was made would likely operate as a complete defense in any subsequent action, thereby making the execution of a formal “release” ministerial.

Proskauer’s Perspective

The Ninth Circuit's decision should be instructive for both multiemployer funds and employers. For multiemployer funds, the decision shows the importance of making releases of liability effective only after the employer fulfills its payment obligations. Otherwise, the fund may unintentionally compromise its withdrawal liability claim, and if the employer subsequently files for bankruptcy, face an unintended further reduction in recovery because the fund will stand to recover only a fraction of the already-reduced amount as a general unsecured creditor.

For employers, the decision shows the uncertainty employers and their affiliates may face when using the bankruptcy process to reduce their withdrawal liability exposure.

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