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Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies

Mark Daniels

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# PENSIONS IN PERIL: SINGLE EMPLOYER PENSION PLAN TERMINATIONS IN THE CONTEXT OF CORPORATE BANKRUPTCIES

*Mark Daniels*

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I. INTRODUCTION

A. Trends And Policies

Two trends in American industry implicating billions of dollars and tens of millions of American workers are on a collision course that will be costly in economic and emotional terms. First, the number of employees covered by private pension plans has increased steadily since 1940.1 Second, the number of employees working for

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1. PENSION AND WELFARE ADMIN., U.S. DEP’T OF LABOR, TRENDS IN PENSIONS (J. Turn-er & D. Beller eds.1989) [hereinafter TRENDS]. This rate had nearly doubled from 1950 to 1975. Id. at 3, 357. However, the percentage of the American labor force covered by pension plans has remained virtually unchanged since 1975 at approximately 53% of the full-time private wage and salary labor force. Id. at 39-40. According to the Department of Labor:

The strong growth in the pension plan coverage from 1950 to 1975, followed by the relative lack of growth since 1975, parallels changes in the employment structure. From 1950 to 1975 growth in coverage occurred primarily in manufacturing, communications, utilities and transportation industries. These industries, each of which has a current coverage rate of 50 percent or more, are characterized by large and/
corporations which have filed for bankruptcy has also increased sub-

or unionized firms, the two characteristics most closely associated with pension coverage. In 1975, 38 percent of all private wage and salary workers were employed in these industries. By 1987, the percentage of workers employed in these industries had decreased to 28 percent. Since 1975, much of the growth in employment has occurred in service industries. Service industries, with employment highly concentrated among small nonunionized firms, have historically had low coverage rates. The disproportionate growth of new jobs in low coverage service industries has offset slight increases in the coverage rate occurring across most industry sectors.

Id. at 3.

The number of participants covered by pension plans is expected to increase as the work force expands, even though the percentage of the work force covered by plans may not rise. Id. at 50. The types of plans being offered have changed, however, from traditional defined benefit plans to defined contribution plans. This phenomenon is significant because defined contribution plans are not covered by ERISA's termination provisions.

Beginning in 1982, plan growth rates slowed drastically for all plans except defined contribution plans with 100 or more participants. These plans showed a 42 percent gain over the three-year period 1982-1985. In contrast, defined contribution small plan growth was 13 percent. The number of medium and large defined benefit plans declined from 25,421 to 24,742 plans, or by about three percent.

Id. at 47. Certainly, the statistics regarding plan termination and formation must be considered carefully in light of the 1986 Tax Reform Act changes which restricted the use of individualized defined benefit plans for highly compensated employees, and may, therefore, have led to the termination of numerous single participant plans. See I.R.C. § 401(a)(26) (1988).

Almost 16,000 defined benefit plans were terminated in 1989, while 5,500 were being created. These numbers reflect a 37% increase in such terminations and a 67% decrease in creations from 1988. Lockhart, The Future of Defined Benefit Pension Plans, 27 Employee Benefits Dig. 3 (1990).

The decline in defined benefit plans has been attributed to increasingly burdensome legislative requirements. Companies seem to be switching to plans without benefit guarantees because ERISA overregulates these plans, and further, changes in the law are burdensome. See Wall St. J., Jan. 23, 1990, at 1, col. 5; see also Trends, at 49-50, 70, 76; Chernoff, Crushed by the Weight; 15 Years Later, Is ERISA Too Much of a Good Thing?, Pensions & Investment Age, Sept. 4, 1989, at 1 (explaining that the chief executive officer of a benefits consulting firm stated costs of maintaining plans have doubled due to regulatory requirements); Ezell, Many Small Firms Scrap Pensions, Chicago Tribune, Mar. 18, 1990, (Business), at 11E (stating that there is an increase in number of small businesses terminating pension plans due to complex, costly federal regulations); Costly, Complicated Pension Laws Not Working As Intended, Utgoff Says, 18 Pens. Rep. (BNA) 826 (May 13, 1991) (stating that Kathleen Utgoff, former director of PBGC, finds that administrative costs of pension plans with fewer than 15 employees are 30% to 50% of contributions and that this accounts for the 12% or less pension coverage rate for firms with 25 employees or less). The latter article notes:

Utgoff also pointed to increasingly complicated sets of pension regulations that are creating enormous costs for employers. She cited, as an example, proposed regulations on separate lines of business under Internal Revenue Code Section 414(r), calling them "an undoable project." One of her firm's larger clients "could think of no alternative but to sell a subsidiary to comply with the rules," Utgoff said.

Id.

On the other hand, a study issued by the PBGC found that the decline in defined benefit plans was due to structural changes in the economy, rather than decisions by plan administrators to shift from defined benefit to defined contribution plans. See Pension Plan Choice: 1979-1987: Clarifications and Extensions (1990); Future of Defined Benefit Plans Debated, 8 Benefits Today (BNA) 44 (February 4, 1991); PBGC Study, Consultants Concur, Plans will not
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Moreover, the size of companies that file for bankruptcy has grown over the past few years. Included among the companies

Vanish in Future, 17 Pens. Rep. (BNA) 2103 (December 24, 1990). The PBGC's director, however, has conceded that the formation of small- and medium-size defined benefit plans may be deterred by the complexity of laws and regulations covering them. Lockhart, To a Solvent Future, 15 EMPLOYEE BENEFITS J. 2, 3 (1990). The PBGC's conclusion that the shift from defined benefit to defined contribution plans was due to changes in the economy, rather than conscious decisions by plan administrators was refuted by Professor Robert L. Clark of North Carolina State University in a hearing before a Congressional House Small Business Committee on March 21, 1991:

The most plausible reason to explain the shift [from defined benefit plans to defined contribution plans] lies in the continuing complexity of pension regulations and the annual legislative changes to pension law, Clark said. The Employment Retirement Income Security Act and subsequent legislation have "substantially raised the price of offering defined benefit plans relative to that of defined contribution plans," he wrote in his testimony.

Post-ERISA regulations have increased the administrative and reporting costs of all pensions, but especially for defined benefit plans, Clark said. "[T]he regulations have had much less impact on defined contribution plans because most defined contribution plans have full funding and are not required to purchase PBGC insurance," Clark said.

The reason for the difference in results between the PBGC study and Clark's study had to do with the way the question was asked, Clark explained to BNA during a break in the hearing. The PBGC study looked at the number of plan participants covered by defined benefit plans — PBGC's premium base, Clark said. Clark's study, on the other hand, looked at the number of pension plans in existence, rather than the number of participants, Clark said. It also looked at the length of time that those plans had been in existence, he said.

The fact that the number of defined contribution plans grew much faster than the number of defined benefit plans among all industries and over all plan sizes cannot be explained by structural changes in the economy, Clark said.

PBGC might not be concerned, because their premium base remains constant, Clark added. However, smaller, growing firms that are "achieving bigness" are increasingly making the decision to cover their employees with defined contribution plans, Clark said.

Shift to Defined Contribution Plans Due to Sponsor's Choices, Study Finds, 18 Pens. Rep. (BNA) 558, 559 (Mar. 25, 1991). Other benefits experts agreed with Professor Clark's conclusions. Id. at 559.


3. Kurtzman, Bankruptcy Courts Are Mired in the ERISA Quicksand, 18 Pens. Rep. (BNA) 804, n.2 (May 6, 1991). Although the number of companies filing for bankruptcy has declined since 1986, the size of the companies filing for bankruptcy has increased. See MacLachlan, A Demand Spiral for Bankruptcy Specialists, Chicago Tribune, Feb. 25, 1990, (Business), at S. In the year ending February 25, 1990, thirteen companies with more than $1 billion in assets sought bankruptcy protection. See id. This fact is worth noting because bankruptcies involving larger companies have a great ripple effect on their creditors and employees. Id. Also, the increased leverage of large United States companies caused by taking on debt, particularly high risk "junk" bonds to fight or fuel takeovers during the 1980's, has heightened...
that have recently filed for bankruptcy are several large, well-known corporations such as LTV, Eastern Airlines, Continental Airlines, Campeau, and Carter Hawley Hale Stores, each of which employed thousands of workers. The trends have accelerated the development of law regarding the obligations of liquidating and reorganizing employers toward their pension plans, the concomitant rights and remedies of the employees covered by such plans, and the role of creditors of the debtor-plan sponsor. The legal issues which arise in this area are extremely difficult to resolve because pensions and bankruptcies are each governed by intricate federal statutes. Pension plans are regulated by the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code ("IRC"). Bankruptcies are governed by the Bankruptcy Code. Failure to comply with ERISA and IRC provisions may result in adverse income tax consequences and in costly excise taxes. The law in these areas has been complicated by significant amendments in all three areas over the past few years. Moreover, there is great confusion and conflict over the probability of financial problems. See Richter, Junk Bond Casualties—The List Keeps Growing, L.A. Times, April 8, 1990, at D1, D10 col. 3. The Bankruptcy Boom, L.A. Times, June 3, 1990, at D1:

The amount of publicly held assets in bankruptcy has soared, from just $5 billion in 1985 to a record $72 billion last year—even at a time the number of business bankruptcies dropped overall. In other words, 'the size and complexity of the bankruptcies is growing very sharply,' said George Putnam III, publisher of Bankruptcy DataSource in Boston. Id. at D7.


The PBGC introduced proposed regulations implementing SEPPAA and PPA amendments on September 2, 1987. 52 Fed. Reg. 33,318 (1987). However, the introduction of final regulations has been delayed. See 54 Fed. Reg. 52,904 (1989).

Amendments to the Bankruptcy Code were made in 1984, 1986, and 1988, and proposed changes to the Federal Rules of Bankruptcy Procedure are presently being considered. The
fundamental legal issues, such as the exclusivity of ERISA to govern pension plan terminations involving bankrupt employers.

The policies of ERISA and the Bankruptcy Code often conflict when the liabilities for a terminated plan are assessed. ERISA is directed at maintaining the integrity of the pension system and assuring ERISA-regulated plan participants receipt of the benefits to which they are entitled. ERISA requires that plan sponsors implement a vesting schedule which assures that plan participants receive a non-forfeitable right to benefits after a reasonable pre-determined amount of time. These vesting requirements are supplemented by minimum funding requirements and by Title IV of ERISA, which

changes enacted by Congress starting in 1984 have dramatically affected the resolution of issues such as the termination of executory contracts and leases, and the right of a bankrupt employer to reject a collective bargaining agreement. 11 U.S.C. §§ 365, 1113 (1988).


Conflicts arise because ERISA policy encourages the accumulation of savings for retirement and protection of accumulated retirement benefits, whereas the bankruptcy laws are motivated by the dual purposes of allowing the debtor a new financial beginning and permitting creditors to recoup from the debtor's existing assets as much of the monies owed them as is possible.

Id. The U.S. District Court for the Southern District of New York recently recognized these tensions when it stated:

While this case arose under ERISA, the concerns of the Bankruptcy Code must also be satisfied. . . . On the one hand, the Bankruptcy Code primarily looks to rehabilitate the business of the debtor/employer in a reorganization proceeding. On the other hand, PBGC's primary purpose is to further the statutory goals of ERISA, encouraging the continuation and maintenance of voluntary private pension plans for the benefit of their participants."


11. ERISA § 4022(a), 29 U.S.C. § 1322(a) (1988). In addition to requiring the plan sponsor to choose a vesting schedule, ERISA also contains minimum participation and coverage standards to obtain favorable tax treatment. See Trends, supra note 1, at 30-31.


In the event of a temporary business hardship, an employer may apply to the IRS for a funding waiver under Sections 303 and 306 of ERISA, and Section 412 of the IRC. A waiver does not actually excuse payment, but must be paid over a number of years as part of future contributions. See Novikoff, supra, at 102-10; Wintner, Funding Waivers—Getting Them, Keeping Them, in A.B.A. THIRD ANN. EMPLOYEE BENEFITS IN BANKR. AND LENDING TRANSACTIONS NAT'L INST. HANDBOOK 24 (1989) [HEREINAFTER Wintner]. Under SEPPAA and the PPA, Congress acted to restrict the terms and availability of funding waivers. Lutgens, Employee Benefit Plans In Chapter 11 Reorganizations, 19 TAX MGMT. COMPENSATION PLAN. J.
is directed at the termination of pension plans. Title IV of ERISA creates the Pension Benefit Guaranty Corporation ("PBGC"), the government agency responsible for overseeing pension plan terminations. Under ERISA, if a pension plan is terminated, the employer is required to ensure payment of all benefits earned to the date of termination. If the employer is in bankruptcy, this obligation may be reduced, but plan participants are guaranteed a minimum amount of benefits. If plan assets are insufficient to pay these benefits, the balance is paid by the PBGC from fees collected from all pension plans covered under Title IV.

On the other hand, debtors facing corporate reorganizations in bankruptcy must be concerned with many more constituencies than pension plan participants. A reorganizing company must reach an accommodation with its creditors to continue in operation and pay at least a portion of its obligations. Creditors' claims are ranked according to the nature of the consideration received by the debtor and the date the consideration was received relative to the filing. Generally, secured debts are granted the highest priority. Administrative expenses, those incurred by the debtor after the bankruptcy petition is filed ("post-petition"), which are actual and necessary costs of preserving the debtor's estate, have the highest non-secured priority. Also, certain unsecured debts, by statute, enjoy priority over typical trade and other unsecured debts, while equity interests are given the lowest priority.

27, 29-30 (1991) [HEREINAFTER Lutgens]. SEPPAA requires the IRS to consult with the PBGC before granting or modifying a funding waiver. See Wintner, supra, at 35. SEPPAA authorizes the IRS, acting in conjunction with the PBGC, to require any plan sponsor seeking a waiver to furnish security for plans having funding deficiencies of $2 million or more (this threshold amount was reduced to $1 million under the PPA). Id. at 25. The PPA reduced the time period for amortizing waived contributions from fifteen years to five years and reduced the maximum number of waivers which may be granted during a fifteen-year period from five to three. Id. at 24-25. In addition, prior to the PPA, the minimum funding requirements and related excise taxes only applied to the employer sponsoring the plan. The PPA extended these provisions to the employer's control group. Id.


19. Id.


B. Underfunded Plans And ERISA

In a corporate bankruptcy, the debtor's pension plans are often underfunded. In order to understand how this underfunding may occur, defined contribution plans must be distinguished from defined benefit plans. In a defined contribution plan, the plan sponsor contributes a certain amount for each participant, but no promise is made as to the ultimate benefit or amount that will be received. A defined benefit plan, by contrast, promises the participant a benefit or pension and the employer contributes what is required to fund that benefit. In order to help insure that the promised benefit will be paid, ERISA and the IRC impose minimum funding requirements on defined benefit plans.

These minimum funding standards reflect a compromise among competing objectives. First, the goal of protecting pension promises argues for a high minimum funding level. Second, Congress also wished to encourage the establishment of plans. Requiring too high a minimum funding level by, for example, making employers responsible for immediate contributions sufficient to fund all future benefits, would have been contrary to this goal. In addition, such a high level of funding would have an adverse impact on tax receipts, since pension deposits are generally tax deductible. Congress reconciled these competing considerations in a complex statutory matrix mandating minimum annual contributions and maximum deductible amounts. Thus, even as was the case before ERISA, a plan may be insufficient to pay all promised benefits upon termination, even though all of the ERISA-mandated funding obligations have been

certain circumstances, claims can be equitably subordinated to other claims, and equity interests can be subordinated to other interests).

23. See, e.g., Solomon & Oscar, The Priority of Minimum Funding Claims and Related Excise Tax Claims in Bankruptcy, 1989 A.B.A. THIRD ANN. EMPLOYEE BENEFITS IN BANKR. AND LENDING TRANSACTIONS NAT’L INST. HANDBOOK 89 (HEREINAFTER Solomon & Oscar) (stating that “[t]ypically in a bankruptcy setting the employer has either failed to contribute to the plan several years prior to filing a petition for bankruptcy and/or for several years thereafter”).


28. Id.

29. Id.


met. A debtor with an underfunded pension plan will face its normal host of creditors as well as claims by the PBGC, and possibly the Internal Revenue Service ("IRS"), and plan participants.

The PBGC is a self-financing, United States government corporation which draws its revenue from premiums paid by plan sponsors. As of 1988 nearly forty million workers participated in plans covered by the PBGC. However, the PBGC is nearly $2 billion in debt from bailing out large underfunded plans and it is taking a

32. *Id.* In a recent report in Congress, the General Accounting Office (GAO) suggested that the IRS, which administers ERISA's funding provisions, should begin targeting underfunded plans for examination even though underfunding is not prohibited by ERISA. See GAO REPORT TO THE CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, PENSION PLAN: IRS NEEDS TO STRENGTHEN ITS ENFORCEMENT PROGRAM 2, 5, 13 (July, 1991). The IRS defended its action, in not basing investigations on underfunding, on the grounds that underfunding was not prohibited; underfunding was not a good indication of ERISA violations; and investigations based on underfunding would be a poor use of IRS resources. *Id.* at 13, 17. The GAO responded to the IRS observation as follows: "We are not suggesting that underfunding violates ERISA or is indicative of violations. However, plans that are underfunded pose a greater risk to the government than those that are not. Therefore, we believe that underfunding should be among the criteria used for targeting plans." *Id.* at 13.

33. *See generally* Sparlin, Minimum Funding Claims and Waivers, in FOURTH NAT'L INSTITUTE ON EMPLOYEE BENEFITS IN BANKR. AND LENDING TRANSACTIONS at Tab. K (1991) (discussing the relevant ERISA and IRC sections supporting this point).

34. ERISA § 4007, 29 U.S.C. § 1307 (1988). Premium rates were originally set at one dollar per participant in 1974 and were substantially increased by the PPA. Current rates range from $16 to $50 per worker for companies with underfunded plans. See TRENDS, supra note 1, at 37, 381. *See also* 1991 Premium Payment Form Issued; Package Includes Increased Premiums, 18 Pens. Rep. (BNA) 861 (May 20, 1991) (reporting the PBGC's issuance of forms and instructions for defined premium payments reflecting changes in the law that increase the single-employer premium).

35. TRENDS, supra note 1, at 384.

36. The bankruptcies of Eastern Airlines, LTV, Pan Am, Wheeling Pittsburgh Steel Corp., Kaiser Steel, and Allis Chalmers Corp. alone will cost the PBGC well over $2 billion. Congress Should Act Before Crisis to Improve PBGC's Standing, Lockhart Says, 18 Pens. Rep. (BNA) 1283 (July 29, 1991). The PBGC has been operating with a deficit virtually since the inception of ERISA. *TRENDS, supra* note 1, at 380. From 1985 to 1989, the annual deficit exceeded $1 billion, with the worst year being 1986 when the PBGC's annual deficit neared $4 billion. *Id.* Between 1989 and 1990, the deficit was reduced from $1.5 billion to $1 billion. A higher return on investment was a major factor in this reduction. Lockhart, The Future of Defined Benefit Pension Plans, 27 EMPLOYEE BENEFITS DIG. 3, 4 (1990). During 1990, however, the PBGC's net deficit ballooned to $1.8 billion. Large Plan Terminations Cause $780 Million Net Loss to Agency, 18 Pens. Rep. (BNA) 404 (Mar. 4, 1991). PBGC Executive Director James Lockhart blamed poorer investment performance and the termination of several large underfunded plans. *Id.* In addition, there is $20 to $30 billion in underfunded pensions concentrated in the steel, auto, and airline industries; the PBGC is exposed to possible losses of $8 billion from these plans. *Id.;* Weakening Economy Takes Its Toll On Agency, Executive Director Says, 18 Pens. Rep. (BNA) 80-81 (Jan. 21, 1991). On February 25, 1991, the PBGC published its second annual list showing the 50 firms with the largest underfunded pension plans. The PBGC's methodology in assembling the list and the list's disclosure were criticized by several companies and the National Association of Manufacturers. See LTV Taps
hard-line stance against employers abandoning their pension plans in bankruptcy. Should these stepped-up efforts fail, the billions of dol-


37. In reorganizations, the PBGC will negotiate to secure plan funding, and to avoid terminations that will be costly to it. An example of such negotiations is found in the reorganization of Sharon Steel Corporation. Sharon Steel, which has been in Chapter 11 reorganization since 1987, has six pension plans covering 6,500 workers and retirees. According to the PBGC, these plans were underfunded by $275 million. In addressing this problem, the PBGC reached an agreement with the New York Merchant Bank (a suitor which proposed to purchase Sharon Steel), a New York creditor of Sharon Steel, and the court-appointed trustee. Under this agreement, the owners of Sharon Steel promised to contribute $110 million to strengthen six underfunded pension plans and prevent their termination. See Sharon Steel Agrees To Contribute $110 Million To Save Underfunded Plans, 7 Benefits Today (BNA) No. 1, at 3, col. 1 (Jan. 12 1990).

According to James B. Lockhart, the PBGC's director, the agreement demonstrates the PBGC's determination to encourage better funding of pension plans and to make it tougher for employers to terminate their plans. Lockhart stated that under the agreement, all parties involved benefitted because "[t]he company will get a chance to reorganize and get out of bankruptcy, the workers and retirees will have safe and healthier pension plans, and PBGC avoids a substantial loss of the federal pension insurance program." Id.

A significant agreement reached between the PBGC and Eastern Airlines was approved by the bankruptcy court on October 3, 1990. See Order Pursuant to Bankruptcy Rule 9019(a) Authorizing and Approving Compromise and Settlement of all Claims of the Pension Benefits Guaranty Corporation, In re Ionosphere Clubs, Inc. and Eastern Airlines Inc., case nos. 89 B 10448 (BRL) and 89 B 10449 (BRL) (Bankr. S.D.N.Y. Oct. 3, 1990). The agreement saved the PBGC from losses that totaled nearly three quarter of a billion dollars. Lockhart, The Future of Defined Benefit Pension Plans, 27 EMPlOYEE BENEFITS DIG. 3, 4 (1990). The negotiated agreement will allow employees and retirees to receive all the benefits they were promised, not only the benefits which the PBGC would have guaranteed. Id. This is significant because, as this article will argue, the gap between benefits that the PBGC guarantees and those which companies promise is divisive and should be eliminated. Unfortunately, the subsequent bankruptcy of Continental Airlines has cast doubt over this element of the settlement, because the PBGC has declared that it will now pay only guaranteed benefits with any additional benefits depending on the PBGC's recovery against Continental. But see Reporting Requirements To Be Enforced by $1,000 Per Day Penalties, Official Says, 18 Pens. Rep. (BNA) 79 (Jan. 21, 1991) (noting that PBGC Deputy Executive Director Diane Burley stated that the PBGC's failure to reach an agreement with Continental before Continental declared bankruptcy would not affect the PBGC's settlement with Eastern). The Eastern settlement was recently summarized as follows:

This settlement called for the PBGC to terminate all of Eastern's defined benefit plans under § 4042 of ERISA, to waive any right it might have to restore any of the plans under § 4047 of ERISA and to guarantee all of the benefits promised under
such plans, even those that exceed ERISA's normal guaranty limits. . . . In exchange, the agreement provided for an immediate $30 million cash payment to the PBGC from the Eastern estate, and for recognition of a general unsecured pre-petition claim of the PBGC against the estate in the amount of $565 million. The agreement also allowed Continental a general unsecured pre-petition claim against the Eastern estate for $71 million, in recognition of its payment of minimum funding contributions to the Eastern plans. Most importantly, the agreement contemplated that Continental (and the other members of its controlled group, excluding Eastern) would pay for all unfunded benefit liabilities not satisfied by the Eastern estate, in an initial payment of approximately $80.5 million (to satisfy the Eastern plans' minimum funding obligations for the 1989 plan year), and thereafter in a series of monthly installment payments for a period not exceeding twelve years. The controlled group members' obligations were required to be secured by collateral satisfactory to the PBGC, including certain international air routes. In re Ionosphere Clubs, Inc. and Eastern Air Lines, Inc., Order dated October 3, 1990, Chapter 11 Case Nos. 89 B 10448 (BRL) and 89 B 10449 (BRL) (Bankr. S.D.N.Y.). The Eastern plans were in fact terminated by the PBGC after the settlement was approved by the bankruptcy court. However, in reaction to Continental's bankruptcy filing, the PBGC subsequently announced that because of the failure to reach agreement over collateral, certain provisions of the settlement were void. Specifically, the PBGC stated that while it would honor its commitment to pay participants' guaranteed benefits under ERISA's normal provisions, any additional payments to participants would depend on the PBGC's actual recovery on its claims against the Continental estate. PBGC Release dated December 3, 1990.


On the other hand, James Lockhart, the PBGC's director, has argued that the pension insurance scheme is unlike the S&L crisis for several reasons. First, the size of the potential shortfall is not as large because:

[A]lthough we insure $800 billion in liabilities, the real risk is $20 billion to $30 billion in underfunded pension plans — a number that could increase significantly with a recession, a drop in the stock market and/or a fall in the interest rates. At the moment, about $7 billion of these undefined plans represent "reasonably possible" losses to PBGC that is about 12 times our annual premium income of $600 million.


Lockhart suggested several other dissimilarities he saw between the pension and loan industry:

Let's be honest; there are similarities between the S&L industry and the pension industry. But I think the differences are far more compelling. And that is what I want to stress.

Whereas the people involved with the S&L crisis took excessive investment risks, that is not true with pension plans. Pension assets are invested in a diversified and prudent manner. The S&L industry had many firms willing to engage in self-decep-
According to the Department of Labor, pension funding rates have improved since 1974, the year ERISA became effective. Prior to the passage of ERISA, federal law did not guarantee any benefits if plans were insufficient to pay such benefits and only about one-third of all plans held assets sufficient to pay all accrued benefits due upon termination. However, by 1985 almost three-quarters of all plans had a sufficient level of assets to pay termination liabilities, with underfunding of pension plans concentrated in only a few plans.

While the paramount pension issue of the 1990's may be bankruptcy, merger mania dominated the 1980's. During the merger wave of the 1980's, plan terminations were often undertaken in the context of corporate takeovers. Many plans had assets in excess of liabilities, due to the "bull" stock market that began in 1982, with plan investments ballooning beyond the level needed to fund benefits. However, in an effort to discourage predators, many potential takeover targets terminated plans and removed excess assets to eliminate accounting procedures. Conservative accounting is the norm for pensions. And the Department of Labor's enforcement proposals will strengthen the controls even further.

The S&L industry had people willing to commit fraud and other criminal activities. Almost no such people can be found in the pension industry. In the S&L industry, the insureds are paid immediately, while our payments are spread out over a long period into the future. The bottom line is that the conditions that brought about the downfall of the S&L industry are not found in pensions. For a lot of reasons, the S&L crisis began almost invisibly and grew quietly, out of sight of the public. That is not going to happen in the pension industry nor, for that matter, in any other federally insured program. The media won't let it, nor will Congress, this Administration or I.


39. TRENDS, supra note 1, at 119-20.
41. TRENDS, supra note 1, at 119.
42. Id. at 120. It should be noted that this data is based upon self reporting by employers and does not include certain contingencies that would increase plan liability. However, even adjusted estimates of plan funding levels that take these contingencies into account demonstrate that the pension plan system is significantly better funded today than it was before ERISA. Id. at 166. Another study, by Hewitt Associates, finds that "pension plan assets exceed vested employee obligations at 94 percent of Fortune 500 companies." See Pension Assets Exceed Vested Benefits At Most Fortune 500 Firms, Hewitt Says, 8 Benefits Today (BNA) No. 3 at 48 (Feb. 8, 1991).
43. TRENDS, supra note 1, at 143. Half of the underfunding in 1985 was concentrated in the 25 most underfunded plans. Id.
44. See TRENDS, supra note 1, at 216-19.
45. TRENDS, supra note 1, at 120. On paper, plan assets also increased because higher interest rate assumptions were used to discount future benefits. Id. For example, in 1977, the average interest rate assumption used by plans was 5.8%. Id. By 1985, this rate had increased to 7.5%. Id.
inate attractive cash caches. Moreover, some companies adopted "pension parachutes" that would distribute surplus plan assets to plan participants in the event of a hostile takeover. Conversely, after a successful takeover, the acquirer might terminate an overfunded pension plan to extract its excess assets.

The threat to the integrity of the pension insurance system posed by underfunded plans and corporate bankruptcies has broad economic repercussions due to the unique economic role played by pensions in this country's capital and labor markets. The low savings rate in the United States has often been criticized as an impedi-

m to the formation of low cost capital needed for research and development and expansion by domestic companies. This situation would be exacerbated were it not for the availability of pension assets which provide a huge investment pool.

Besides being a source of investment capital, a second salutary purpose served by the private pension system is as a supplement to public retirement assistance, such as social security. In addition to compensating for individual disinclinations to save, pensions provide two additional advantages to private savings. First, from a broad economic perspective, pensions permit the aggregation of resources to achieve a greater rate of return. Second, from the employer's perspective, deferred compensation may be used as a device to re-

46. TRENDS, supra note 1, at 222.
47. TRENDS, supra note 1, at 223-28.
48. TRENDS, supra note 1, at 216-20. For example, it has been suggested that the proxy fight for control for Lockheed Corporation was motivated, in part, by a supposed $1 billion surplus in Lockheed's pension plan. See Gaffney, It's Bad for Lockheed - and America, L.A. Times, Mar. 27, 1990, at B7, col. 4.
51. In 1986, American pension assets were nearly 32% as large as this country's GNP. TRENDS, supra note 1, at 20. Pension assets in the United States far exceed those in other industrial countries. See id. at 15-23. One study has estimated that "pension contributions accounted for fifty percent of new savings in 1986." See Chernoff, Crushed By The Weight; 13 Years Later, Is ERISA Too Much Of A Good Thing?, PENSIONS & INVESTMENT AGE, Sept. 4, 1989, at 1. Also, between 1950 and 1987, assets in private pension plans increased almost six times as fast as the economy as a whole. TRENDS, supra note 1, at 6. In fact, the $2.6 trillion in assets held by corporate and public retirement funds represents the largest pool of capital in the world, almost equal to the entire gross national product of Japan. Flanagan, '80s Takeover Furor Will Pale Next To '90s Pension Debate, L.A. Times, Apr. 8, 1990, at D1, col. 2.
52. See TRENDS, supra note 1, at 29.
53. Id., at 30.
roduce turnover of employees during highly productive years while encouraging retirement during less productive years.54

Two disturbing facts will emerge from this article. The first is that the debt accrued by the PBGC from bailing out underfunded plans is immense.55 The second is that even when they receive guaranteed benefits from the PBGC, plan participants often receive far less than they were promised by the plan sponsors. Thus, not only have the pension insurance system and its participants been operating at a net loss, but the PBGC has adopted a position adverse to maximum recovery by plan participants. In effect, the PBGC, which is charged with administering the termination provisions of ERISA and which often acts as a trustee for terminated plans, has a conflict of interest with plan participants in the scramble for diminishing resources.

This article will examine single employer pension plans,56 the plans which constitute the overwhelming majority of PBGC-covered plans. The lion’s share of the PBGC deficit stems from bailing out underfunded single employer plans.57 Separate concerns and special ERISA rules govern the termination of multi-employer plans; these will not be addressed here.58 Retiree health benefits, although sometimes provided under pension plans, are subject to special statutory provisions that also will not be addressed.59 The conditions and ef-
fects of bankruptcy and the termination of a pension plan will be discussed as they affect the main interested parties: (1) the employer; (2) the plan participants; (3) the employer’s creditors; (4) the PBGC; and (5) the Internal Revenue Service. In addition, the critical disputed legal issues will be analyzed and resolutions will be suggested.60 The major reform recommended will be that the termination insurance system should be expanded to include all pension benefits, and that premiums should be based on the risk of exposure a plan poses to the system.61 As will be seen, the level of benefits guaranteed under ERISA is inferior to that offered under plans and participants have little, if any, recourse to recoup lost benefits. Such a situation leads to hardship among participants whose expected benefits are reduced. Where employers have sought to make up lost benefits, the PBGC has objected and responded by foisting the terminated plan back onto the employer. However, by guaranteeing all benefits, and forcing employers to pay risk-rated premiums for their plans, the uncertainty and inequities caused by the terminations of plans in bankruptcy would be reduced.

II. TERMINATION OF A PENSION PLAN UNDER ERISA

One step that an employer with an ERISA-regulated pension plan might take, when anticipating or dealing with bankruptcy, is to terminate the plan under ERISA. Title IV of ERISA62 is devoted to plan terminations and plan termination insurance. Many of the statutory provisions contained in this title are highly technical and the area is further complicated by a bevy of regulations63 and proposed regulations.64 ERISA’s termination procedures have been greatly affected by two statutory amendments, the Single Employer Pension Plan Amendments Act of 1986 (“SEPPAA”)65 and the Pension Protec-

60. See infra notes 576-85 and accompanying text.
61. See infra note 584 and accompanying text.
65. Single Employer Pension Plan Amendments Act, Pub. L. No. 99-272, 100 Stat. 237 (1986). SEPPAA applied to all terminations for which a notice of intent to terminate was filed by the plan’s administrator on or after January 1, 1986. SEPPAA set forth the general frame-
tion Act ("PPA"). The thrust of these amendments was to increase the obligations on plan sponsors and to limit the potential liability of the PBGC.

A. The Pension Benefit Guaranty Corporation

The termination insurance provisions of ERISA establish the PBGC and procedures which employers, who maintain certain types of pension plans, must follow in terminating a pension plan. The statute delineates the priorities to be accorded various types of benefits under a terminated plan when plan assets are insufficient to provide all benefits promised by the plan. It also provides the remedies the PBGC may seek against the employer that terminates its plan.

The function of the PBGC is to administer Title IV of ERISA and to insure pension benefits for plans covered by that title. Under Title IV, single employer pension plans may be terminated by either plan administrators or the PBGC. When a plan terminates, the PBGC guarantees the payment of a minimum level of benefits, which are known as "guaranteed benefits." The PBGC does not guarantee the payment of benefits that become nonforfeitable solely by reason of the fact that the plan terminates. In addition, the PBGC provides only a limited guarantee of benefits under a plan that has been in effect less than five years at the time it terminates.

work for terminations currently in place.

66. Pension Protection Act, Pub. L. No. 100-203, 101 Stat. 1330 (1987). See Albert & Schelberg, Repeal the Old, Ring in the New, PENSION WORLD, Mar. 1990, at 54 (summarizing principal provisions of the Omnibus Budget Reconciliation Act of 1987 of which the PPA is a part of). As discussed more fully below, the PPA modified SEPPAA and ERISA in several important respects. The PPA applies generally to plan terminations for which a notice of intent to terminate was filed after December 17, 1987. See id. The effective dates of the amendments are significant because cases decided prior to statutory change may be of limited significance under the new statute.


70. ERISA § 4002, 29 U.S.C. § 1302 (1988). The PBGC was created for three purposes: (1) to encourage the continuation and maintenance of voluntary private pension plans; (2) to provide for the timely and uninterrupted payment of pension benefits; and (3) to maintain premiums at the lowest level consistent with carrying out its obligations. Id. Among the PBGC's powers in administering Title IV are the powers to adopt rules and regulations, see id., ERISA § 4002(b)(3), 29 U.S.C. § 1302(b)(3) (1988), to conduct necessary investigations, ERISA § 4003(a), 29 U.S.C. § 1303(a) (1988), and to bring civil actions, ERISA § 4003(e)(1), 29 U.S.C. § 1303(e)(1) (1988). In addition, the PBGC may be appointed as the trustee of a terminated plan. See id., ERISA § 4002, 29 U.S.C. § 1302 (1988).

71. See ERISA § 4041(a),(b), 29 U.S.C. § 1341(a), (b) (1988).


and by the same token, only a limited guarantee of any increase in the amount of benefits under a plan resulting from a plan amendment that was made, or became effective (whichever is later), within five years before the date on which the plan terminates. The PBGC has statutory authority to guarantee additional benefits.

If the PBGC determines that a plan was terminated for a legitimate business purpose, and not to obtain payment of benefits from the PBGC, then benefits provided in plans or amendments that were in effect for less than five years at the time of termination are guaranteed to the extent of the greater of twenty percent or $20 per month, multiplied by the number of years (but not more than five years) that the plan or amendment has been in effect. In addition to these exceptions, ERISA also limits the dollar value of the maximum amount of benefits that may be received. Substantial owners' benefits are subject to additional limitations.

The PBGC obtains funds for these guaranteed benefits from two sources. First, sponsors of plans within the scope of Title IV must pay insurance based on the number of plan participants. Second, funding is drawn from employer liability payments collected from employers whose plans terminate with insufficient assets to pay their benefit liabilities.

76. ERISA § 4022(d), 29 U.S.C. § 1322(d) (1988). "The [PBGC] is authorized to guarantee the payment of such other classes of benefits and to establish the terms and conditions under which such case classes of benefits are guaranteed as it determines to be appropriate."
78. Pursuant to these limitations, the amount of guaranteed monthly benefits may not have an actuarial value which exceeds the actuarial value of a monthly benefit in the form of a life annuity commencing at age 65 equal to the lesser of: (a) the participant's average monthly gross income from his employer during which his gross income from that employer was greater than during any other such period with that employer determined by dividing 1/12 of the sum of all such gross income by the number of such calendar years in which he had such gross income; or (b) $750 multiplied by a fraction, the numerator of which is the contribution and benefit base in effect when the plan terminates and the denominator is the contribution and benefit base in effect in 1974. ERISA § 4022(b)(3), 29 U.S.C. § 1322(b)(3) (1988).
80. ERISA § 4006, 29 U.S.C. § 1306 (1988). This includes a risk rated premium for underfunded plans. Id. Congress substantially increased the rate in 1987 to its current levels ranging from $16 to $54 for underfunded plans. See supra note 34 (discussing premium rates); TRENDS, supra note 1, at 357, 381.
81. ERISA § 4062(b)(1)(A), 29 U.S.C. § 1362(b)(1)(A) (1988). The 1987 Pension Plan Amendments increased the plan sponsor's funding liabilities and extended liability for unpaid contributions to trades or businesses under the common control of the plan sponsor. Pursuant to changes enacted by the PPA, "the PBGC [may] perfect a lien upon . . . the property of each member of a plan sponsor's 'controlled group,' [which is defined as the plan sponsor and all other persons under common control of the sponsor] for missed . . . funding
When a plan terminates with insufficient assets, the PBGC may pursue the plan sponsor for both unfunded benefits and for a plan's accumulated funding deficiency. Since the PBGC's potential unrecouped liability increases the longer a plan's funding deficiency continues, the agency must make a judgment regarding when to terminate an underfunded plan.

B. Exclusivity of ERISA Termination Provisions

In the bankruptcy context, a question arises regarding whether a plan sponsor must follow the procedures mandated by ERISA in order to terminate plan funding obligations. The exclusivity of ERISA regulation of termination procedures of a company in bankruptcy was challenged in *In re The Bastian Co.*, where the United States Bankruptcy Court for the Western District of New York held that the Bankruptcy Code governs the termination of pension plans in bankruptcy and that such plans may be rejected as executory contracts — even where participants have provided service to the employer post-petition.

The court’s decision in *Bastian I* potentially represents an op-
portunity for employers to avoid ERISA’s termination requirements in bankruptcy. The decision must be closely scrutinized, however, because one of its major underpinnings was legislatively reversed by a 1984 amendment to the Bankruptcy Code.

In *Bastian I*, the debtor filed its petition for Chapter 11 reorganization on September 30, 1983. The court found this fact significant in deciding not to apply the 1984 amendments to the Bankruptcy Code. Also, it appears that the pension plan at issue was created by a collective bargaining agreement which expired on October 31, 1983. In February of 1984, the debtor commenced an action to terminate the plan under ERISA. On April 6, 1984, the debtor filed a motion to reject its pension plan as an executory contract under the Bankruptcy Code. In response, the PBGC objected to the proposed rejection.

The *Bastian I* court made several significant rulings. First, the court rejected the PBGC’s argument that ERISA provided the exclusive procedure for plan termination. In reaching this conclusion, the court cited ERISA’s preemption provision for the proposition that ERISA does not preempt other federal laws. The PBGC argued that under 29 U.S.C. § 1342(f) (1988), ERISA should gov-

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86. *Bastian II*, 66 Bankr. at 92.
87. Id.
88. Id. The *Bastian II* court expressed confusion as to whether the plan at issue was part of the collective bargaining agreement which expired on October 31, 1983, or part of a new agreement which was signed on November 1, 1983. Id. at 93. The *Bastian I* court did not raise this issue. The *Bastian I* court must have been dealing with the plan found in the collective bargaining agreement which expired on October 31, 1983, because that court was addressing a plan which was in effect at the time the bankruptcy petition was filed. *Bastian I*, 45 Bankr. at 717.
89. *Bastian II*, 66 Bankr. at 92.
90. *Bastian I*, 45 Bankr. at 717.
91. Id. at 722.
92. Id.
93. ERISA § 514(d), 29 U.S.C. § 1144(d) (1988). This section provides that “[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(c) of this title) or any rule or regulation issued under any such law.” Id. 29 U.S.C. § 1031 (1988) deals with the repeal of the Welfare and Pension Plans Disclosure Act, while 29 U.S.C. § 1137(c) (1988) provides that no employee of the Department of Labor or the Department of the Treasury shall administer plans for which they are participants or beneficiaries except for plans which cover only employees of the United States.
94. *Bastian I*, 45 Bankr. at 718.
95. ERISA § 4042(f), 29 U.S.C. § 1342(f) (1988). This section provides: Upon the filing of an application for the appointment of a trustee or the issuance of a decree under this section, the court to which an application is made shall have exclusive jurisdiction of the plan involved and its property wherever located with the
ern exclusively. The court rejected this argument based on a finding that this provision applied only to involuntary terminations, and the case at bar was a voluntary termination. Also, the court reemphasized its determination that under ERISA Section 544(d), ERISA could not impair other federal laws.

The court next stated that besides the fact that ERISA's termination provisions were non-exclusive, they were not even applicable to the debtor's plan. In reaching this conclusion, the court reasoned that where a conflict between bankruptcy and ERISA law exists, bankruptcy law should prevail. Thus, it concluded that ERISA's termination scheme applied only to active and enforceable plans and found the plan at issue to be neither active nor enforceable because the filing of a bankruptcy petition immediately made a pension plan unenforceable under the United States Supreme Court's decision in NLRB v. Bildisco & Bildisco. Consequently, the court determined that ERISA did not apply to pension plans which had not been terminated prior to the filing of a bankruptcy petition. Further, Bastian I found that a pension plan was an executory contract, which could be rejected in bankruptcy, subject to court approval.

The court also ruled that, based on Bildisco, the post-petition performance of services by employees did not affect the employer's ability to reject the pension plan as an executory contract because the rejection would relate back to the time of the petition's filing. The major problem with placing reliance on Bastian I is that Bildisco was legislatively overruled by Section 1113 of the Bankruptcy powers, to the extent consistent with the purposes of this section, of a court of the United States having jurisdiction over cases under chapter 11 of Title 11. Pending an adjudication under subsection (e) of this section such court shall stay, and upon appointment by it of a trustee, as provided in this section such court shall continue the stay of, any pending mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the plan or its property and any other suit against any receiver, conservator, or trustee of the plan or its property. Pending such adjudication and upon the appointment by it of such trustee, the court may stay any proceeding to enforce a lien against property of the plan or any other suit against the plan.

Id.  
96. See Bastian I, 45 Bankr. at 718.  
97. Bastian I, 45 Bankr. at 719.  
98. Id.  
99. Id.  
100. Id.  
101. Id.  
103. Bastian I, 45 Bankr. at 722.  
104. Id.  
105. Id.
ruptcy Code in 1984.\textsuperscript{106} Under Section 1113, an employer must make certain proposals and negotiate with the union before a petition to reject or modify the agreement can be filed.\textsuperscript{107} Thus, plans created by collective bargaining agreements are no longer immediately unenforceable upon the filing of the bankruptcy petition, and the conflict perceived by the \textit{Bastian I} court no longer exists.\textsuperscript{108}

Another argument supporting ERISA exclusivity today is the amendment to ERISA made in SEPPAA which expressly provides that ERISA's termination requirements are the exclusive means for terminating a plan.\textsuperscript{109} The legislative history of SEPPAA, however, reveals that Congress did not intend to change pre-SEPPAA law regarding the ability of an employer to reject pension plans as executory contracts.\textsuperscript{110} Finally, the fact that ERISA explicitly provides for the circumstances under which plans may be terminated in bankruptcy indicates that Congress envisioned ERISA-regulated terminations of pension plans in bankruptcy.\textsuperscript{111} A contrary argument is that although Congress may have envisioned some ERISA-regulated terminations in bankruptcy, it did not deprive employers of the option


\textsuperscript{107} Even without section 1113 of the Bankruptcy Code, \textit{Bastian I} would have been limited to situations involving collective bargaining contracts in which the court determined that the equities favored rejection of the plan. Finding that the equities favored such a rejection is not a foregone conclusion, as seen in \textit{Bastian II}, where the court ruled that, even under \textit{Bildisco}, it would not allow rejection because to do so would be inequitable. See \textit{Bastian II}, 66 Bankr. at 93.


\textsuperscript{109} ERISA § 4041(a)(1), 29 U.S.C. § 1341(a)(1) (1988). This section provides: Except in the case of a termination for which proceedings are otherwise instituted by the corporation as provided in section 1342 of this title, a single-employer plan may be terminated only in a standard termination under subsection (b) of this section or a distress termination under subsection (c) of this section.

\textit{Id.}

\textsuperscript{110} The Conference Committee Report of SEPPAA states: As under present law, to the extent a pension plan is an executory contract included within the scope of Section 365. . . or . . . 1113 . . . these Bankruptcy Code Provisions are applicable to the court's decision on whether to approve the termination of the pension plan. The distress termination criteria are not intended to make any substantive changes in the bankruptcy laws. The conferees take no position on when or whether a pension plan is an executory contract.

to exercise the right to reject pensions in bankruptcy.

Notwithstanding Section 1113, a debtor corporation could argue that ERISA’s termination provisions are not the exclusive procedure to follow in bankruptcy. Surviving from Bastian I is the notion that ERISA should not impair other federal statutes and that the Bankruptcy Code does provide a mechanism for rejecting executory contracts. It could be argued that by not amending these ERISA and Bankruptcy Code provisions, Congress meant to keep the right to reject executory contracts intact and that ERISA’s termination provisions continue to impair this right. Support for this argument is found in at least three bankruptcy cases decided subsequent to Bastian I which held that, where there is a conflict, the Bankruptcy Code preempts ERISA, although none of these cases involved the exclusivity of termination under Title IV of ERISA. Even if this argument was accepted, without Bildisco as valid precedent, it would be difficult, at least in the collective bargaining context, to argue that pension plans are executory contracts for that portion of work performed under them post-petition.

112. Two significant distinctions between a rejection in bankruptcy and a termination under ERISA were aptly summarized as follows:

There are important conceptual differences between rejection in bankruptcy and plan termination under ERISA. . . . [R]ejection in bankruptcy may have a retroactive effect, by converting liabilities which accrued under the contract after the petition but before rejection (which would otherwise be considered administrative expenses of the bankruptcy estate) into pre-petition claims. Under ERISA, in contrast, the only way to cut off contribution obligations is to terminate the plan, and termination must always be prospective because of the 60-day notice requirement. More importantly, rejection under the Bankruptcy Code generally is based on the debtor’s situation alone, while ERISA now requires that each entity affiliated with the debtor also satisfy at least one of the three criteria for a distress termination before the debtor is permitted to terminate the plan.

Lutgens, supra, note 12, at 31.


115. E.g., In re Chateaugay Corp., 130 Bankr. 690 (S.D.N.Y. 1991) (holding that federal bankruptcy law, not ERISA, determines the discount rate to be applied in calculating the present value of PBGC claim against an involuntarily terminated pension); see Lutgens, supra note 12, at 36, n.64.; In re Bruce, 80 Bankr. 927, 930 (Bankr. C.D. Ill. 1987) (stating “[s]ection 1144(d) prevents ERISA from impairing the provisions of the Bankruptcy Code which allow a debtor to reject an executory contract.”), rev’d on other grounds sub nom. In re Crippen, 877 F.2d 594 (7th Cir. 1989).

116. See, e.g., In re Alan Wood Steel Co., Bankr. L. Rep. (CCH) ¶ 67,020 (E.D. Pa. 1978). In Alan Wood, the court permitted the debtor-employer to reject the executory portion of a pension plan where the employer had discontinued its operations because such obligations were deemed onerous, burdensome and an impediment to a successful reorganization. Id. However, the court found that vested benefits for which participants had completed the “age and service” requirements could not be rejected because they were not executory and a rejection would be a repudiation of obligations. Id.
C. Plans Subject To ERISA Termination Provisions

In analyzing termination procedures under ERISA, the threshold question is: Which plans are subject to these provisions?

Section 4021 of ERISA addresses which plans are within ERISA's termination scheme, and declares that in order to be covered, a plan must: (1) be a defined benefit plan; (2) which is established or maintained by an employer or labor organization or both, in any industry or activity affecting commerce; and (3) which has operated as a tax-qualified plan for the past five years or has been determined by the Secretary of the Treasury to be a tax-qualified plan under the IRC.

Certain plans are specifically excluded from the termination framework. Perhaps the most significant exclusion is for defined contribution plans. Another significant exclusion is for unfunded plans maintained primarily to provide deferred compensation for a select group of management or highly compensated employees. Plans that have not provided for employer contributions at any time after September 2, 1974, the date ERISA first became effective, are also excluded, as are excess benefit plans.

D. Three Types Of Termination

SEPPAA established the current framework for terminating a plan. Under this statute, a plan may be terminated by using one of only four methods. Two of these approaches, standard terminations and distress terminations, are accomplished voluntarily by the plan sponsor. The third method is an involuntary termination instituted by the PBGC. Finally, the adoption of an amendment converting a

118. See ERISA § 4021(a), (b)(1), (c)(1), 29 U.S.C. § 1321(a), (b)(1), (c)(1) (1988).
120. See ERISA §§ 4021(a)(1) - (a)(2), 29 U.S.C. § 1321(a)(1) - (a)(2) (1988). It would appear that an annuity plan under I.R.C. § 403 would also be covered since such a plan is described in I.R.C. § 419, unless such plan can be excluded as an individual account plan. (ERISA § 4021(b)(1), (12)). Moreover, successor plans, defined as plans which "cover a group of employees which includes substantially the same employees as a previously established plan, and provides substantially the same benefits as that plan provided" are covered.
defined benefit plan to a defined contribution plan constitutes a termination under ERISA and such an amendment may only take effect after a plan satisfies the requirements for a standard termination or a distress termination.\textsuperscript{128}

Certain general rules apply to both forms of voluntary termination. First, written notice of intent to terminate must be provided to each affected party not less than sixty days before such proposed termination date.\textsuperscript{127} However, the PBGC need not be provided with such notice in a standard termination, only a distress termination.\textsuperscript{128} Failure to provide this notice may result in liability for any deterioration in plan assets which occurs due to the lack of notice.\textsuperscript{129} Second, the PBGC may not proceed with a standard or distress termination if the termination would violate an existing collective bargaining agreement.\textsuperscript{130} This restriction does not apply to involuntary terminations which are instituted by the PBGC.\textsuperscript{131}

The PBGC has found that ninety-nine percent of voluntary terminations are standard terminations.\textsuperscript{132} The distinguishing characteristic of a standard termination is that in order to be eligible to elect such a termination, an employer must first demonstrate that it can pay all benefit liabilities under the plan. One of the major changes made by the PPA was to increase the plan benefits which had to be paid in order for a plan to terminate in a standard termination.\textsuperscript{133} The pre-PPA rule required that a plan be able to discharge its benefit commitments under the plan.\textsuperscript{134} Under the current scheme, employers are liable to the PBGC for 100\% of the plan benefit liabilities.\textsuperscript{135} The term "benefit liabilities" means the benefits of employees and their beneficiaries under the plan within the meaning of IRC Section 401(a)(2).\textsuperscript{136} Benefits under IRC Section 401(a)(2) generally include all accrued benefits, even those which

\begin{itemize}
  \item \textsuperscript{126} ERISA § 4041(e), 29 U.S.C. § 1341(e) (1988).
  \item \textsuperscript{129} PBGC v. Beadle, 685 F. Supp. 628, 632 (E.D. Mich. 1988) (stating that the PBGC was permitted to pursue a breach of contract suit on behalf of a plan against the plan's actuarial firm which failed to file the Notice of Intent to terminate despite assuring the plan that it had done so).
  \item \textsuperscript{132} See 54 Fed. Reg. 52,904 (1989).
  \item \textsuperscript{133} See 53 Fed. Reg. 1905 (1988).
  \item \textsuperscript{134} See id.
  \item \textsuperscript{135} Hennessy, \textit{Benefits for Bankruptcy Attorneys}, A.B.A. \textbf{FOURTH ANN. EMPLOYEE BENEFITS IN BANKR. AND LENDING TRANSACTIONS}, at 5 (1991).
\end{itemize}
have not vested, as well as subsidized retirement benefits. An employer unable to demonstrate that the projected amount of plan assets, as of the proposed date of final benefit distribution, is sufficient to cover the actuarial present value of the benefit liabilities, as of that date, is not eligible for standard termination.

The PBGC has suggested that if a plan sponsor is uncertain about whether it will qualify for a distress or standard termination, then it should apply for both types of termination. The advantage of this approach is that a plan will be able to retain its proposed termination date if one method fails but the other succeeds. Unless both methods are pursued at the same time, the method sought, if it is not approved, cannot be converted into the other form in order to preserve the original proposed termination date.

1. Standard terminations

ERISA contains a special framework for single employer standard terminations. In order to qualify, the employer must comply with the sixty-day notice to affected parties, not including the PBGC as mentioned above.

The employer must also provide separate notice to the PBGC and the plan’s participants and beneficiaries. ERISA specifies the required contents of each notice. The plan administrator must provide written notice to plan participants and beneficiaries in a form likely to be understood by them, no later than the date notice is given to the PBGC. This notice must advise each participant individually of the amount of his benefit as of the proposed termination date and relevant information, such as length of service, used in calculating the benefit. Thus a participant will have some basis for ascertaining whether he is to be treated properly.

140. See id.
142. Id.
147. ERISA § 4041(b)(2)(B)(ii), 29 U.S.C. § 1341(b)(2)(B)(ii) (1988). ERISA specifies certain additional information which must be provided. This includes: length of service; age of the participant or beneficiary; wages; and assumptions, including interest rate. ERISA §
A standard termination is effective only if the PBGC does not issue a notice of noncompliance within sixty days after receiving notice of the termination. Such notice may be issued by the PBGC for one of two reasons: (1) failure of the plan sponsor to meet the sixty-day notice of intent to terminate; or (2) insufficiency of the plan to meet benefit liabilities.

The final step in a standard termination is the distribution of assets. The plan administrator is required to distribute assets at the end of the sixty-day period during which the PBGC can issue a notice of noncompliance. Final distribution may only occur if the plan administrator has not received notice of noncompliance and the plan is sufficient for benefit liabilities when final distribution occurs.

ERISA sets forth two acceptable methods for distributing plan assets in a standard termination. First, a plan administrator may purchase irrevocable commitments from an insurer to provide all benefit liabilities under the plan. Alternately, the administrator...
may offer participants the option of receiving a cash amount equal to

**Annuity Contracts,** 18 Pens. Rep. (BNA) 1382 (Aug. 5, 1991). The dispute is based, in part, on a 1975 PBGC opinion letter which indicates that the PBGC would be obligated to pay benefits in the event an annuity provider were to become insolvent. *Id.* at 1383.

In addition, several congressional aides challenged the PBGC's position that it was not liable. *Former Plan Sponsors Not Liable For Failed Insurer's Benefits, PBGC Says,* 18 Pens. Rep. (BNA) 823 (May 13, 1991). The aides based their challenge on a preamble to a 1981 regulation in which the PBGC promised to provide benefits to retirees if an insurance company defaulted. *Id.* at 1383.

The PBGC acknowledged the statement, but concluded that it was "made without legal analysis and was simply incorrect." *Id.; see also, Aides Say PBGC Responsible For Policies; Congress Waiting to See Industry Response,* 18 Pens. Rep. (BNA) 715 (Apr. 22, 1991).

In criticizing the PBGC's position regarding insuring annuities, Professor Norman Stein of the University of Alabama School of Law has argued that the PBGC had adopted its no-insurance position in order to avoid exposing itself to greater liability. *Witnesses Disagree Over PBGC Liability For Annuity Bought From Executive Life,* 18 Pens. Rep. (BNA) 1081 at 1082 (July 1, 1991). Statements made by PBGC Executive Director James Lockhart before a congressional hearing on July 25, 1991, do not dispel Professor Stein's analysis:

Lockhart noted that PBGC has an accumulated deficit of $1.8 billion. A federally run, annuity guaranty program "could lead to the kind of moral hazards that resulted in the savings and loan bailout," Lockhart asserted. "The PBGC is already financially weak and cannot afford a $50 billion increase in our exposure," he said. *Officials Defend Efforts to Protect Pensions Following Insurance Failures,* 18 Pens. Rep. (BNA) 1280 (July 29, 1991).

One step being taken by the PBGC to avoid a repeat of the Executive Life Insurance Company situation, with respect to annuities, is to require plan sponsors with pending termination applications to inform the PBGC of the annuity company they would use. *PBGC Denies Insurance Responsibility In Aftermath of Executive Life Takeover,* 18 Pens. Rep. (BNA) 679 (Apr. 15, 1991). Where the annuity company's standing was questionable, the PBGC would notify the Department of Labor to determine if ERISA's fiduciary standards had been violated. *Id.* In addition, advanced notice of proposed rule-making on two new federal regulations were issued on June 19, 1991, regarding other steps to assure future safety of annuities. Labor Department, *PBGC Issue Notices On Selection of Providers,* 18 Pens. Rep. (BNA) 1027 (June 20, 1991). These notices are aptly summarized as follows:

- The Labor Department's notice invites comment on whether it is appropriate for the federal government to establish minimum standards under Title I of the Employee Retirement Income Security Act for the selection of an annuity that is distributed to a pension plan participant, according to a department press release. The PBGC notice seeks comments on the necessity of minimum standards under Title IV of ERISA regarding the distribution of annuities upon plan termination.


The full scope of the impact of the Executive Life Insurance Company conservatorship is beyond the scope of this article. It may be noted, however, that the PBGC has issued an opinion letter that plan sponsors who have terminated plans and distributed plan assets by purchasing annuities from an insurance company which later fails are not liable for benefits. *See Letter from Carol Conner Floe to Melanie Franco Nussdorf, Esq. (May 3, 1991), reprinted in 18 Pens. Rep. (BNA) 850 (May 13, 1991).*

On the other hand, the Labor Department has brought suit against fiduciaries of companies which purchased group annuity contracts from Executive Life Insurance Company, charging them with breach of fiduciary duty. *See Charges of Fiduciary Breaches Raised In Challenge to Annuity Provider Selection,* 18 Pens. Rep. (BNA) 1242 (July 22, 1991); *Labor Department Annuity Concerns Focus On Safety of Insurance Carrier,* 18 Pens. Rep. (BNA) 1082 (July 1, 1991); *Labor Department Cautious Before Filing Two Executive Life Lawsuits,*
the present value of his benefit under the plan.\(^{156}\) (Generally, if the benefit has a value in excess of $3,500, the participant must be accorded the option of receiving his or her benefit in the form of an insured annuity.)\(^{157}\)

Inasmuch as a standard termination requires that all benefit liabilities can be covered by plan assets, it will be of use to only a limited number of plan sponsors facing bankruptcy.

2. Distress terminations

a. Applying for distress termination

A plan sponsor desiring to terminate a plan with insufficient assets to meet benefit liabilities must qualify for distress termination.\(^{158}\) In a distress termination, it is necessary to distinguish between benefit liabilities and guaranteed benefits. Benefit liabilities are the benefits of employees and their beneficiaries under the plan.\(^{156}\)

As for guaranteed benefits, the PBGC essentially guarantees benefits up to a statutorily specified dollar limit, if the benefits are vested immediately prior to plan termination and were not increased by a plan amendment less than five years prior to termination.\(^{156}\) Under SEPPAA, a portion of non-guaranteed benefits are paid to participants by the PBGC based on a "recovery ratio."\(^{161}\) The recovery ratio is based upon the PBGC’s rate of recovery in prior

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A breach of fiduciary duty lawsuit has been brought by employees and retirees of Unisys Corp. in which they charge that the company’s benefits committee's investment of more than $200 million in Executive Life Insurance Company guaranteed investment contracts was imprudent. See Retirees, Employees Sue Unisys Over Executive Life Investments, 18 Pens. Rep. (BNA) 1029 (June 24, 1991). See also, Two More Exemptions Proposed For Firms With Executive Life GICs, 18 Pens. Rep. (BNA) 1281 (July 29, 1991); Blair & Keegan, Defined Contribution Plans and Investments in GICs, 18 Pens. Rep. (BNA) 1215 (July 15, 1991); Employee Benefits Alert (The Research Institute of America, Inc.) (Apr. 16, 1990) at 1.


terminations.\footnote{162}

As with standard terminations, the plan administrator must inform the affected parties with a sixty-day notice of intent to terminate.\footnote{163} In a distress termination, the PBGC must also receive this sixty-day notice.\footnote{164}

As soon as practicable after providing notice of intent to terminate, the plan administrator must provide certain information to the PBGC as well as a certification that the information provided is accurate and complete.\footnote{165}

\textbf{b. Distress termination criteria}

Once the required information is provided, the PBGC must determine whether a plan qualifies for distress termination under any one of three possible criteria.\footnote{166} The three possible situations which will support a distress termination are: (a) a liquidation in bankruptcy; (b) a reorganization in bankruptcy in which the court determines that a termination is necessary to facilitate said reorganization; and (c) a non-bankruptcy situation where termination is necessary.\footnote{167}


164. Id.

165. ERISA § 4041(c)(2)(A), 29 U.S.C. § 1341(c)(2)(A) (1988). The administrator must provide a certification by an enrolled actuary stating, as of the proposed termination date: (1) the amount of the current value of the assets of the plan; (2) the actuarial present value of the benefit liabilities under the plan; (3) whether the plan is sufficient for benefit liabilities under the plan; (4) the actuarial present value guaranteed benefits under the plan; and (5) whether the plan is sufficient for guaranteed benefits as of such date. ERISA § 4041(c)(2)(A)(ii), 29 U.S.C. § 1341(c)(2)(A)(ii) (1988).

166. In order to qualify, each company that is a contributing sponsor of the plan or a member of the sponsor's controlled group must meet the criteria. The definitions of contributing sponsor and control group are very inclusive, making it difficult for some entities to qualify for distress termination where only some parts of the entity are suffering financial distress. Control group "means, in connection with any person, a group consisting of such person and all other persons under common control with such person." ERISA § 4001(a)(14)(A), 29 U.S.C. § 1301(a)(14)(A) (1988). A "contributing sponsor" is defined as a person who is responsible for meeting the funding requirements of a plan or who is a member of the controlled group of such a person, has been responsible for meeting such funding requirements, and has employed a significant number of participants under such a plan. ERISA § 4001(a)(13), 29 U.S.C. § 1301(a)(13) (1988). The control group definition impacted on the Eastern Airlines bankruptcy by preventing Eastern Airlines from terminating its underfunded plans when merging its control group, such as its parent corporation, and Continental Airlines which had not yet filed their own Chapter 11 reorganization petitions. Lutgens, supra note 12, at 31; Wagner, supra note 37, at 156-57.

i. Liquidations

Distress termination is appropriate where a company has filed or has had filed against it, as of the proposed termination date, a petition seeking liquidation under federal or state bankruptcy law, or similar law, or has had a case converted into a liquidation case. It is our experience that PBGC recognizes that liquidation may occur in Chapter 11 as well as in Chapter 7 and that a liquidation under Chapter 11 qualifies for distress termination. Furthermore, the liquidation case must not have been dismissed as of the proposed termination date. Therefore, employers who are in liquidation as of the termination date qualify for distress termination. Not only the contributing employer, but every other commonly controlled entity must be in liquidation.

ii. Certain reorganizations

Distress termination is also appropriate where a company has filed or has had filed against it, as of the proposed termination date, a petition seeking reorganization under federal or state bankruptcy law, or similar law, or has had a case converted into a reorganization case. Further, the reorganization case must not have been dismissed as of the proposed termination date.

In addition to being in reorganization, three further requirements must be met. First, the company must submit to the PBGC any request for bankruptcy court approval of the plan termination. Second, the bankruptcy court must determine that the company will be “unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the Chapter 11 reorganization process” unless the plan is terminated and third, the bankruptcy court must approve the termination. Thus, not every reorganizing company will qualify for distress termination.
deed, ERISA contemplates a netherland for reorganizing companies between standard terminations, where all benefit liabilities can be satisfied, and distress terminations, where the company will be unable to satisfy its reorganization debts if the plan is not terminated.\textsuperscript{176} A reorganizing company desiring to terminate its plans can either fund the plans sufficiently to qualify for standard termination or allow conditions to deteriorate until distress terminations are available under ERISA.\textsuperscript{177} This result seems ill-conceived, since the PBGC may not be able to collect sufficient funds to cover its expenditures in a distress termination. Thus, not allowing companies to terminate plans in the “middle ground” may well increase the PBGC’s exposure while at the same time forcing companies to place their reorganizations in greater jeopardy than they might otherwise allow.

\textit{iii. Non-bankruptcy situations}

Unlike the first two distress termination categories, the third way to qualify for distress termination does not contain a prerequisite that the company be liquidating or reorganizing.\textsuperscript{178} There are two instances that qualify for such a distress termination.\textsuperscript{179} First, a company may demonstrate that unless a distress termination occurs, it will be unable to pay its debts when due and will be unable to continue in business.\textsuperscript{180} The second way to qualify is even more nar-
row. It requires a showing that the costs of providing pension coverage have become unreasonably burdensome to the company "solely as a result of a decline in the company's work force covered as participants under all single employer plans of which [the company] is a contributing sponsor."\(^{181}\)

c. Restrictions on conduct by plan administrator awaiting PBGC approval of distress termination

In a distress termination, the plan administrator's conduct is regulated during the interim period between the filing of the sixty-day notice of intent to terminate and the PBGC notification regarding whether the termination is granted.\(^{182}\) During this time period, the plan administrator must "refrain from distributing assets or taking any other actions to carry out the proposed termination."\(^{183}\) The plan administrator may only "pay benefits attributable to employer contributions, other than death benefits only in the form of an annuity"\(^{184}\) and he may "not use plan assets to purchase irrevocable commitments to provide benefits from an insurer."\(^{185}\)

d. Determination of plan sufficiency by the PBGC

If the PBGC determines that a plan meets the requirements for a distress termination, it must then determine whether the plan is sufficient to pay guaranteed benefits and benefits liabilities or whether it cannot make such determinations with the information provided.\(^{186}\) Once these determinations are made, the PBGC must inform the plan administrator of them.\(^{187}\)

e. Implementation of the termination

After the PBGC has notified the plan administrator of its finding, the termination, if approved, must be carried out as soon as practicable with the type of implementation dependent upon the

\(^{181}\) ERISA § 4041(c)(2)(B)(iii)(II), 29 U.S.C. § 1341(c)(2)(B)(iii)(II) (1988). Although it involved a multi-employer situation, the facts in Amalgamated Ins. Fund v. William B. Kessler, Inc. 55 Bankr. 735 (Bankr. S.D.N.Y. 1985), may illustrate such a circumstance. Due to the decline of the American garment industry, many companies' proportion of current employees to retirees shrank considerably and required a greater contribution per active worker to sustain pension funds. Id. at 738.


level of sufficiency. Whenever a plan is sufficient for benefit liabilities, the plan administrator shall distribute the plan’s assets and make certification to the PBGC within thirty days of the final distribution. Where the PBGC determines that a plan is sufficient for guaranteed benefits, but it is unable to determine that the plan is sufficient for benefit liabilities, the plan administrator must distribute the plan’s assets as he would in a standard termination.

Where the PBGC is unable to determine that the plan is sufficient for even guaranteed benefits, however, then the PBGC must commence involuntary termination proceedings. As a practical matter, this result may be accomplished by an agreement between the plan sponsor and the PBGC whereby the PBGC becomes a successor trustee of the plan.

f. Finding of inability to pay expected benefits after commencement of authorized termination

If an authorized termination commences and the plan administrator discovers that the plan is unable, or will become unable to pay guaranteed benefits, he must notify the PBGC. If the PBGC agrees with the administrator, then involuntary termination proceedings must be instituted. If, under similar circumstances, the plan administrator discovers that the plan can pay guaranteed benefits, but is unable or will be unable to pay benefit liabilities which are not guaranteed, he must notify the PBGC.

3. PBGC-instituted terminations

PBGC-instituted terminations are also known as involuntary terminations. Under ERISA, the PBGC must terminate plans under certain circumstances, but it has discretion to terminate them in others. The PBGC is required to institute termination proceedings whenever it determines that a plan does not have assets available to pay benefits which are currently due.

The PBGC may, but is not required to, terminate a plan when it

determines that any of the following circumstances exist: (1) "the plan will be unable to pay benefits when due"; 198 (2) the plan has not met the minimum funding standard under Section 412 of Title 26; 199 (3) there is distribution of $10,000 or more to a participant who is a substantial owner and the distribution is not made by reason of the participant's death and immediately after the distribution the plan has unfunded nonforfeitable benefits; 200 and (4) where the possible long run loss to the PBGC with respect to the plan may "increase unreasonably if the plan is not terminated." 201

Where the PBGC institutes an involuntary termination, it is authorized by ERISA to apply to a United States district court for appointment of a trustee to administer the plan while awaiting judicial determination ordering the plan's termination. 202 In Pension Benefit Guar. Corp. v. Beadle, 203 the PBGC caused a plan to be involuntarily terminated, and it had itself appointed as trustee to protect the interest of the plan participants and to avoid any unreasonable deterioration of the plan's financial condition or any unreasonable increase in PBGC's liability. 204

Following the appointment of a trustee, the PBGC or trustee may apply to the district court to have the plan terminated. 205

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198. ERISA § 4042(a)(2), 29 U.S.C. § 1342(a)(2) (1988). Thus, if current benefits cannot be paid, the PBGC must terminate the plan, but if the PBGC only determines that the plan will be unable to pay future benefits, then it has the option of terminating the plan. Id.
199. ERISA § 4042(a)(1), 29 U.S.C. § 1342(a)(1) (1988). This provision also authorizes involuntary terminations when the PBGC has been notified by the Secretary of the Treasury that a notice of deficiency under section 6212 of title 26 has been mailed with respect to the tax imposed under section 4971(a) of title 26. Id.
202. ERISA § 4042(b)(1), 29 U.S.C. § 1342(b)(1) (1988). Where the PBGC is appointed as trustee, it assumes a role distinct from its role as a government regulatory agency. Id. This was illustrated in Pension Benefit Guar. Corp. v. Alloytek, 924 F.2d 620 (6th Cir. 1991), where the court held that the PBGC was not required to assert a claim for insufficient funding or contribution in a prior suit brought by it before it was appointed trustee. Thus, the doctrine of res judicata did not apply to bar the action when it was brought by PBGC as trustee. Id.

The PBGC's power as trustee was illustrated in Martin v. Lundberg, 13 EBC 1713 (N.D. Tex. 1991), where the court held that the PBGC as trustee of several terminated plans could sue a nonfiduciary for participating in fiduciary violations with former trustees. The court rejected the argument that the PBGC lacked ERISA enforcement authority outside ERISA's termination procedures. Id. Instead, the court found that as statutory trustee, the PBGC is a plan fiduciary that may sue to enforce ERISA's fiduciary provisions. Id. See also PBGC's Right to Enforce ERISA as Statutory Trustee Upheld by Court, 18 Pens. Rep. (BNA) 557 (Mar. 25, 1991).
204. Id. at 633.
Where the plan administrator and the PBGC agree that the plan should be terminated and agree to the appointment of the trustee, there is no need to give pre-termination notice to plan participants or to an affected union.\textsuperscript{206}

Involuntary terminations have a significant impact on pending bankruptcy proceedings and their interaction is directly addressed in ERISA.\textsuperscript{207} First, the PBGC is given the power to file for involuntary termination notwithstanding the pendency of any bankruptcy, reorganization or liquidation.\textsuperscript{208} Second, an involuntary termination will preempt most other actions.\textsuperscript{209} Further, the filing of an application for appointment of a trustee or the issuance of a decree vests exclusive jurisdiction over the plan and its property in the district court to which the application is made with such court having power consistent with that of a bankruptcy court presiding over a Chapter 11 reorganization.\textsuperscript{210} Under ERISA, the district court must stay any "mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve or liquidate the plan or its property and any other suit against any receiver, conservator, or trustee of the plan or its property" pending an adjudication that the plan must be terminated.\textsuperscript{211} This stay is to remain in effect upon the appointment of a trustee.\textsuperscript{212} The court is also authorized to "stay any proceeding to enforce a lien against property of the plan or any other suit against the plan."\textsuperscript{213}

E. Determining The Termination Date

The date a plan terminates has significance for plan participants, the PBGC, the plan's sponsor, and the plan sponsor's creditors. Determining the termination date depends in part on how the plan is terminated.\textsuperscript{214} Under a standard termination, the termination date is the one proposed in the notice of termination, if it is accepted by the PBGC.\textsuperscript{215} Under distress and involuntary terminations, the

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\textsuperscript{206} In re Jones & Laughlin Hourly Pension Plan v. LTV, Corp., 824 F.2d 197, 200 (2d Cir. 1987). The applicable notice provision only comes into play when the administrator does not agree with the termination decision of the PBGC and applies to the court for the appointment of a trustee. R. Cooke, ERISA, Practice And Procedure \S 7.26 (1991).
\textsuperscript{207} See ERISA \S 4042, 29 U.S.C. \S 1342 (1988).
\textsuperscript{208} ERISA \S 4042(c), 29 U.S.C. \S 1342(e) (1988).
\textsuperscript{209} ERISA \S 4042(f), 29 U.S.C. \S 1342(f) (1988).
\textsuperscript{210} Id.
\textsuperscript{211} Id.
\textsuperscript{212} Id.
\textsuperscript{213} Id.
\textsuperscript{214} See ERISA \S 4047, 29 U.S.C. \S 1347 (1988).
\textsuperscript{215} ERISA \S 4048(a)(1), 29 U.S.C. \S 1348(a)(1) (1988); see In re Syntex Fabrics,
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administrator and the PBGC attempt to agree on a termination date. However, where such an agreement cannot be reached, the date must be set by the court.

*In re Maryland Glass Corp.* demonstrates the tensions inherent in setting the termination date in the context of a bankruptcy. In *Maryland Glass*, the PBGC sought to involuntarily terminate a plan and set the termination date two years retroactive to its decision. The company and its unions did not dispute the involuntary termination but challenged the retroactive date proposed by the PBGC. The court addressed how the effects of termination create a conflict among the parties. Since benefits cease to accrue on the date of termination, participants want a later termination date to allow their benefits to increase. In addition, whether some benefits

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Inc., 698 F.2d 199 (3d Cir. 1983) (noting that PBGC accepted termination date proposed by employer; employer had no discretion to change date and court intervention was unauthorized).

216. See ERISA § 4048, 29 U.S.C. § 1348 (1988). The only difference in setting the termination date between distress termination and involuntary termination is the party who sets the date. Id. In a distress termination, the date is set by the plan administrator and agreed to by the PBGC. ERISA § 4048(a)(2), 29 U.S.C. § 1348(a)(2)(1988). In an involuntary termination, it is the PBGC that proposes the date and the plan administrator who must agree. ERISA § 4048(a)(3), 29 U.S.C. § 1348(a)(3)(1988); see also *In re Pension Plan For Employees of Broadway Maintenance*, 707 F.2d 647, 651 (2d Cir. 1983).

217. ERISA § 4048(a)(4), 29 U.S.C. § 1348(a)(4) (1988). It has been ruled that a district court ordinarily cannot set a termination date earlier than ten days after the notice of intent to terminate is filed. United Steelworkers v. Harris & Sons Steel Co., 706 F.2d 1289, 1295 (3d Cir. 1983). Disputes have arisen when courts have been called upon to determine the date because different constituencies have argued for different termination dates. See Pension Benefit Guar. Corp. v. Heppenstall Co., 633 F.2d 293, 297 (3d Cir. 1980). In *Heppenstall*, the court noted that the termination date must be decided in a way which protects the interests of the participants and avoids further deterioration of the plan's financial condition and also protects the PBGC's fund from increases in liability. Id. at 300; see also *In re Syntex Fabrics, Inc.*, 698 F.2d at 201 (holding that employees have justifiable reliance until they receive actual or constructive notice of termination); *In re Maryland Glass Corp. v. Non-Salaried Employees' Pension Plan*, 618 F. Supp. 1410, 1415 (D. Md. 1985) (holding that the earliest date for involuntary termination is the date for which employees received reasonable notice of termination), aff'd, 814 F.2d 655 (4th Cir 1987); *United Steel Workers*, 706 F.2d at 1296 (stating that the interest of participants and PBGC is identified, but its primary focus is protection of plan participants); Pension Benefit Guar. Corp. v. Dickens, 535 F. Supp. 922, 925 (W.D. Mich. 1982) (stating that the date will affect liability of employer for underfunded vested pension benefits, but the purpose is to promote reasonable employee expectations in their pension benefits).


219. *Id.*

220. *Id.* at 1412.

221. *Id.*

222. *Id.* at 1412-14.

223. See *id.* at 1414. The participants' interests vary somewhat depending on whether they are retirees or employees, but both of these groups benefit from later termination dates.
will vest under the plan's terms, and therefore become eligible for the PBGC guarantee, will depend on the termination date. A company's creditors may prefer an early termination date since a lower PBGC claim means more assets would be available for them. Similarly, the PBGC will desire an early termination date to limit its liability and prevent deterioration of a claim.

A three-step process for setting a termination date was broadly outlined in Pension Benefit Guaranty Corp. v. Heppenstall Co. First, the interests of all the plan participants and the PBGC must be identified. Second, the parameters which maximize those interests must be established. Third, the termination date must be set accordingly.

Before analyzing the monetary effect of termination, courts consider the threshold question of the expectation and reliance interests of participants. Because benefits will not accrue after termination, courts have refused to set termination dates earlier than the date on which participants had some reasonable notice that the PBGC was seeking termination. Courts have searched for the earliest date on which all affected parties would be reasonably informed of the termination date.

*Id.* Retirees are affected to the extent that payments guaranteed by the PBGC may be less than they are currently receiving or may be recaptured. *Id.* The later the termination date, the less the impact on these retirees. *Id.* On the other hand, participants who were current employees when the plan terminated are more directly affected because whether or not they continue to work, these participants no longer accrue pension rights. *Id.* Because only vested benefits are guaranteed by the PBGC, the termination date will prevent the accumulation of additional guaranteed benefits by employees who are not fully vested under the plan's vesting schedule. *Id.* Thus, part of a court's analysis depends upon the vesting period of a plan's benefits and how different termination dates will affect the level of vesting. See *id.* at 1414-15.

224. *Id.* at 1414.

225. *Cf.* Pension Benefit Guar. Corp. v. Dickens, 535 F. Supp. 922, 925 (W.D. Mich. 1982), *aff'd,* 719 F.2d 146 (6th Cir. 1983) (removing employer net worth limitations on employer liability for unfunded benefits prior to PPA amendments to ERISA). The court noted that due to the net worth limitations on employer liability, "where the net worth of the employer is undergoing significant changes, the termination date . . . could have a great effect on the liability of the employer for unfunded vested pension benefits." *Id.* at 925.

226. *In re Maryland Glass Corp.*, 618 F. Supp. at 1414 (stating that PBGC's interest is in protecting its resources against increased liability).

227. 633 F.2d 293 (3d Cir. 1980).

228. *Id.* at 301.

229. *Id.* at 302.

230. *Id.* at 301-02; *see also In re Maryland Glass Corp.*, 618 F. Supp. at 1414 (adopting three-part Heppenstall analysis). It has been ruled that only two factors are to be considered in setting a termination date in an involuntary termination: the expectations of the participants and the financial implications of termination for the PBGC; and the financial interest of the employer plays no interest in such proceedings. See Broadway Maintenance, 707 F.2d at 652; Heppenstall, 633 F.2d at 301.


232. *Id.* at 1415.
which "the [plan's] participants had actual or constructive knowledge of the [plan's] termination, i.e., notice sufficient to extinguish the reliance interest." Since actual knowledge of the termination date is often not known to participants, courts have devised constructive knowledge tests. "Several courts have held that the employees have at least constructive notice of plan termination on the date the employer ceases operation." In Maryland Glass, the court rejected the union's argument that the earliest date suitable for termination was the date of lay-off and liquidation. Rather, the court concluded that a plant shutdown which occurred prior to liquidation was sufficient to constitute a constructive notice of the termination. Once the actual or constructive notice date is determined, the court then sets the date that "serves the interest of the PBGC."

Neither the interests of the company nor of its creditors are considered in setting the termination date in the context of a corporate bankruptcy. It is reasoned that if the company or its creditors had wished to have their interests considered, they could have initiated voluntary termination proceedings to set the termination date. While this rationale holds true for the employer/sponsor, it is inappropriate for the creditor that cannot control whether to initiate termination procedures.

**F. Consequence Of Not Terminating A Plan And Of Terminating A Plan**

The failure to terminate a plan which is within the termination system results in the continued accrual of funding obligations and benefit liabilities. However, it may be argued that companies already in bankruptcy need not follow the termination procedures. The consequences of terminating a plan in the context of a bankruptcy is the subject of the remainder of this article.

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234. In re Maryland Glass Corp., 618 F. Supp. at 1415; see also In re Syntax Fabrics, Inc., 698 F.2d at 201 (holding that reliance is no longer justifiable when plan participants receive actual or constructive notice that the plan will be terminated).
235. 618 F.Supp. at 1416.
236. Id.
237. Broadway Maintenance, 707 F.2d at 653 (indicating that this could be a later date to benefit the participants, if the interests of the PBGC are not adversely affected).
238. Id.
239. Id.
240. See Bastian I, 45 Bankr. at 719-22.
III. Overview Of Bankruptcy Issues

In order to understand the bankruptcy issues involved in single employer pension plan terminations, a basic understanding of several Bankruptcy Code considerations is necessary.

A. Goals Of Liquidation And Reorganization

Liquidation under Chapter 7 of the Bankruptcy Code is aimed at collecting the assets of a debtor and arranging them for orderly distribution.241 The Bankruptcy Code sets forth the priorities for payment of claims.242 This priority system is fully enforced in liquidation, usually requiring the full satisfaction of the claims of the highest priority creditor before the next highest priority creditor receives anything.243

On the other hand, reorganization under Chapter 11 is designed to give the debtor a "fresh start."244 "The purpose of a Chapter 11 reorganization under the Bankruptcy Code is to restructure the business' finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders."245 In Chapter 11, a compromise plan of reorganization is contemplated between the debtor and its creditors.246 The priority scheme still plays a large role in a reorganization because priority claimants may demand full payment before lower levels are paid.247 As opposed to the liquidation context, however, priority claimants are not entitled to full satisfaction and lower priority creditors can receive a dividend on their claims if the debtor can prove that full payment would be more than the claimant would receive in a liquidation.248 Also, since a successful reorganization is a negotiated ar-

243. 11 U.S.C. §§ 502, 725 (1989). Even in a straight liquidation, however, properly secured creditors are entitled to the collateral underlying the secured claim. Id.
248. This concept is known as "cramdown". See 11 U.S.C. §§ 1129(a)(7), 1129(b). It can be argued that any deviation from the absolute priority concept of Chapter 7 liquidations gives a priority creditor less than what the priority creditor would be entitled to in a liquidation. These competing concerns frequently cause plans to be challenged by priority creditors. Perhaps the ultimate fallback position that a priority creditor can take is that plans must be "fair and equitable." See id. § 1129(b)(2); see also B. WEINTRAUB & A. RESNICK, BANKRUPTCY LAW MANUAL § 8.23[4] (1986) (planning is "fair and equitable" when "senior" class of claims receives full compensation for allowed claims before "junior" class).
rangement, lower priority claims are more likely to receive some payment under a reorganization than under a liquidation.

B. The Priority Scheme

The date a petition for bankruptcy is filed is highly significant in the priority scheme. Generally, claims are determined as of the date the debtor filed a petition for bankruptcy. The highest priority of claims, after secured claims, are known as administrative claims. Administrative claims include “the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.”

The next relevant priority category for purposes of this article is the third priority. This group includes wages, salaries or commissions earned by an individual within ninety days before the filing of the petition or the date of the cessation of the debtor’s business, whichever occurs first.

The fourth bankruptcy priority encompasses unsecured contributions to an employee benefit plan arising from services rendered within 180 days before the filing of the petition or the date of the cessation of the debtor’s business, whichever occurs first.

The final pertinent category, known as the “seventh priority,” covers certain tax claims of governmental units. The PBGC often seeks this priority for its liens.

Pre-petition claims that do not come within one of the priority groups are treated as general unsecured claims. Courts have made it difficult for debtors to obtain priority treatment because the granting of priority to one set of claims leaves less assets to be divided among the other creditors. Thus, “[b]ecause the presumption in bankruptcy cases is that the debtor’s limited resources will be equally distributed

252. See 11 U.S.C. § 507(a)(2) (1988). The second priority provides for unsecured claims arising from the ordinary course of business or financial affairs in an involuntary bankruptcy. Id. This priority claim is not of consequence to this article.
253. Including vacation, severance and sick leave pay.
254. 11 U.S.C. § 507(a)(3) (1988). This category has a limit of $2,000 per person. Id.
among its creditors, statutory priorities are narrowly construed."

C. Automatic Stay

The Bankruptcy Code provides that the filing of a bankruptcy petition invokes an "automatic stay" against nearly all kinds of acts or proceedings to assert, collect, assess, or recover pre-petition claims.

D. Rejection Of Executory Contracts

Another important bankruptcy concept is the power of the debtor to reject executory contracts. As discussed previously, an unconventional approach for an employer is to go outside of ERISA's termination procedures and treat the pension plan as an executory contract.

E. Enjoining Other Proceedings

A bankruptcy court has the power to enjoin other proceedings to preserve the integrity of the reorganization process, however, a showing of harm to the reorganization is required. Recently, the United States District Court for the Southern District of New York upheld a bankruptcy court injunction against a separate action filed in the United States District Court for the Western District of Pennsylvania by former employees of the debtor's subsidiaries and other related entities. In upholding the injunction, the court ruled that it was irrelevant that the enjoined suits were not brought against the debtor or its assets because a bankruptcy court may enjoin the prosecution of suits which threaten the integrity of the reorganization process without a showing that direct liability was sought against the debtor.

259. See 11 U.S.C. § 365(a) (1988). Claims arising from the rejection of executory contracts under all but the liquidation context are treated as having arisen before the date the bankruptcy petition was filed. 11 U.S.C. § 502(g) (1988).
260. See Bastian I, 45 Bankr. at 722.
262. See In re Chateaugay Corp., 76 Bankr. 945 (S.D.N.Y. 1987) (vacating and remanding bankruptcy court injunction against all other pension litigation where there was insufficient showing of harm to the LTV reorganization).
264. Id. The major findings upon which the court upheld the injunction were that the
F. Withdrawal Of Issues From The Bankruptcy Court

In the opposite direction of a bankruptcy court’s ability to enjoin other proceedings is the concept of withdrawal of certain issues from the bankruptcy court. One aspect of withdrawal, which is particularly important in pension terminations, allows a district court to withdraw issues “for cause shown” dealing with bankruptcy and other federal laws, such as ERISA. It should be noted that it is premature to seek withdrawal of claims prior to an objection being made.

G. Major Bankruptcy Issues Implicated In A Plan Termination

1. Termination liability and unpaid minimum funding liability

While a standard termination of a plan under ERISA results in the payment of all benefit liabilities, a distress or involuntary termination does not. The latter forms of termination may result in several claims which require bankruptcy characterization. These include: (1) claims by the PBGC for unfunded benefit liability; (2) claims by the plan’s trustee or the PBGC, as the plan’s successor trustee, for unpaid contributions; (3) claims by participants for the difference between guaranteed benefits and promised benefits; (4) IRS excise taxes for accumulated funding deficiencies; and (5) PBGC liens. Since it is generally agreed that contribution obligations continue to accrue until a plan is terminated, two dates which must be considered in determining priorities for the contributions are the date of plan termination and the date the bankruptcy petition is filed. Contributions due for benefits that accrue post-petition are more likely to receive priority classification than pre-petition liabilities.

other litigation would divert the energies of LTV’s legal and managerial talent away from the efforts to reorganize; and that the cost of defending the actions would deplete the debtor’s estate and the debtor’s effort to reorganize would be hindered if critical issues were decided in a piecemeal fashion. Id.

265. 28 U.S.C. § 157(d) (1988). This provision was used with respect to LTV when the United States District Court for the Southern District of New York granted the PBGC’s motion to withdraw all objections and counterclaims from the bankruptcy court. In re Chateau-gay Corp., 108 Bankr. 27 (S.D.N.Y. 1989). However, the court followed a procedure where matters are initially referred to the bankruptcy judge for proposed findings of fact and conclusions of law, subject to de novo review by the district court. Id. This procedure is in accordance with the provisions of 28 U.S.C. § 157(c)(1) (1988).


268. See infra notes 271-575 and accompanying text.

2. Reversions of assets and reinstatements of plans

While not directly covered by the Bankruptcy Code, two post-termination contingencies exist which may affect the debtor's estate. First, if a plan is overfunded, the debtor may seek a reversion of any surplus assets with such assets inuring to the benefit of the debtor's estate and its creditors. Second is the reinstatement of a terminated plan by the PBGC.

IV. RIGHTS AND REMEDIES OF THE INTERESTED PARTIES

A. Participants And Beneficiaries

The termination procedures have a profound impact on the benefits which will be paid under a terminated plan. To understand this impact, some critical pension benefit concepts must be defined. An "accrued benefit" in a defined benefit plan is the individual's benefit under the plan "expressed in the form of an annual benefit commencing at normal retirement age" or the actuarial equivalent of such benefit.

A "nonforfeitable benefit" is a benefit for which a participant has satisfied the conditions for entitlement under the plan or the requirements of ERISA, whether or not the benefit may subsequently be reduced or suspended. The terms "vested" and "non-forfeitable" are often used interchangeably. Thus, a vested benefit is one that would survive the employee's termination.

The United States Court of Appeals for the Third Circuit summarized the relationship between these concepts as follows:

270. See Stein, Reversions from Pension Plans: History, Policies and Prospects, 44 Tax L. Rev. 259 (1989) (discussing in detail the reversion phenomenon which is beyond the scope of this article).

271. ERISA §§ 3(23)(A), 204(c)(3), 29 U.S.C. §§ 1002(23)(A), 1054(c)(3) (1988). Courts have interpreted this to mean that current benefit accrual represents the portion of a retirement benefit that a participant earns each year. See Ashenbaum v. Crucible, Inc., 1975 Salaried Retirement Plan, 854 F.2d 1516, 1523-24 (3d Cir. 1988) (citing Hoover v. Cumberland, Md. Teamsters Pension Fund, 756 F.2d 977, 981-82 (3d Cir. 1985)), cert. denied, 109 S.Ct 3155 (1989). Thus, benefits continue to accrue throughout an employee's service and unaccrued benefits are those which the employee has not yet earned. Id.

272. ERISA § 4001(a)(8), 29 U.S.C. § 1301(a)(8) (1988). Excluded from the conditions which must be satisfied are submission of formal application, retirement, completion of required waiting period, or death in the case of a benefit that returns all or a portion of a participant's accumulated mandatory employee contributions upon the participant's death. Id.


The concepts of accrued on the one hand, and vested or "nonforfeitable", on the other, are related, but not the same. A participant becomes fully vested when he gains a nonforfeitable right to receive his entire accrued benefit. Vesting provisions do not affect the amount of the accrued benefit, but rather govern whether all or a portion of the accrued benefit is nonforfeitable. Accrual provisions provide a formula for calculating the amount of the normal retirement benefit which an employee has earned at any given time.²⁷⁶

Therefore, a participant may have accrued benefits which are not yet vested, but benefits must accrue before they can vest.²⁷⁶

1. Allocation of a terminated plan's assets

ERISA Section 4044 provides for the allocation of a single employer plan's assets among the plan's participants and beneficiaries in the event of the plan's termination.²⁷⁷ Plan assets that are available to provide benefits include all plan assets remaining after the subtraction of all liabilities, other than liabilities for future benefit payments, paid or payable from plan assets.²⁷⁸ Liabilities include expenses, fees and other administrative costs and benefit payments due before the allocation date.²⁷⁹ These assets must be distributed according to a six-tier system under Section 4044(a).²⁸⁰ In Mead Corp. v. Tilley,²⁸¹ the United States Supreme Court, agreeing with the PBGC, stated that this system does not create benefit entitlement, but instead "simply provides for the orderly distribution of plan assets."²⁸²

All claims within a particular category must be distributed before any assets are distributed in the next lower category.²⁸³ If the plan's assets are insufficient to meet all the claims within a particular category, then the assets will be distributed to a participant according to the value of that participant's benefits relative to the total

²⁷⁶. The concept of vesting under a plan, as discussed here, must be distinguished from automatic vesting which occurs when a plan terminates.
²⁷⁸. 29 C.F.R. § 2618.3(a) (1989).
²⁷⁹. Id.
²⁸². Id. at 725.
²⁸³. 29 C.F.R. 2618.10(d) (1989); see also Blessitt, 848 F.2d at 1168.
value of all benefits in that category. Where the plan allows for reversion, any assets remaining after satisfaction of all liabilities in categories one through six can revert to the employer under certain circumstances.

The first four levels distribute nonforfeitable benefits guaranteed by the PBGC. The first class of benefits covers benefits derived from participants' voluntary contributions to the plan. The second class includes benefits from mandatory contributions, i.e., contributions that an employee must make in order to secure a benefit under the plan. The third class covers benefits that retired workers were receiving or could have received if they had retired within three years prior to plan termination. The fourth class contains all other benefits guaranteed by the PBGC without certain limits which apply to guaranteed benefits. The fifth level contains all other nonforfeitable benefits under the plan. Finally, the sixth level contains all other benefits under the plan.

There has been an explosion of litigation involving the meaning of the fifth and sixth levels. Conflicts have commonly arisen between participants seeking benefits which had not yet accrued when the plan terminated, and employers seeking reversions. In Mead, the Supreme Court resolved a conflict among the circuits over this issue. The Mead Court was faced with a plan providing early retirement benefits which required that participants reach a certain age in order to be entitled to a specified level of early retirement benefits. At the time the plan was terminated, none of the participants had

284. 29 C.F.R. § 2618.10 (e) (1989); see also Blessitt, 848 F.2d at 1168-69.
285. See infra notes 467-94 and accompanying text; see also Blessitt, 848 F.2d at 1169.
286. Mead, 490 U.S. at 718.
293. 490 U.S. at 721 n.8. In Mead, the Court held that benefits which had not accrued before a plan terminated were outside the allocation scheme. 490 U.S. 714. This conclusion had been adopted earlier by the Third and Eleventh Circuits. See Ashenbaugh, 854 F.2d 1516, 1529 (3d Cir. 1988), cert. denied, 490 U.S. 1105 (1989); Blessitt, 848 F.2d 1164, 1178-79 (11th Cir. 1988). A contrary conclusion had been reached by the Second and Fourth Circuits. These circuits held that unaccrued benefits were within the allocation scheme and had to be distributed before reversions could occur. See Tilley v. Mead, 815 F.2d 989 (4th Cir. 1987), rev'd on other grounds, 490 U.S. 714 (1989); Amato v. Western Union Int'l Inc., 773 F.2d 1402, 1415-16 (2d Cir. 1985), cert. dismissed, 474 U.S. 1113 (1985).
294. 490 U.S. at 714.
295. Id. at 721.
296. Id. at 723.
297. Id. at 725.
299. 29 C.F.R. § 2613.6(b) (1989). A graphic description of the effect of not having a guaranteed benefit is provided in one of the opinions in the LTV bankruptcy:

Following termination of the Plans, therefore, payments of current pension benefits payable under the 1986 Pension Agreements were reduced to the extent they were not guaranteed by the PBGC. Certain early retirement, disability, and surviving spouse benefits not guaranteed by the PBGC were terminated completely. As a result, more than 7,000 LTV pensioners under the age of 62 immediately had their monthly pensions reduced by as much as $400. Thousands of retirees who were solely dependent on pension benefits for food, clothing, housing and other essentials received substantially reduced pension benefits following termination. Thousands of current employees who had worked in return for a contractually guaranteed right to early retirement thereafter forfeited such benefits and stopped accrual of service for any pension plan. Surviving spouses of employees who died while actively employed also lost certain pension benefits.

In re Chateaugay, 87 Bankr. at 788.

3. Participants' rights to pursue the debtor for the difference between the amount guaranteed by the PBGC and the amount originally promised

Participants in a terminated plan which is not terminated in a standard termination will generally receive smaller benefits than their plan originally promised. The rights of participants to pursue the debtor for the difference between what they were promised and the guaranteed benefits they receive will turn on the language of the plan and trust agreement which created the pension arrangement.

This issue was addressed squarely in *In re Johnson Steel & Wire Co.*, where the claimants were former employees of the debtor who had retired and, with one exception, were receiving payments under the company's pension plan when the company terminated the plan. The PBGC, which became trustee of the plan following its termination, began paying guaranteed benefits in amounts less than the benefits calculated under the terms of the plan. In turn, the claimants sought the value of the difference between the monthly payments they had been receiving under the plan and the monthly payments they received from the PBGC. The court ruled that nothing in ERISA precluded the claimants from seeking these amounts. Yet, the court disallowed these claims on the grounds that the terms of the plan and trust agreement clearly limited the liability of the debtor to the amount of benefits funded at the time of

301. See Bechtel v. Pension Benefit Guar. Corp., 781 F.2d 906 (D.C. Cir. 1986). In Bechtel, an employer filed for bankruptcy and sought to terminate its pension plan because of inadequate funding. *Id.* The PBGC authorized the plan trustee to continue paying benefits at pre-existing levels pending a calculation of guaranteed benefits. *Id.* The PBGC explicitly noted the possibility of a recapture if payment levels were determined to be in excess of guaranteed levels. *Id.* A few years later, the PBGC determined the amount of guaranteed benefits and informed the plan's participants that recoupment would be effected by decreasing levels of ongoing payment. *Id.* The court in Bechtel elaborated upon the PBGC's rights to recoup payments made in excess of the guaranteed levels, and affirmed the district court's finding in favor of the PBGC. *Id.* at 907. The court found that ERISA's specific provision for recapture of certain preferential payments made prior to a plan's termination date did not negate the existence of a more general right of recoupment. *Id.* Rather, the court determined that, notwithstanding the direct language of the statute, Congress "must have contemplated that the PBGC may recoup payments in excess of guaranteed levels." *Id.*


303. *Id.* at 204.

304. *Id.*

305. *Id.

306. *Id.* at 206.
plan termination. The court found that such clauses were proper under ERISA since there were no allegations that the debtor attempted to mislead its employees about the plan's provisions.

Under the reasoning of Johnson Steel, to the extent that a pension plan limits an employer's liability to plan contributions and establishes the plan as the sole source of benefits, it will be difficult for participants to collect more than benefits actually funded or payable by the PBGC.

Consistent with this analysis, suits for the difference between benefits actually received and those promised by the employer have been permitted where employers expressly promised to pay benefits without regard to the plan's funding status.

In one recent decision, a U.S. District Court disallowed the claims by plan participants for non-guaranteed benefits on the theory that such claims would disrupt the allocation of plan assets by the PBGC. The decision is of interest because it reaches the same conclusion as Johnson Steel, but under a different rationale.

Participants whose plans are based on a collective bargaining agreement may have an additional basis for their claims because such agreements provide a separate source of rights from the pension plan documents and failure to provide benefits may violate the collective bargaining agreement.

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307. Id. at 207.
308. Id.
309. The United States Supreme Court has found that employers typically include a clause limiting the employer's responsibility to that of making contribution. See Nachman Corp. v. Pension Benefit Guar. Corp., 446 U.S. 359 (1980); see also Piech v. Midvale-Heppenstall Co., 594 F. Supp. 290 (E.D. Pa. 1984) (granting summary judgment in favor of employer in suit by participants for insurance and pension benefits from plan in effect when plant closed, because benefits not guaranteed by employer), aff'd, 770 F.2d 1070 (3d Cir. 1985); Cf. In re White Motor Corp., 731 F.2d 372 (6th Cir. 1984) (giving PBGC power, as co-debtor, to bring a claim to enforce guaranty of company that in event of plan termination, employees with ten years of service would be paid full vested benefits in bankruptcy).
311. Each of these cases involved benefits established by a collective bargaining agreement. Id. This may be significant because in cases where the pension was unilaterally established by a non-unionized employer, that employer could argue that ERISA preempted a contract suit for benefits and that there was no separate jurisdictional basis available under § 301 of the Labor Management Relations Act. See Morse v. Adams, 857 F.2d 339, 343 (6th Cir. 1988); cf. Murphy, 635 F.2d at 237 (3d Cir. 1983).
312. See United Steelworkers of America v. Cyclops Corp., 860 F.2d 189, 197 (6th Cir.
Even in the non-collective bargaining context, where the promise of benefits is limited to those funded, one possible route left open to participants is to pursue the debtor for any failure to make contributions. Suits for failed contributions are rare, however, because there are procedural obstacles; because they are economically suspect inasmuch as any recovery inures to the benefit of the plan, not any individual members; and because in the case of a terminated plan, they are largely duplicative of efforts made by the PBGC. In 1988); Policy v. Powell Pressed Steel Co., 770 F.2d 609, 618 (6th Cir. 1985), cert. denied, 475 U.S. 1017 (1986); United Steelworkers of America v. North Bend Terminal, 752 F.2d 256, 259 (6th Cir. 1985); United Paper Workers Int'l Union v. Muskegon Paper Box Co., 704 F. Supp 774, 777 (W.D. Mich. 1988).

314. For example, in McMahon v. McDowell, 794 F.2d 100 (3d Cir. 1986), cert. denied, 479 U.S. 971 (1986), a company received a funding waiver from the IRS for its 1980 pension plan funding obligations. In 1982, pursuant to the agreement with the IRS, the company paid the necessary installments of the contributions that had been waived for the 1980 plan year. Id. at 105. The company later applied for a waiver for the 1981 plan year, but the company was still pending when the company filed for bankruptcy in February, 1983. Id. In September of 1983, the company sought to terminate the pension plans. Id. The plans were terminated as of June 1983 with the PBGC's approval. Id.

The plaintiffs in McMahon were former employees and certain former officers and directors of the company. Id. at 103. The plaintiffs sought wages, pension contributions, and fringe benefits allegedly owed them under state law. Id. The plaintiffs also claimed that the plan fiduciaries had violated ERISA. Id. at 108. The court rejected the plaintiffs' state law claims on the grounds that they were preempted by ERISA. Id. at 105-08. The court found that the termination provisions of ERISA precluded the state law claims:

Furthermore, [ERISA], Sections 4001-4068, 29 U.S.C. §§ 1301-1368, and the regulations, 29 C.F.R. §§ 2615-2623, institute a comprehensive framework designed to accommodate the different policies implicated when an employer seeks to terminate a single employer plan that has not been fully funded. This scheme, which includes plan termination insurance and gives the plan preferred status as a creditor, does not contemplate that the substantial liability imposed upon a terminating employer will be supplemented by private state law actions. Id. at 107 (citations omitted).

The court also rejected plaintiffs' claims for breach of fiduciary duty for the plan's fiduciaries' failure to collect delinquent pension plan contributions and the employer for its failure to make those contributions. Id. at 108-13. The plaintiffs sought to hold the fiduciaries liable for not seeking payments from the employer for the period from the granting of the first funding waiver in December, 1981 until the bankruptcy filing in February, 1983. Id. The plaintiffs brought their claim pursuant to 29 U.S.C. § 1109. The court found that under the United States Supreme Court's decision in Massachusetts Mut. Life Ins. Co. v. Russell, 473 U.S. 134 (1985), Section 409 of ERISA does not authorize a private right of action for compensatory relief. McMahon, 794 F.2d at 109. The Court allowed the action to proceed under ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2). McMahon, 794 F.2d at 109. Under § 502(a)(2), a beneficiary or participant to a plan can recover damages for the welfare of the plan against the plan's fiduciaries. Further, if the participants and beneficiaries can show that a plan trustee breached his fiduciary duty, then a derivative action may be maintained against the employer to recover damages for the welfare of the plan. McMahon, 794 F.2d at 109 (citing Struble v. New Jersey Brewery Employees Welfare Trust Fund, 732 F.2d 325, 337 (3d Cir. 1984)).

Although the McMahon decision creates the possibility for a breach of fiduciary duty suit
the context of plans funded under collective bargaining agreements, both unions and the plans may bring claims for contributions.¹¹⁵

4. Suits for breach of fiduciary duty

Plan participants have occasionally sought to assert suits for breach of fiduciary duty against employers in the context of bankruptcy.¹¹⁶ Fiduciary responsibilities fall into two general categories. First, there is a category of specific standards of conduct that fiduciaries must observe when acting in their fiduciary capacity.¹¹⁷ Second, there is a set of "prohibited transactions" that must be avoided.¹¹⁸

Participants’ suits for breach of fiduciary duty in the context of plan terminations during bankruptcy have not fared well. In *Morse* against a plan trustee, and perhaps against the employer itself, the court’s ultimate resolution of the dispute made the success of such a claim unlikely in the context of a bankruptcy. The *McMahon* court found that the purpose of the IRS minimum funding waiver is to discourage employers from terminating plans in times of financial difficulty. *Id.* at 112. Therefore, the court found that the trustees breached no fiduciary duty in failing to bring suit against the company to enforce minimum funding obligations that had been waived. *Id.* The court’s reasoning seems to expand beyond situations where there has been a formal IRS funding waiver: “It normally will be reasonable for plan fiduciaries to refrain from action which might send the employer into bankruptcy or lead to the termination of the plan.” *Id.* at 112.

One question left open by *McMahon* is whether the participants would be able to bring suit to recover benefits directly under ERISA § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B) (1988). *See McMahon*, 794 F.2d at 100. Under *Johnston Steel*, such a suit would only be available against the plan. 61 Bankr. 203. In the distress termination context, such a suit would be fruitless because the plan would have terminated with insufficient assets and would effectively be judgment proof.

One early case that permitted claims for benefits to proceed involved an extreme fact situation where the employer failed to make numerous contributions to the plan, many of the benefits were not guaranteed by the PBGC because they were created to a recent plan amendment, and the employer's liability to the PBGC was limited to the pre-PPA level of 30% of its net worth. *M&M Transp. Co.*, 3 Bankr. 722 (S.D.N.Y. 1980).


v. Adams, the Sixth Circuit rejected a fiduciary breach claim that plan participants brought against the directors and officers of a company for not opposing actions taken by the company when it encountered financial difficulty and filed for Chapter 11 reorganization. The bankruptcy court below allowed the company to reduce and terminate welfare benefit plans and to terminate its pension plan. None of the directors were plan trustees. The court rejected the claims on the grounds that a corporate officer who is not a trustee has no fiduciary duty to base corporate decisions on the interests of plan beneficiaries.

In McMahon v. McDowell, the Third Circuit reached the same conclusion of no liability in a suit against trustees who did not seek contributions to a plan from a financially distressed employer. In McMahon, the court stressed that collections would probably have been futile due to the company's dire financial circumstances. The McMahon rationale forecloses a number of suits in bankruptcy. Under McMahon, the dire financial conditions associated with a bankruptcy will often excuse fiduciaries from bringing suit to enforce contribution requirements.

B. Employer Conduct And Liability

1. Liability to PBGC

a. Types of claims

The PBGC may make claims against debtors based on several, often overlapping bases, including: (1) secured claims; (2) private agreements to fund in excess of guaranteed benefits; failure to meet ERISA's minimum funding requirements; and (4) un-

319. 857 F.2d 339 (6th Cir. 1988).
320. Id. at 341-43.
321. Id. at 341.
322. Id.
323. Id. at 343.
324. 794 F.2d 100 (3d Cir.), cert. denied, 479 U.S. 971 (1986).
325. Id. at 108-13.
326. Id. at 110.
327. Id. at 111.
328. Id. at 110-13.
330. See id. at 2.
331. Id.
paid contributions under ERISA. The last two bases, both found in ERISA Section 4062, are imposed on all contributing sponsors or members of the contributing sponsor’s control group, on a joint and several basis.

i. **Secured claims** — Since secured claims have priority over unsecured claims, they are highly desired by creditors. On rare occasions, the PBGC will have claims in which a security was perfected pre-petition. An example of such a claim was made in the LTV cases where the PBGC claimed secured status for $240 million based on LTV’s security pledge for a waiver of 1984 plan year contributions.

ii. **PBGC as co-debtor on private agreements** — The PBGC may maintain a proof of claim as a co-debtor against the debtor for any private agreements made by the plan sponsor to pay benefits in excess of guaranteed benefits.

333. *Id.*


335. See ERISA § 4062(a), 29 U.S.C. § 1362(a); ERISA § 3, 29 U.S.C. § 1002(40)(B)(ii) (1988) (defining a control group in generally broad terms); In re Challenge Stamping and Porcelain, 719 F.2d 146 (6th Cir. 1983) (defining a control group in the context of a bankruptcy more narrowly by finding that the company purchasing the parent corporation of an employer one month after the employer filed bankruptcy did not have control over the employer when the employer’s assets were sold and its pension plan terminated, therefore, no control group liability for underfunding was appropriate for the purchaser); compare Pension Benefit Guar. Corp. v. Ouimet Corp., 711 F.2d 1085 (1st Cir.), cert. denied, 464 U.S. 961 (1983) (apportioning liability under ERISA § 4062 among solvent non-bankrupt control group members) with Pension Benefit Guar. Corp. v. Anthony Co., 575 F. Supp. 953 (N.D. Ill. 1983) (disagreeing with Ouimet’s exoneration of non-bankrupt control group members and imposing liability on bankrupt direct employer of participants as well as debtor’s non-bankrupt parent).

336. The constitutionality of joint and several liability under ERISA has been challenged in the LTV litigation. See In re Chateaugay Corp., 108 Bankr. 27, 29 (S.D.N.Y. 1989), rev’d on other grounds sub. nom., Pension Benefit Guar. Corp. v. LTV Corp., ___ U.S. ___, 110 S. Ct. 2668 (1990). Previous challenges to the constitutionality of ERISA’s provisions as they apply to control groups have failed. See *Ouimet*, 711 F.2d 1085 (holding that it is not a due process violation to impose liability on control group for the period before the terminating employer was acquired by that group); Pension Benefit Guar. Corp. v. Ouimet, 630 F.2d 4 (1st Cir. 1980), cert. denied, 450 U.S. 914 (1981) (holding that it is not a due process violation in retroactive impact of ERISA for underfunding liability); A.T.O. Inc. v. Pension Benefit Guar. Corp., 634 F.2d 1013 (6th Cir. 1980) (holding that PBGC’s denial of waiver of liability to company is not a due process violation); see also Teamsters Pension Trust Fund v. Allyn Transp. Co., 832 F.2d 502 (9th Cir. 1987); Robins v. Pepsi-Cola Metro. Bottling Co., 636 F. Supp. 641 (N.D. Ill. 1986).


338. See In re White Motor Corp., 731 F.2d 372, 374 (6th Cir. 1984) (holding that
iii. Minimum funding requirements — Prior to the enactment of the PPA in 1987, an employer’s liability under ERISA Section 4062 was limited to the lesser of the difference between a plan’s assets and its liabilities, or 30% of the employer’s net worth.\textsuperscript{339} This net worth limit led to litigation over how net worth should be calculated.\textsuperscript{340} The PPA eliminated the net worth requirement.\textsuperscript{341} Currently, liability is based generally on the total amount of unfunded benefits to all participants and beneficiaries under the plan plus interest.\textsuperscript{342} The PPA also extended liability to all corporations sharing common ownership with the plan sponsor.\textsuperscript{343}

In addition, failure to meet ERISA’s minimum funding requirements may result in the imposition of a lien by the PBGC.\textsuperscript{344} When an employer’s aggregate funding deficiency exceeds $1 million, a lien will be imposed against the employer and its control group for the lesser of the amount the deficit exceeds $1 million (interest included) or the aggregate unpaid balance of payments for plan years beginning in 1987.\textsuperscript{345} This lien may only be perfected and enforced by, or at the direction of, the PBGC.\textsuperscript{346}

iv. Unfunded benefit liabilities — Unfunded benefit liability is due to the PBGC as the agency responsible for administering and enforcing Title IV of ERISA.\textsuperscript{347} Unfunded benefit liability consists of the excess of the present value of benefit liabilities of the plan, as of the termination date, over the current value of plan assets, plus interest.\textsuperscript{348} Such liability is subject to a lien for up to 30% of the collective net worth of the contributing sponsor and its controlled group.\textsuperscript{349} ERISA provides that in the event of a reorganization under Chapter 11, this lien is to be treated as a tax due to the

PBGC, as co-debtor, could maintain claim against plan sponsor based on separate letter agreements entered between sponsor and union representing plan participants, in which sponsor guaranteed that vested pension benefits for workers with at least ten years seniority would be paid in full in the event of plan termination.); Flowe & Beyer, supra note 328, at L11; supra notes 301-14 accompanying text (discussing the promises of benefits in excess of guaranteed amounts).  

\begin{itemize}
 \item \textsuperscript{339} ERISA § 4062, 29 U.S.C. § 1362 (1988).
 \item \textsuperscript{341} ERISA § 4062, 29 U.S.C. § 1362 (1988).
 \item \textsuperscript{342} Id.
 \item \textsuperscript{343} Id.
 \item \textsuperscript{345} Id.
 \item \textsuperscript{349} ERISA § 4068(a), 29 U.S.C. § 1368(a) (1988).
\end{itemize}
United States; this treatment has significance in assessing the bankruptcy priority of the claim.\textsuperscript{350}

\textbf{v. Unpaid contributions owed to the plan's successor trustee} — Unpaid minimum funding liability runs to the trustee appointed to administer the plan, which may be the PBGC.\textsuperscript{351} This liability is for accumulated funding deficiencies, including amounts due if past funding waivers were denied, plus interest.\textsuperscript{352}

In the LTV reorganization, the debtor successfully argued that the PBGC's unpaid contribution claims and its unfunded liability claims were redundant and allowing recovery under both would result in double payment:

In the case of each of the plans, a substantial portion on that insufficiency claim is attributable to the fact that the plan has not yet realized any recovery on one of its major assets, the plan's claims for unpaid contributions (which are being asserted by the PBGC as successor plan trustee).\textsuperscript{353}

When confronted by this issue, both the bankruptcy court and the U.S. District Court ruled that to allow the PBGC to collect on both claims would be to allow two dollars of claims for one dollar of loss which would violate "principles of equality and fair treatment of creditors" fundamental to the Bankruptcy Code.\textsuperscript{354} Thus, "to the extent that unpaid contribution claims of the pension plans are allowed, any amount constituting insufficiency claim is disallowed as duplicative."\textsuperscript{355}

\textbf{b. Priority sought by PBGC}

Depending on the facts of the particular case, the PBGC can be expected to assert certain priorities. As will be seen below, the central difference between claims asserted by the PBGC for unfunded benefit liability from those asserted by the PBGC, as successor trust-
tee, for an unpaid contribution, is the assertion of tax and lien status for unfunded benefit liability. The major priority categories sought by the PBGC are:

i. Administrative priority — where plans are terminated post-petition, the PBGC has, at least in some cases, sought a first level administrative priority for unfunded benefit liability on the grounds that these claims arise during the administration of the bankruptcy.356

ii. Lien and tax status for unfunded benefits — the PBGC has asserted that its unfunded benefit liability liens are entitled to first priority treatment, so that if the plan is terminated in bankruptcy, first priority treatment is appropriate.357 For pre-petition aspects of this claim, a seventh level tax priority is sought.358

iii. 180-day pre-filing fourth level priority — the PBGC has asserted fourth level claims for unpaid contributions attributable to services rendered during the 180 days prior to the filing of the bankruptcy petition.359 In Chateaugay, these claims were for over $100,000,000.360

iv. General unsecured claims — as successor trustee, the PBGC will assert general claims for unpaid contributions attributable to services rendered prior to 180 days before the bankruptcy filing.361

c. Bankruptcy categorization of PBGC claims permitted by the courts

The PBGC’s assertion of high priority claims has not fared well in the courts. In this respect, the PBGC may become a victim of ERISA’s tightened rules regarding termination. That is, as discussed above in Section II, underfunded plans can now rarely terminate outside of bankruptcy.362 Thus, the PBGC is not likely to hold many secured claims, such as perfected liens, unless it involuntarily terminates plans pre-petition and perfects such claims.363 The current re-

356. Id. at 697. As successor trustee for the plan, the PBGC will also seek administrative priority for unpaid contributions for the time period from the filing of the bankruptcy petition to the termination of the plan. See Flowe & Beyer, supra, note 329.


360. Id.

361. Id.

362. See supra notes 82-116 and accompanying text.

363. See Wagner, supra note 37, at 158.
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...regime would not be a problem for the PBGC if it was achieving administrative or other high priority status for its claims. However, as discussed immediately below, the few courts to confront the issue have generally dealt the PBGC bruising defeats, leaving it with unsecured claims with little or no priority.\textsuperscript{364} In this section, we examine how courts have dealt with PBGC's claims.

i. Administrative priority rejected except for claims based on post-petition/pre-filing labor — in the LTV reorganization, the U.S. District Court for the Southern District of New York withdrew reference of LTV's objections to the PBGC's claims from the bankruptcy court.\textsuperscript{365} The court then referred the matter to the bankruptcy court for its findings, which would be subject to \textit{de novo} review in the Southern District.\textsuperscript{366} The Bankruptcy Court for the Southern District of New York issued its Report and Recommendation on May 24, 1990, generally denying bankruptcy priority to the PBGC's claims.\textsuperscript{367} The PBGC and the Department of Labor sought review of the Report and Recommendation.\textsuperscript{368} The District Court adopted the Report and Recommendation of the Bankruptcy Court.\textsuperscript{369} The opinions of the bankruptcy court and the district court are discussed in this section and the sections which follow.

The Bankruptcy Court's Report and Recommendation which was adopted by the District Court rejected all of the PBGC's claims for administrative priority except for the portion which represented claims attributable to post-petition labor by LTV employees.\textsuperscript{370} The PBGC had sought administrative priority for over $2,000,000,000 in

\begin{itemize}
  \item \textsuperscript{364} Not surprisingly, James Lockhart, the executive director of the PBGC, stated on February 7, 1991, that the goals of his agency included improving its standing in bankruptcy. \textit{See Agency Goals Include Reducing Losses; No Premium Hike Planned, Lockhart Says}, 18 Pens. Rep. (BNA) No. 6, at 266 (Feb. 11, 1991). He suggested that improving PBGC's bankruptcy claims would mean that less would be available for creditors and stockholders and that, in turn, this would provide incentive not to terminate plans. \textit{Id.} More recently, the shape of PBGC's legislative initiative has become more clear. According to statements by Lockhart and PBGC Deputy Executive Director Diane Burley, the priority status of PBGC's claims should be clarified and improved, the PBGC should have the option of becoming a member of the creditor's committee, and the interest rate to be used for discounting PBGC liabilities should be clarified. \textit{See Congress Should Act Before Crisis To Improve PBGC's Standing, Lockhart Says}, 18 Pens. Rep. (BNA) No. 30 at 1283-84 (July 29, 1991); \textit{Bill to Clarify Bankruptcy Standing To Be Introduced Within Month}, 18 Pens. Rep. (BNA) No. 17 at 751 (April 29, 1991).
  \item \textsuperscript{366} \textit{Id.}
  \item \textsuperscript{367} \textit{Id. at 760.}
  \item \textsuperscript{368} \textit{See}, \textit{In re Chateaugay Corp.}, 130 Bankr. 690 (S.D.N.Y. 1991).
  \item \textsuperscript{369} \textit{Id. at 700.}
  \item \textsuperscript{370} \textit{Id. at 697.}
\end{itemize}
claims, including, among other things, all of its unfunded benefit liabilities and for unpaid contributions from the time of filing of the bankruptcy petition to the plans' termination date. The reasoning of both courts is instructive.

Both courts first noted that priorities are to be narrowly construed and that the burden is on the claimant to establish entitlement to priority. Further, such entitlement should only be granted under extraordinary circumstances, that is, when the parties seeking priority have demonstrated that their services are actual and necessary to preserve the estate.

The bankruptcy court found that the test for administrative priority was twofold: the obligation must have (1) arisen from a transaction with the debtor-in-possession (that is, post-petition); and (2) resulted in a direct benefit to the estate.

The PBGC argued to the bankruptcy court that both elements were met because (1) the termination occurred after the bankruptcy; and (2) the termination benefitted LTV in several ways. With regard to the first element, the PBGC argued that its claims became due and payable upon plan termination, which was post-petition. With regard to the second element, the PBGC argued that LTV was able to obtain its sought-after restructuring of pension obligations due to the termination. According to the PBGC, LTV also benefited due to having (1) no further liability for benefits accrual or vesting; (2) no minimum funding obligations; and (3) assumption of unfunded obligations by the PBGC.

The bankruptcy court rejected the PBGC's argument, instead finding, in its Report and Recommendation, that the PBGC's claims failed under both parts of the test for administrative priority.

The bankruptcy court ruled that the focus for determining when a claim arises is the time frame in which the acts giving rise to the liability were performed. Under this approach, the key event was

373. See In re Chateaugay Corp., 115 Bankr. at 771; In re Chateaugay Corp., 130 Bankr. at 696.
375. Id.
376. Id.
377. Id.
378. Id.
379. Id. at 772-73.
380. Id. at 774.
381. Id.
not the plans' termination, but rather, it was the labor of the LTV employees. This conclusion is based on the fact that the pension benefits were provided to the employees of LTV for the labor they performed, most of which occurred before the bankruptcy petition was filed. Thus, except for claims based on post-petition labor, the claims failed the first part of the test for administrative priority. Instead, the bankruptcy court characterized the PBGC's claim as a contingency claim against LTV based on pre-petition labor. The act of terminating the plans could not convert pre-petition claims into post-petition claims.

The bankruptcy court found that the PBGC's claims did not meet the second part of the test for administrative priority because they were not actual and necessary to preserve the estate. Here, the bankruptcy court reasoned that the bulk of the claims were from obligations to retirees and that LTV did not induce these retirees to provide post-petition services by promising pension benefits.

In adopting the Report and Recommendation, the Southern District of New York, following the bankruptcy court's reasoning, stated, in more abbreviated form, that:

In order for a debtor-in-possession to continue in business, the Bankruptcy Code allows certain claims and expenses first priority as "actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." 11 U.S.C. §§ 503(b)(1)(A) and 507(a)(1). Although PBGC asserts that a number of its claims are entitled to such administrative priority, the Bankruptcy Court suggested that, except to a very limited extent, PBGC's claims are not entitled to administrative priority. I agree.

There is a clear policy favoring ratable distribution among similar claimants. Consequently, priority status is rarely allowed. That which constitutes a claim, however, is broadly construed. Under the Bankruptcy code, a claim is defined as any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable secured, or unsecured." 11 U.S.C. § 101(4)(A). PBGC and the DOL have stated claims here.

382. Id.
383. Id. at 775.
384. Id. at 776.
385. Id. at 775.
386. Id.
387. Id. at 776.
388. Id. at 775.
The burden of establishing entitlement to priority, however, rests with the claimant and should only be granted under extraordinary circumstances.

In order to allow the debtor to start anew, a claim is deemed to exist “when the acts giving rise to the alleged liability were performed.” For priority status, the claimant must show that the claim arose post-petition.

In this case, PBGC argues that its statutory obligations under the plan at bar were triggered by post-petition termination, thus according its obligations post-petition priority status. I disagree. PBGC's claims are pre-petition contingent claims because the labor giving rise to the pension obligations was performed pre-petition. The contingent right to payment arose only when the Republic Retirement Plan was terminated. There being nothing adduced here compelling me to find that these claims are post-petition, neither the DOL nor PBGC are entitled priority status of their claims. (See Trustees of Amalgamated Ins. Fund. v. McFarlin's, Inc., 789 F.2d 98, 101 (2d Cir.1986) (“debt is not entitled to priority simply because the right to payment arises after the debtor in possession has begun management of the estate”.)

Neither are PBGC's pre-petition claims entitled to administrative status on the alternative theory of providing “actual and necessary” expenses of preserving the estate. See 11 U.S.C. §§ 503(b)(1)(A) and 507(a)(1). LTV did not induce retirees to provide post-petition services by promissory pension benefits. Only those employees who provided post-petition services to LTV could benefit the company post-petition. Thus, only that portion of pension liabilities arising from post-petition labor of employees would be entitled to administrative priority as “actual and necessary” expenses of preserving the estate.\(^{389}\)

In what may be a significant portion of its Report and Recommendation, the bankruptcy court rejected the decision of the U.S. District Court of Massachusetts in Columbia Packing Co. v. Pension Benefit Guar. Corp.\(^{390}\) which was relied on by the PBGC in support of its administrative priority claim.\(^{391}\)

\(^{389}\) In re Chateauagay Corp., 130 Bankr. at 696-97 (emphasis added) (some citations omitted).


\(^{391}\) See In re Chateauagay Corp., 115 Bankr. at 777. Thus, the LTV bankruptcy court stated:

Moreover, the Court is not persuaded by the decision Columbia Packing Co. v. PBGC... [T]he Columbia Packing decision cannot be reconciled with the Second Circuit's holding in Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc.... which... established that the resolution of the administrative priority issue essentially turns on whether the debtor's employees provided labor in consideration for
In Columbia Packing, the United States District Court for the District of Massachusetts granted priority status to unpaid contribution claims based in part on pre-petition services on the ground that the pre-petition services were really a unit of measurement, not a source of consideration. In Columbia Packing, the debtor company had established a pension plan, subject to ERISA termination provisions, for its union employees in 1969.

Columbia Packing’s actuarial method is known as the frozen initial liability funding method. As explained by the court, there are two charges to the account under this method. First is the normal cost, which consists of the present cost of future pension benefits and administrative expenses assigned to a designated time period. Thus, the normal cost is based on the present value of benefits to be paid in the future for the time worked during the period under consideration.

The second cost element, known as past service liability, is based on the employees’ years of service prior to the creation of the plan. This liability arose because when the plan was created, the employees were given credit for the time they worked up to that point. The past service liability is amortized over a number of years, as are any retroactive increases in the monthly dollar multiplier.

The company made its last contribution to the plan for the plan year ending October 31, 1981. The company filed its petition for reorganization under Chapter 11 of the Bankruptcy Code on February 28, 1983. Business ceased on September 16, 1983. The plan was to have terminated by its terms on October 31, 1983. The PBGC was appointed as statutory trustee of the pension fund on
April 17, 1984. The number of active employees covered by the plan decreased from 168 on September 16, 1982 to 105 on September 16, 1983.

The PBGC filed claims for $300,089, the amount by which the plan's funding deficiency increased between the last contribution and the time the plan was to have terminated by its terms. Included in the PBGC claim was a priority claim for $100,034 for administrative priority and $76,699 for fourth priority claims covering employee benefit plan contributions arising from services rendered within 180 days before the filing of the bankruptcy petition.

The Bankruptcy Court allowed a portion of the PBGC's claims as priority claims under both the first priority for administrative expenses and the fourth priority for 180-day pre-petition contributions. Both parties agreed that the normal cost element of the contributions have a priority under both of these categories. The critical issue, however, was whether the past service liability should be given priority under either of these categories.

More specifically, the issue confronting the court was whether the portion of an employer's contribution that was due during the priority period, but calculated by reference to service rendered prior to the priority period, was entitled to administrative expense priority. Two cases were considered to be relevant in connection with this issue. In the first case, In re Mammoth Mart, Inc., the First Circuit held that the consideration for severance pay determined by length of service was provided over the period of employment. Under this view, the part of the severance pay earned pre-petition is not entitled to administrative priority. The Columbia Packing court found Mammoth Mart to stand for the proposition that in order for a claim to be awarded priority as an administrative expense, the consideration upon which the claim is based must be supplied to

405. Id.
406. Id.
407. Id. The parties had stipulated that $300,089 was the correct amount owed to the fund. Id. at n.1.
408. Id.
411. Columbia Packing, 81 Bankr. at 207.
412. Id.
413. Id.
414. Id.
415. 536 F.2d 950 (1st Cir. 1976).
416. Id. at 955.
417. Id.
the estate during the priority period.\textsuperscript{418}

In the second case, \textit{In re Pacific Far East Line, Inc.},\textsuperscript{419} the Ninth Circuit examined a pension plan which required the employer to contribute based on the number of days worked by participants during the prior month.\textsuperscript{420} The court upheld administrative expense priority for contributions that had accrued after the filing, but were based on man-hours prior to filing.\textsuperscript{421} The court distinguished \textit{Mammoth Mart} on the ground that the pre-filing labor was not consideration for the contributions, but instead was merely a unit of measure for the amount to be contributed for a plan that continued post-petition.\textsuperscript{422}

In \textit{Columbia Packing}, the court concluded that the past service liability cost at issue should be viewed under the unit of measure perspective.\textsuperscript{423} Although the liability was calculated by reference to services performed before the priority period, the obligation did not accrue until after the priority period began.\textsuperscript{424} Therefore, the court found that:

\begin{quote}
The consideration for which the employees’ present services are rendered is in reality the total annual contribution to the pension fund pro-rated on a daily basis. Under \textit{Mammoth Mart}, then, both the normal cost and the past service liability cost of an employer’s contribution ‘arise from’ service rendered during the period in which the contribution accrues.\textsuperscript{425}
\end{quote}

The court granted first and fourth level priority to the funding standard account deficiency that accrues, on a daily basis, during the priority period.\textsuperscript{426} The amount owed was adjusted to reflect the true normal cost chargeable to the funding account during that period.\textsuperscript{427} No adjustment is made to the past service liability because that amount is essentially fixed at a certain point.\textsuperscript{428}

\begin{itemize}
\item \textsuperscript{418} \textit{Columbia Packing}, 81 Bankr. at 207. This is consistent with other courts’ interpretations of \textit{Mammoth Mart}. See \textit{In re Amarex Inc.}, 853 F.2d 1526, 1530 (10th Cir. 1988) (containing a collection of relevant cases).
\item \textsuperscript{419} 713 F.2d 476 (9th Cir. 1983).
\item \textsuperscript{420} \textit{Id.} at 477.
\item \textsuperscript{421} \textit{Id.} at 479.
\item \textsuperscript{422} \textit{Id.} at 480.
\item \textsuperscript{423} 81 Bankr. at 209.
\item \textsuperscript{424} \textit{Id.} “The past service liability cost is more properly viewed as an actuarial unit of measure for determining the employer’s current periodic contribution than as compensation for work performed before the inception of the plan.” \textit{Id.}
\item \textsuperscript{425} \textit{Id.} at 209.
\item \textsuperscript{426} \textit{Id.} at 210.
\item \textsuperscript{427} \textit{Id.}
\item \textsuperscript{428} \textit{Id.}
\end{itemize}
In adopting the Bankruptcy Court’s Report and Recommendation, the District Court did not directly address the Columbia Packing decision. It would not be too large a leap of faith, however, to suggest that in adopting the Report and Recommendation, the district court was accepting the bankruptcy court’s criticism of Columbia Packing. The LTV bankruptcy court decision, and to a lesser extent — due to its silence on the case — the district court decision, may signal the demise of Columbia Packing, a desirable result. The machinations engaged in by the Columbia Packing court may reflect the court’s recognition of the firmly established rule that if a claim is to be awarded administrative expense priority, the consideration on which it rests must be supplied during the priority period. What Columbia Packing attempted to establish was that while no labor supplied pre-petition can serve as the consideration for an administrative priority claim, the mere fact that a plan ties benefits to pre-petition labor does not mean that this pre-petition labor is the consideration for the benefits. The court’s resolution of the matter, however, involving the somewhat obscure realm of pension funding, provides no guarantee that the amount accorded administrative priority will be limited to the value of service rendered after the filing of the petition. From both a practical and a conceptual standpoint, it would seem that a simple and relatively clear alternative standard is available: post-petition pension costs allowable as administrative expenses should be limited to the present value of the benefits earned post-petition. Suppose, for example, that under a pension plan’s formula, a plan participant earned a pension benefit equal to an additional $15 per month (for life commencing at age 65) based upon six months of post-petition labor. Actuarial tables may be consulted to determine the cost of providing that benefit at age 65, and that number would then be discounted by an appropriate interest rate factor over the period between the participant’s current age and age 65.

Other courts agree with the decision of the bankruptcy and district courts in LTV that contributions for services rendered post-petition are not sufficient to support administrative priority claims. Whether the creditor’s right to payment arises post-petition is irrelevant: An expense is only entitled to administrative expense priority to the extent that the consideration for the expense was both supplied to, and beneficial to the debtor-in-possession, in the operation of the business post-petition. See Amarex, 853 F.2d at 1530 (quoting Trustees of Amalgamated Ins. Fund v. McFarlin’s, Inc., 789 F.2d 98 (2d Cir. 1986)). The rationale for this rule is that it best serves the purpose of a priority category by allowing a debtor-in-possession to induce suppliers to furnish goods and services during the reorganization. Id.
tion are entitled to administrative priority. As stated by the United States District Court for the Southern District of New York: "Compensation to employees for services rendered during the bankruptcy proceeding is an administrative expense. It is conceded that this includes indirect compensation consisting of payments to a pension fund for the benefit of employees."

A debtor, however, could assert the more sweeping argument that although the pension benefits are a form of deferred compensation akin to wages, employees who work post-petition do so for their own benefit, not for the benefit of the estate and thus administrative priority is improper. As stated in a withdrawal liability case, the fact that "the Debtors' employees would benefit from the Debtors' payment of the Fund's claim is not determinative, since the employees worked post-petition primarily for their own benefit rather than for that of the estate."

Aside from the first class of administrative priority, a question arises as to whether delinquent contributions should be classified as third level 90-day wage priorities. Although the contributions may be seen as a form of deferred compensation, the contributions are more properly viewed as belonging to the fourth category which specifically provides for them. Accordingly, there is authority to the effect that the third level is limited to amounts payable directly to employees.

**ii. PBGC liens and tax claims found fatally flawed** — a knotty problem is presented by the priority classification of PBGC liens. As discussed above, there are two sources for such liens: first, for unfunded benefit liabilities, up to 30% of collective net worth; and second, funding deficiencies in excess of one million dollars.

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436. See In re Shearon, 10 Bankr. 626 (Bankr. D. Neb. 1981); Novikoff, supra note 12, at 153. To the extent that the third and fourth categories share the same $2,000 per employee limit, there is a great potential for conflict over the categorization of these claims. Claims in excess of the $2,000 limit and those contribution claims that accrued more than 180 days prepetition will be categorized as general unsecured claims. See Beyer, Pension Benefit Guaranty Corporation Claims In Bankruptcy Cases, in ABA THIRD ANNUAL EMPLOYEE BENEFITS IN BANKRUPTCY AND LENDING TRANSACTIONS NATIONAL INSTITUTE HANDBOOK 171 (1989).
437. Prior to the PPA, the PBGC's right to a lien did not extend to a sponsor's failure to meet minimum funding obligations. See In re Divco Philadelphia Sales Corp., 72 Bankr. 199 (Bankr. E.D. Pa. 1986) (finding that PBGC claims based on the ERISA provision governing minimum funding standard were not entitled to a lien); see also Solomon & Oscar, supra note
ERISA provides that in a corporate bankruptcy reorganization, both of these liens will be treated as amounts due the United States as tax liens. The PBGC has interpreted this provision to mean that if a plan is terminated in bankruptcy then the liens are entitled to administrative priority as a tax incurred by the estate post-petition. As discussed above in connection with delinquent contributions, this position is flawed and has been rejected because the proper inquiry focuses on when the consideration for the claim took place, not when the triggering event took place. Thus, the same bankruptcy court that denied the PBGC administrative priority also denied its asserted liens administrative priority for the same reason.

For plans terminated pre-petition or for any part of a claim that arose pre-petition, the PBGC may seek a seventh level tax priority.

Inasmuch as the liens will not be entitled to administrative expense priority, the real inquiry is whether the liens will be entitled to any tax priority or whether they will be unsecured claims. The LTV bankruptcy court denied the PBGC claims that priority and found that the claims never ripened into liens. The central flaw with the PBGC’s post-petition lien is that the Bankruptcy Code prohibits the imposition of a lien on a debtor in bankruptcy. Thus several commentators have suggested, and the LTV bankruptcy and U.S. district courts have ruled, that post-petition termination cannot give rise to a seventh level claim because no enforceable lien is presented. This view is bolstered by the fact that the seventh level priority describes the taxes and claims to which it applies and this description does not include the PBGC’s claim.

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23, at 87.

438. ERISA § 302(f)(4)(c), 29 U.S.C. § 1082(f)(4)(C) (1988) (providing for the minimum funding lien that “any amount with respect to which such a lien is imposed under paragraph (1) shall be treated as taxes due and owing the United States and rules similar to the rules of subsections (c), (d), and (e) of § 1368 of this title [ERISA § 4068] shall apply with respect to a lien imposed by subsection (a) and the amount with respect to such lien.”). “In a case under Title 11 or in insolvency proceedings, the lien imposed under ... this section shall be treated in the same manner as a tax due and owing to the United States for purposes of Title 11 or section 3713(a) of Title 31.” See ERISA § 4068(c)(2), 29 U.S.C. § 1368(c)(2)(a).

439. See In re Chateaugay Corp., 115 Bankr. at 765; see also Flowe & Beyer, supra note 329, at 8.

440. See In re Chateaugay Corp., 115 Bankr. at 774.

441. Id.


443. Id.

444. See Novikoff, supra note 12, at 159; Solomon & Oscar, supra note 23, at 83-85; In re Chateaugay Corp., 115 Bankr. at 780.

445. See Novikoff, supra note 12, at 159.
courts also relied on this fact in denying tax priority.\footnote{448}

One case somewhat at odds with this analysis is \textit{Washington Group, Inc. v. Washington Group, Inc.}\footnote{447} In a tortured decision that one commentator has described as "hopelessly confused,"\footnote{448} the United States District Court for the Middle District of North Carolina apparently ruled that the PBGC’s claim for underfunding is entitled to be treated like a tax lien even though the PBGC’s lien arose post-petition and was thus unenforceable.\footnote{449} The court did not confront the Bankruptcy Code bar to post-petition liens in granting priority to a PBGC lien and determined that the PBGC’s lien arose post-petition when the PBGC demanded payment of a plan’s funding insufficiency.\footnote{450} The court further found that the PBGC will seldom, if ever, be able to file its claim pre-petition and if ERISA’s goal of protecting vested beneficiaries is to be preserved, the claims must be given priority.\footnote{451} \textit{Washington Group} cannot be seen as a resolution of this area as the case was a Chapter X case under the former Bankruptcy Act.\footnote{452} Also, the court did not mention the tax priority provisions of the Bankruptcy Act or Code, and it did not address the fact that ERISA cannot impair other federal statutes.\footnote{453}

\textbf{iii. Fourth priority claim reduced by direct payment —} one hundred and eighty million dollars in 180 day pre-petition contribution claims were filed by the PBGC in LTV’s bankruptcy proceedings.\footnote{454} As noted above, the fourth priority category is limited to $2,000 per employee.\footnote{455} The \textit{LTV} courts further limited the utility of this category for the PBGC by ruling that claims based on services performed during this 180-day period which would have been entitled to this priority must be reduced by payments directly made to employees for wages and benefits paid directly to employees during that period.\footnote{456} The effect of this ruling is not difficult to fathom. It would be rare to find an employee who had not directly received at least $2,000 in wages and benefits during the nearly six-month period preceding a bankruptcy filing. As one commentator has sug-

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\footnote{446. 115 Bankr. at 780, aff’d as modified, 130 Bankr. 690, 697 (S.D.N.Y. 1991).}
\footnote{448. Novikoff, \textit{supra} note 12, at 162.}
\footnote{450. \textit{See} id.}
\footnote{451. \textit{Id.}, 1987 U.S. Dist. LEXIS, at *22.}
\footnote{452. \textit{Id.}, 1987 U.S. Dist. LEXIS, at *1.}
\footnote{453. \textit{See} id.}
\footnote{454. 115 Bankr. at 784, aff’d as modified, 130 Bankr. 690 (S.D.N.Y. 1991).}
\footnote{455. \textit{See supra} note 255 and accompanying text (discussing bankruptcy fourth priorities).}
\footnote{456. \textit{In re Chateaugay Corp.}, 115 Bankr. at 785.}
gested, the ruling will “essentially wipe out the fourth priority claim.”

d. Discount rate

The PBGC’s claims in bankruptcy were dealt a further blow in findings of fact and conclusions of law made by the bankruptcy court regarding the proper discount rate for discounting cash payments owed by LTV to the PBGC after the date a bankruptcy petition is filed. The court rejected three methodologies sought by the PBGC, including allowing the PBGC to set the rate under ERISA. Instead, the court found as follows:

The proper methodology for valuing a claim based on an obligation of the Debtors to make cash payments subsequent to the Filing Date requires an examination of the rate of return available to the reasonable prudent private pension fund investor who invests in a “prudent” portfolio. That investor’s guiding objective is to earn the highest return on the invested capital consistent with preservation of the capital and minimization of risk. This projected rate of return should then be used to discount the Debtors’ obligations to make cash payments subsequent to the Filing Date to determine the present value of the claim.

The PBGC’s executive director had criticized this discount rate decision and the PBGC has challenged it at the district court level while also seeking to have it legislatively overruled. The legislative arena may offer more promise to the PBGC on this issue than the courts. In a more recent decision, the U.S. District Court for the Southern District of New York agreed with a bankruptcy court decision that federal bankruptcy law, rather than the PBGC, is determinative of the discount rate to be used in valuing the PBGC’s

457. Lutgens, supra note 12, at 37, n. 72.
459. Id.
460. Id. at 177. Based on this conclusion, the court derived an 11.5% discount rate, far greater than the 7.3% rate sought by the PBGC. Id.

“No plan could do a standard termination at anything close to this rate,” Lockhart said.

Furthermore, if upheld, “this ruling would have a devastating impact on PBGC, decreasing claims and, therefore, recoveries in bankruptcy proceedings by as much as 50 percent,” Lockhart said.

Id. at 679.
2. Liability to the IRS for excise taxes

In addition to liability to the PBGC, an employer that has not fully funded a plan may face a claim by the IRS for a two-tier excise tax. Failure to meet the statutory minimum funding requirements gives rise to a first-tier excise tax of ten percent of the plan’s accumulated funding deficiencies. A second-tier tax equal to 100 percent of the funding deficiency is instituted if a contribution is not made to eliminate the funding deficiency within the taxable period.

In bankruptcy, the IRS may assert two alternative priorities for its excise taxes. First, if the date for making the contributions on which the tax is based is post-petition, then the IRS may seek administrative priority. However, as with the PBGC claims, the date payment is due is not dispositive. Rather, whether the obligations accrued pre-petition will determine if the claims are entitled to administrative expense priority. Moreover, due to the punitive nature of these taxes, the likelihood that they will be viewed as necessary costs of business is remote. The second priority classification that the IRS may seek is the seventh level. IRS claims for seventh level priority have not been well received by the courts and have been rejected on the grounds that the excise taxes are punitive in nature and thus not a “tax” within the meaning of the Bankruptcy Code.

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464. See Solomon & Oscar, supra note 23, at 81. For single employer plans starting in 1988, liability for first- and second-tier excise taxes is joint and several and is imposed upon all members of the employer’s control group. Id.
466. See In re Airlift Int’l, Inc., 97 Bankr. 664 (Bankr. S.D. Fla. 1989) (demonstrating the difficulty the IRS faces in seeking any type of priority for its excise tax). The district court in Airlift held that the IRS’s claim for excise tax due to underfunding was not entitled to the administrative priority sought by the IRS. Id. at 668. In fact, the court subordinated the claim to those of general unsecured creditors. Id.

When the debtor in Airlift filed for protection under Chapter 11 of the Bankruptcy Code on June 4, 1981, it maintained two pension plans pursuant to a collective bargaining agreement. Id. at 666. The court subsequently appointed a trustee, and on June 15, 1984, the bankruptcy estate’s trustee sought court approval for rejection of the collective bargaining agreements and its obligations under the pension plans. Id. The PBGC approved the rejections. Id. The PBGC sought administrative priority for its claims, including unpaid contributions under
3. Reversion of residual assets to plan sponsors

On occasion, a bankrupt employer’s pension plan will have assets greater than those needed to fund benefit liabilities. In such cases, a conflict will develop between plan participants and the debtor’s creditors for entitlement to excess plan assets. Qualified plans are, essentially, irrevocable trusts for the exclusive benefit of employees of the plan sponsor. Consequently, the plan sponsor, and by extension its creditors, have no interest in the assets of the trust. In a defined benefit plan, it is possible for the plan sponsor to recover some of the trust assets after the plan has been terminated and all liabilities to plan participants have been satisfied. The court rejected these claims on the grounds that rejection of the collective bargaining agreement relegated any post-petition funding obligations to pre-petition status and that any such obligation was not essential to preserving the estate. The reasoning in this case was apparently similar to that employed in In re The Bastian Co., 45 Bankr. 717 (Bankr. W.D.N.Y.), aff’d, No. 85-241T, (W.D.N.Y. Oct. 21, 1985), on rehg., 66 Bankr. 92 (Bankr. W.D.N.Y. 1986), discussed above in connection with whether ERISA’s termination provisions are exclusive in the bankruptcy context. See supra notes 83-115 and accompanying text.

The question confronted by the court in Airlift was whether a subsequent claim by the IRS for excise tax and interest was entitled to administrative priority. 97 Bankr. at 667. The court rejected this classification for three reasons. First, the rejection of the collective bargaining agreement and its pension plans was seen as terminating the plans prior to the filing of the petition. As discussed in connection with Bastian, this argument may not be valid under the current Bankruptcy Code. See supra notes 85-107 and accompanying text. Second, the court found that the claim was not incurred post-petition. Airlift, 97 Bankr. at 667. As discussed above, this analysis should dispense with most claims for administrative priority. Finally, the court found that the IRS’s excise tax was not a tax under the Bankruptcy Code because it was punitive in nature. The court determined that the claims should be subordinated to the claims of general unsecured creditors because it would be unfair to have innocent creditors pay for the wrongdoing of the debtor. This last reason is valid notwithstanding changes in the bankruptcy law regarding rejection of collective bargaining agreements. The court’s reasoning on this point carries great normative force, especially with regard to the innocent creditors. If this reasoning is adopted by other courts, then the IRS’s excise tax will have little weight in bankruptcy.

Based on similar reasoning, and citing to Airlift, the bankruptcy court, in In re C-T of Virginia, Inc., 128 Bankr. 628 (Bankr. W.D. Va. 1991), found that the 10 percent tax on terminated pension plan assets reverting to an employer were punitive and were not entitled to priority status.

A contrary view, upholding the seventh level of excise taxes, was upheld recently by the Sixth Circuit. U.S. v. Mansfield Tire & Rubber Co., No. 90-4103 (6th Cir. August 28, 1991); see also Tax Decisions and Rulings (BNA), No. 90-4103, at K-I (Sept. 5, 1991). The Sixth Circuit found that the IRS excise tax for failure to meet minimum funding requirements is not a penalty, but instead is a tax entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code. Id.

There were 1,600 terminations of defined benefit plans with $1 million or more in excess assets between 1980 and 1987. See TRENDS, supra note 1, at 208. Of these terminations, only one percent of plan sponsors gave bankruptcy as the reason for termination. Id. See I.R.C. § 401(a) (1983).

tors may, therefore, seek to have the surplus assets of a defined benefit plan revert to the plan sponsor. In one case, a creditor even sought to have a debtor grant a security interest in residual assets prior to the debtor either filing a petition for bankruptcy or terminating the plan.470

The statutory guidelines for a reversion of surplus assets, found in ERISA,471 provide that after the assets of a plan attributable to employee contributions are distributed, any residual assets may revert to the plan sponsor if three conditions are met: (1) all liabilities of the plan to participants and their beneficiaries have been satisfied;472 (2) the distribution does not contravene any provision of law;473 and (3) the plan provides for a reversion in these circumstances and has so provided for at least five years.474

Much debate has arisen concerning the third requirement that the plan provide for reversions. Controversy exists because many plans contain language which mirrors the exclusive benefit requirement of ERISA and the IRC, that a plan’s assets are meant for the exclusive benefit of plan participants, not plan sponsors.476 Plan participants can point to this language in the plan document and argue that it forbids reversion to the sponsor. Courts that have grappled with this issue have generally concluded that in a defined benefit plan, language which mirrors the exclusive benefit provision of ERISA is not sufficient to prevent reversion; and thus it is possible even when such language is present to obtain a distribution to creditors from excess plan assets.477 Moreover, even where a pension agreement does not address the reversion question, reversion may be proper if permitted under the terms of the trust agreement.477

The third requirement for reversions was enforced by the Sixth Circuit Court of Appeals in Bryant v. International Fruit Product.478 In Bryant, the court rejected an attempt by an employer to recapture surplus assets because it found language in the plan which it construed as an unequivocal prohibition against the recapture of

477. See Schuck v. Gilmore Steel Corp., 784 F.2d 947 (9th Cir. 1986).
478. 793 F.2d 118 (6th Cir. 1986).
The plan contained two pertinent provisions: one provided that "[i]n no event and under no circumstances shall any contributions to this Trust by the Employer, nor any of the Trust Estate or the income therefrom, revert to or be repaid to the employer;" the other provision reserved to the employer the right to amend the plan, but provided that "no such amendment shall cause or permit any part of the Trust Estate to revert to or be repaid to the Employer or be diverted to any purpose other than the exclusive benefit of the participants or their beneficiaries or estates. . . ." The court rejected the employer's argument that these provisions were standard pension language required by the IRS. The court also distinguished cases allowing reversion under plans with similar language on the ground that none of those plans assured employees that once contributed, no money paid into the funds could ever be reclaimed by the company.

Tensions over the reversion question in a bankruptcy are analyzed in the Third Circuit decision in Chait v. Bernstein. In Chait, the sponsor of an overfunded defined benefit plan was in liquidation. The company's receiver amended the plan to provide for reversion to the company of all assets remaining after all vested benefits had been paid. The surplus assets totaled approximately $500,000. After making this amendment, the receiver filed a notice of termination with the PBGC. Arnold Chait, the former chairman of the board and chief executive officer, who stood to collect approximately half of the surplus if it was distributed to plan participants, sued to prevent the company from recapturing the surplus. The court determined that the reversion was proper. The court determined that the plan language regarding exclusive benefit of the plan was close enough to the ERISA and IRS requirements.

479. Id. at 122-23.
480. Id. at 120.
481. Id.
482. Id. at 122.
483. Id. at 122-23.
484. 835 F.2d 1017 (3d Cir. 1988).
485. Id. at 1019.
486. Id.
487. Id.
488. Id.; see also supra, note 82 and accompanying text (discussing that the court determined that a freeze on accrual of benefits did not constitute a termination even though it may have constituted a partial termination under the I.R.C. and that the receiver was thus free to amend the plan after freezing benefits).
489. Chiat, 835 F.2d at 1019.
490. Id. at 1023.
that it did not serve to prevent a reversion.\textsuperscript{491}

Each party argued that retention of the surplus by the other would constitute an unwarranted windfall.\textsuperscript{492} In determining that it was appropriate to allow reversion of the surplus to the company, the court found that it was more fair to grant the reversion to the company (and in turn, to its creditors) than to employees who received full payments under the plan:

[I]t strikes us as relevant that Ambassador is presently in receivership, and any “windfall” it receives will eventually go to good faith creditors, who as the record indicates, will only receive pennies on the dollar. Without speculating as to Chait’s personal responsibility for Ambassador’s fiscal state, fairness dictates awarding any surplus to the unpaid creditors rather than to Chait and the other vested employees, all of whom received payments in accordance with the provisions of the plan.\textsuperscript{493}

This logic would favor reversion in most bankruptcies.\textsuperscript{494}

4. Restoration of plans

ERISA provides for the restoration of a previously terminated plan\textsuperscript{495} by entrusting the PBGC with broad discretion to restore plans based on “circumstances as the [PBGC] determines to be relevant.”\textsuperscript{496} This grant of power has been interpreted as giving the

\textsuperscript{491} See id. (stating that “[t]he language of the [plan] does not, therefore, represent a unique expression of its designers’ desire to mandate that every penny, even amounts in excess of accrued benefits, must revert to employees. Rather the Plan merely rescribes [sic] the standard language of ERISA.”).

\textsuperscript{492} Id. at 1026.

\textsuperscript{493} Id. at 1027.

\textsuperscript{494} See supra note 82 and accompanying text.


\textsuperscript{496} Id. This section provides:

Whenever the corporation [PBGC] determines that a plan which is to be terminated under section 1341 or 1342 of this title, or which is in the process of being terminated under section 1341 or 1342 of this title, under this subtitle should not be terminated under section 1341 or 1342 of this title as a result of such circumstances as the corporation determines to be relevant, the corporation is authorized to cease any activities undertaken to terminate the plan, and to take whatever action is necessary and within its power to restore the plan to its status prior to the determination that the plan was to be terminated under section 1341 or 1342 of this title. In the case of a plan which has been terminated under section 1341 or 1342 of this title the corporation is authorized in any such case in which the corporation determines such action to be appropriate and consistent with its duties under this subchapter, to take such action as may be necessary to restore the plan to its pretermination status, including, but not limited to, the transfer to the employer or a plan administrator of control of part or all of the remaining assets and liabilities of the plan.
PBGC authority to restore a plan to its pre-termination status "thereby converting the PBGC's claim for minimum funding contributions and for termination liability back to contingent claims against [the debtor] and reinstating [the debtor's] ongoing statutory obligations as a sponsor of qualified plans under ERISA." However, restoration of a plan by the PBGC may not be enough to bring a plan into active status by itself. The most publicized source of litigation concerning the PBGC's power to restore a plan has arisen in the LTV reorganization. LTV maintained many pension benefit plans for its employees, including three plans which the PBGC sought to restore. In 1985, LTV sought a waiver of its minimum funding requirement from the IRS for the 1984 plan year. This request was granted. In 1986, LTV sought another waiver. The 1986 request was denied and the IRS revoked LTV's waiver of its 1984 obligation.

On July 17, 1986, LTV Corporation and most of its subsidiaries filed for reorganization under Chapter 11 of the Bankruptcy Code. On December 16, 1986, LTV sent a letter to the PBGC stating that it could not and would not make contributions to eliminate accumulated funding deficiencies and that it did not expect to have funds available for future years.

On January 12, 1987, the PBGC brought an action seeking to involuntarily terminate the LTV plans. LTV agreed to the terminations.

The union representing LTV's non-management employees brought suit in the United States Bankruptcy Court for the Southern District of New York, alleging that the company's failure to make the contributions promised under the plans amounted to a breach of the collective bargaining agreements and a violation of section 1113 of the Bankruptcy Code, which provides a detailed procedure for the

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Id.
498. See id. (determining that restoration will not result in requiring immediate involuntary payments from a debtor's assets because such payments require a separate action by the Department of Labor).
499. Id. at 784.
500. Id. at 786.
501. Id.
502. Id.
503. Id.
504. Id. at 788.
505. Id.
rejection of collective bargaining agreements.⁵⁰⁶

The debtor obtained approval from the bankruptcy court to make a single hardship payment to each retiree.⁵⁰⁷ Fearing a strike by the union, the company and the union entered into negotiations that resulted in a 1987 collective bargaining agreement to remain in effect until a plan of reorganization was confirmed.⁵⁰⁸ Under the 1987 collective bargaining agreement, some of the benefits that employees had under the previous collective bargaining agreement were reinstated with modifications and several new programs were instituted.⁵⁰⁹

The PBGC argued that the plans provided by the 1987 agreement were “follow-on” plans which merely continued the earlier plans and allowed LTV to provide benefits that were not being paid for by the PBGC (either because the benefits in question were not nonforfeitable or they were in excess of PBGC maximum payment levels).⁵¹⁰ Nonetheless, the bankruptcy court approved the 1987 agreement.⁵¹¹

On September 22, 1987, based on the recommendation of a committee established to advise the PBGC, the executive director of the PBGC issued a Notice of Restoration stating that under section 4047 of ERISA, it was appropriate for the PBGC to restore full liability for the plans to LTV and that restoration would be effective as of January 13, 1987.⁵¹² LTV refused to comply with the Notice of Restoration and the PBGC brought an action for enforcement in the United States District Court for the Southern District of New York.⁵¹³ The district court ruled that the PBGC’s decisions were not based on the record and its conclusion had been reached in an arbitrary and capricious manner.⁵¹⁴ Thus, the Notice of Restoration was vacated and the matter was remanded to the PBGC.

In the district court proceeding, LTV argued that the PBGC’s efforts to restore a previously terminated plan violated the Bankruptcy Code’s automatic stay provision.⁵¹⁶ The district court determined that the automatic stay was not violated, however, for several

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⁵⁰⁷. In re Chateaugay Corp., 87 Bankr. at 789.
⁵⁰⁸. Id.
⁵⁰⁹. Id. at 780-90.
⁵¹⁰. Id. at 790.
⁵¹¹. Id.
⁵¹². Id. at 792.
⁵¹³. Id.
⁵¹⁴. Id. at 810.
⁵¹⁵. Id. at 793.
reasons. In the first place, although the court found that restoration of the plan would impose an obligation to observe the minimum funding obligations for the period during which the plan had been terminated (as well as a continuing obligation to make future contributions), it also found that whether the debtor would be required to make these contributions would not be determined by restoration, but instead would be determined by enforcement actions which the Department of Labor would have to institute. Therefore, the court found that restoring the plans to their pre-termination status would not result in any direct payments to the PBGC or to the plans and, therefore, did not result in a violation of the Bankruptcy Code’s automatic stay provisions.

The district court also found that restoration would not constitute control of the debtor’s property, which is also prohibited by the automatic stay. The court found that the purpose of this provision of the automatic stay was to protect the debtor’s estate from direct action taken by creditors of the estate. The court found that restoration did not constitute proscribed action because it merely reimposed obligations to provide benefits and did not transfer or exercise control over the debtor’s property.

The district court rejected LTV’s argument that restoration was an effort by the PBGC to collect more on its plan by restoring the plan and making it subject to the tougher provisions contained in the PPA which were instituted during the interim period between the original termination and the time when restoration was sought. LTV argued that if the plans were restored, and later terminated subject to the PPA, then the PBGC’s claim for termination liability would be increased by $800 million upon re-termination. The PBGC did not dispute this estimate. The court found that the automatic stay did not apply to speculation about recovery on such an “attenuated future liability.”

Upon review, the United States Court of Appeals for the Second Circuit upheld the district court’s decision. The Second Cir-

516. Id. at 799.
517. Id. at 800.
518. Id. at 800-01.
520. In re Chateaugay Corp., 87 Bankr. at 801.
521. Id.
522. Id. at 802.
523. Id.
524. Id.
525. In re Chateaugay Corp., 875 F.2d 1008 (2d Cir. 1989), rev’d on other grounds sub
cuit was more convinced that restoration was exempt under a public health and welfare exemption to the automatic stay, rather than not being subject to the automatic stay.\textsuperscript{526}

Although the district court and the Second Circuit agreed that the PBGC's efforts to restore the plans did not violate the automatic stay, both found that the PBGC's efforts were inappropriate. The Second Circuit determined that the PBGC overemphasized ERISA and failed to consider the other federal statutes involved, namely bankruptcy and labor law.\textsuperscript{527} The court also ruled that the PBGC's decision was not supported by the record.\textsuperscript{528}

The Second Circuit concluded that the PBGC was not entitled to base its restoration decision on the establishment of a follow-on plan. Rather, the court found that although an improvement in financial circumstances was meant to be a basis for restoring plans, there was no indication that follow-on plans were impermissible.\textsuperscript{529} The Second Circuit also found that the PBGC failed to support its conclusion that the 1987 plans were merely continuations of the old plans and the record reflected that the plans were not identical.\textsuperscript{530} Further, the court determined, the PBGC's conclusion that LTV's financial condition had improved was based on an erroneous analysis and unfounded assumptions.\textsuperscript{531} Further, the court noted that the PBGC focused inordinately on short-term factors and did not give enough weight to the long-term ability of LTV to fund the plans.\textsuperscript{532}

Finally, the Second Circuit found that the PBGC's procedure was defective and resulted in making the decision arbitrary and capricious. Specifically, the PBGC failed: to apprise LTV of the material on which it would base its decision; to give LTV an adequate opportunity to offer contrary evidence; to proceed in accordance with ascertainable standards to evaluate when a plan sponsor's financial condition had improved sufficiently to warrant restoration; and to provide a statement showing its reasoning in applying these

\textsuperscript{nom. Pension Benefit Guar. Corp. v. LTV Corp., ___ U.S. ___, 110 S. Ct. 2668 (1990).}

\textsuperscript{526. Id. at 1020 (ruling that even if its determinations regarding the automatic stay's applicability were wrong and restoration could be deemed a violation under the automatic stay, then restoration could be seen as being exempt from the automatic stay under a provision of the Bankruptcy Code which exempts police or regulatory actions taken to protect the public health and welfare from the automatic stay).}

\textsuperscript{527. Id. at 1016.}

\textsuperscript{528. Id.}

\textsuperscript{529. Id. at 1017.}

\textsuperscript{530. Id.}

\textsuperscript{531. Id. at 1018-19.}

\textsuperscript{532. Id. at 1020.}
standards.\textsuperscript{533}

In \textit{Pension Benefit Guaranty Corp. v. LTV Corp.},\textsuperscript{534} the U.S. Supreme Court reversed the Second Circuit Court of Appeals' finding that the PBGC's decision to restore LTV's plans was not arbitrary or capricious or contrary to law under the Administrative Procedures Act.\textsuperscript{535} The Court based its decision on three grounds.\textsuperscript{536}

First, the Court disagreed with the Second Circuit's finding that the PBGC's decision was arbitrary and capricious because the PBGC did not take account of bankruptcy and labor law.\textsuperscript{537} The Supreme Court gave three reasons for reversing this finding.\textsuperscript{538} Initially, the Court found that the express language of ERISA authorized the PBGC to restore plans when the PBGC found such action to be "appropriate and consistent" with the PBGC's duties under Title IV of ERISA.\textsuperscript{539} The Court found that given this broad mandate, the PBGC not only did not, but also could not, focus "inordinately" on ERISA.\textsuperscript{540} Second, even if this explicit language had not existed, under general principles of agency law, the Second Circuit's decision was problematic because there were numerous federal statutes with "countless policies" and permitting challenges based on these statutes would subject many agencies' decisions to judicial invalidation.\textsuperscript{541} Third, the Court found that the Second Circuit's approach was misguided because the PBGC had no expertise in labor and bankruptcy law.\textsuperscript{542}

The Court's second ground for reversal was its rejection of the Second Circuit's conclusion that the PBGC's reliance on follow-on plans as a basis for restoring the LTV plans was contrary to ERISA.\textsuperscript{543} The Supreme Court found that basing restoration decisions on the existence of follow-on plans was not contrary to Congress' intent and it was a permissible construction of ERISA.\textsuperscript{544} The Court rejected LTV's argument that restoration should be based only on a company's improved financial situation and that the exis-

\textsuperscript{533} Id. at 1021.
\textsuperscript{534} ___ U.S. ___, 110 S. Ct. 2668 (1990).
\textsuperscript{535} Id. at ___, 110 S. Ct. at 2681.
\textsuperscript{536} Id. at ___, 110 S. Ct. at 261.
\textsuperscript{537} Id. at ___, 110 S. Ct. at 2675.
\textsuperscript{538} Id. at ___, 110 S. Ct. at 2675-76.
\textsuperscript{539} Id. at ___, 110 S. Ct. at 2675.
\textsuperscript{540} Id. at ___, 110 S. Ct. at 2676.
\textsuperscript{541} Id. at ___, 110 S. Ct. at 2676.
\textsuperscript{542} Id. at ___, 110 S. Ct. at 2676.
\textsuperscript{543} Id. ___, 110 S. Ct. at 2676.
\textsuperscript{544} Id. at ___, 110 S. Ct. at 2677-78.
tence of follow-on plans was irrelevant to the restoration decision.\textsuperscript{545} The Court found that the PBGC's follow-on policy was "eminently reasonable" because employees would object to a plan termination more strenuously if the employer could not institute a follow-on plan.\textsuperscript{546} Thus, if a follow-on plan was available, employee resistance to termination would be reduced and ERISA's objective of having employers continue and maintain pension plans would be frustrated.\textsuperscript{547} The Court stopped short of stating that the sponsor's financial condition was never relevant:

None of this is to say that financial improvement will never be relevant to a restoration decision. Indeed, if an employer's financial situation remains so dire that restoration would lead inevitably to immediate re-termination, the PBGC may decide not to restore a terminated plan even where the employer has instituted a follow-on plan.\textsuperscript{548}

The Supreme Court did not address the Second Circuit's finding that the PBGC's methodology with regard to the sponsor's financial condition was flawed because the Court found that the PBGC's anti-follow-on policy constituted an independent ground for the restoration decision.\textsuperscript{549} As discussed below, this finding was challenged in the dissenting portion of Justices White's and O'Connor's separate partial concurrence and dissent.\textsuperscript{550}

The third, and final, portion of the majority opinion addressed the Second Circuit's finding that the PBGC's restoration was arbitrary and capricious because the PBGC did not apprise LTV of the material on which it based its decision and by not offering LTV the opportunity to offer contrary evidence.\textsuperscript{551} The Court found that the LTV argument in this connection was improperly based on authority addressing whether an agency's decision was sufficient for judicial review, but did not address the PBGC's authority toward LTV.\textsuperscript{552} Further, the Court found that the PBGC had not violated the Administrative Procedure Act's requirements regarding informal adjudication.\textsuperscript{553}

\textsuperscript{545} Id. at \textenquote{110 S. Ct. at 2678.\textsuperscript{564}}
\textsuperscript{546} Id. at \textenquote{110 S. Ct. at 2678.\textsuperscript{564}}
\textsuperscript{547} Id. at \textenquote{110 S. Ct. at 2678.\textsuperscript{564}}
\textsuperscript{548} Id. at \textenquote{110 S. Ct. at 2679.\textsuperscript{564}}
\textsuperscript{549} Id. at \textenquote{110 S. Ct. at 2679 n.11.\textsuperscript{564}}
\textsuperscript{550} Id. at \textenquote{110 S. Ct. at 2681 (White and O'Connor, JJ., concurring in part, dissenting in part).\textsuperscript{564}}
\textsuperscript{551} Id. at \textenquote{110 S. Ct. at 2679.\textsuperscript{564}}
\textsuperscript{552} Id. at \textenquote{110 S. Ct. at 2680-81.\textsuperscript{564}}
\textsuperscript{553} Id. at \textenquote{110 S. Ct. at 2680-81.\textsuperscript{564}}
Justices White and O'Connor concurred in part and dissented in part. They agreed with the majority that the PBGC's anti-follow-on policy was not contrary to ERISA and that the PBGC would not have been prohibited from relying on it as a basis for restoration. However, they found that the PBGC had not, in fact, relied on the follow-on plan and LTV's presumed improved financial condition of LTV as separate and independent grounds. Based on this, Justices White and O'Connor suggested that the case be remanded to have the PBGC consider whether the follow-on plan by itself provided sufficient grounds for restoration.

Justice Stevens dissented on the grounds that no restoration should take place unless a company's financial condition has improved sufficiently to warrant restoration. Justice Stevens found that so long as a company was making its best effort to complete its reorganization, it should be allowed to use the additional capital, gained by having its plan terminated, for whatever purpose it chose, be it capital improvements or current salaries or pension benefits.

Justice Stevens found that the majority's rationale for supporting the PBGC's anti-follow-on policy — to preserve the strenuous objections of employees to proposed plan terminations — did not apply in the case of an involuntary termination. The involuntary termination would take place because the PBGC determined that it was necessary and employees would have the same incentive to object to plan termination with or without the availability of follow-on plans, because even if such plans were available, they would only take place where a union, perhaps years later, insisted upon them.

In assessing the impact of the Supreme Court's decision, it should be noted that all three opinions recognize, to one degree or another, that the financial condition of the plan sponsor is relevant to the question of plan restoration. This qualification to the view that follow-on plans are inherently abusive has practical ramifications as plan sponsors seeking to avoid restoration will likely argue that re-termination is imminent. Of course, one must ask what is to be accomplished by allowing restoration of a plan whose re-termination,

554. Id. at ___, 110 S. Ct. at 2681 (White and O'Connor, JJ., concurring in part, dissenting in part).
555. Id. at ___, 110 S. Ct. at 2681.
556. Id. at ___, 110 S. Ct. at 2681.
557. Id. at ___, 110 S. Ct. at 2681.
558. Id. at ___, 110 S. Ct. at 2682 (Stevens, J., dissenting).
559. Id. at ___, 110 S. Ct. at 2682.
560. Id. at ___, 110 S. Ct. at 2682.
561. Id. at ___, 110 S. Ct. at 2682-83.
although not "imminent," will take place in nine months or one year in order for the plan sponsor to proceed with its reorganization. In the case of LTV, whose original termination came before the ERISA amendments which increased employer's potential liability to the PBGC, the answer is clear. Even if the restoration fails to take hold, LTV will owe more to the PBGC after a future re-termination.\footnote{562} Moreover, even if the re-termination takes place, the PBGC will most probably seek to assert a first priority administrative expense under Section 503(b) of the Bankruptcy Code.\footnote{563} Thus, by having the plan restored, the PBGC is poised to move up on the priority list over other creditors.

The justification for the PBGC's anti-follow-on policy, that the pressure employees will presumably bring to bear to a plan's termination, warrants some analysis. The converse of this argument is that if follow-on plans are permitted, employees would not object to plan terminations as vigorously because they would obtain the same benefits through a combination of guaranteed benefits and the benefits offered through a follow-on plan. But this line of reasoning begs several questions. First, under the current regime, terminations are permitted in only very limited circumstances. If the employer is able to meet its full pension obligations and applies for a standard termination, then the employees would not be receiving PBGC funds and the PBGC would have no basis to object if a different plan was instituted. In the other circumstances under which a termination is possible, the employer's financial distress is the issue and prolonging a plan based upon employee objections may not be in anyone's interest if it leads to a larger shortfall in the future. Indeed, the effect of the Supreme Court's ruling is to place the full burden for a sponsor's problems on the employees. The same outcome of not allowing supplementation to guaranteed benefits applies whether the employees protest vocally and meet the deaf ears of the sponsor or whether they make no protest at all. This is an odd result given that the employer is under no obligation to heed the complaints of its employees before terminating a plan.

Moreover, there is nothing to suggest that employee objections to a plan's termination have any impact. If they do not, then the unavailability of follow-on plans serves to cement the employees in a worse-off economic condition post-termination because they receive less benefits than they were promised and the employer cannot make

\footnote{562} See Lutgens, supra note 12, at 36 n.64.\footnote{563} See id. at 37.
up the difference unless it can pay for the entire terminated plan. Thus, under the current regime, the employer is confronted with a choice: allow the employees to receive only guaranteed benefits or pay all plan benefits. This choice does not provide for employers who can only pay the difference between guaranteed and promised benefits during their reorganizations.

The battle over restoring LTV’s plans illustrates the tensions between federal bankruptcy, labor, and ERISA policies described at the beginning of this article. The genesis of the dispute in *LTV* is the gap between promised benefits under the plan and benefits guaranteed by the PBGC. LTV contended that it was forced to offer the benefits that were not guaranteed by the PBGC because these benefits were contained in a collective bargaining agreement and if the company did not comply then the union would have gone on a crippling strike that would have forced a liquidation. Thus, in the interests of labor peace and continuing in business, LTV restored many of the benefits that were not paid by the PBGC.

On the other hand, the PBGC viewed follow-on plans as inherently abusive because they allow employers to offer a level of benefits that is subsidized by the PBGC.

The PBGC’s view of follow-on plans as inherently abusive is both anachronistic and unfounded in the bankruptcy context. Prior to the enactment of the PPA, the PBGC could only collect a maximum of thirty percent of an employer’s net worth as termination liability. Under this system, a solvent employer could conceivably

566. *See Crenshaw, Picking up the Tab for Pension Plans*, The Wash. Post, Feb. 25, 1990, at H1. At oral argument, Supreme Court Justices Rehnquist and Scalia inquired into this aspect of the arrangement. *See Justices Question LTV’s Motives in PBGC Dispute*, Bus. Ins., Mar. 5, 1990, at 3. Chief Justice Rehnquist asked whether LTV was attempting to “fob off” its unfunded liabilities on the PBGC. *Id.* Associate Justice Scalia stated: “It would seem very strange indeed for the federal government to allow your company to compete with others . . . and have taxpayers fund it.” *Id.* The concern over using PBGC funds was also expressed by steel companies that compete with LTV’s subsidiaries who filed an amicus brief contending that LTV obtained an unfair competitive advantage by having lower labor costs while still providing the same benefits. *See Frantz, Workers with Best Benefits Stand to Lose Most*, L.A. Times, Nov. 13, 1989, at 15, col. 2. The PBGC expressed its concern that if the LTV plan was not restored then other employers would follow LTV’s example and terminate underfunding plans, shifting liabilities to the PBGC, then establishing low cost plans to cover benefits not guaranteed by the PBGC. *Id.* According to the PBGC this would cost the PBGC a great deal of money and would be inconsistent with ERISA’s purpose of encouraging pension funding and discouraging terminations. *Id.*

567. *See Lutgens, supra note 12, at 36 n. 67.*
terminate its plan and devise a follow-on plan that, in combination with guaranteed benefits, would pay the full level of benefits promised under the original plan while saving the employer money. It was while this scenario was still possible that the PBGC developed its opposition to follow-on plans. Under current law, however, there is no limit to an employer's termination liability; thus, an employer may have no incentive to terminate an underfunded plan to save money.

Moreover, pursuant to the current scheme, discretionary terminations are highly restricted. As discussed above, unless employers can pay all liabilities, plans can only be terminated in a "distress termination" under a limited number of circumstances. An employer liquidating in bankruptcy will qualify for a distress termination but obviously will not be able to create a follow-on plan. A reorganizing employer can terminate its plan only if the termination is necessary to the success of the reorganization. On the other hand, an employer that does terminate during a reorganization may face the same incentives that confronted LTV: to fund a follow-on plan or face extreme labor strife over the loss of non-guaranteed benefits by its employees. This type of follow-on plan is done to stay in business, rather than to abuse the PBGC.

Furthermore, much of the difficulty confronting the PBGC in LTV was the $2.2 billion in underfunding liability. However, the PBGC is not blameless in the accumulation of this amount because the PBGC could have terminated the plans earlier. The central flaw with the PBGC's position is the linking of restoration to the establishment of a follow-on plan. One event should not necessarily follow from the other. Although the establishment of a follow-on plan may reflect an improvement in the employer's financial condition, it does not mean that the employer is in a position to resume funding the entire prior plan.

568. See Shinevar, After the Plan is Over . . . Post-termination Plans for Pension Plans, in A.B.A. THIRD ANN. EMPLOYEE BENEFITS IN BANKR. AND LENDING TRANS. NAT'L INSTITUTE HANDBOOK 453, 461 (1989). Shinevar notes that even under the 30% of net worth limit, abusive follow-on plans did not develop as the phenomena feared by the PBGC. Id. at 461-62.


570. In this connection, the Chairman and Chief Executive Officer is correct when he characterizes the PBGC's position as follows:
The agency then seized the pension fund, valued at $1.5 billion, in January 1987. It has been using the fund to pay reduced benefits to LTV's employees and retirees. When the fund runs out of money the agency at that point will assume payments from its own assets. That would have been O.K. for LTV, except the pension agency will not pay certain benefits and will not allow LTV to pay them either. For example, workers employed with LTV for a number of years, and forced, in effect, to
Financial ability to pay benefits is a better criterion for restoration because it borders on nonsensical to reimpose a financial burden on an employer that cannot pay it. Further, this standard would weed out the employers who were merely trying to shift the burden to the PBGC. One potential problem with such a plan would be the possibility of an employer who promises more than it can possibly pay with the intent of pushing the burden onto the PBGC. As discussed earlier, however, such a development is dealt with by present statutory safeguards denying effect to recent plan amendments.

While ERISA does provide for restoration of plans, the basis for that restoration must be consistent with the goals of ERISA. It is inconsistent with the goals of ERISA to restore a plan under conditions not conducive to the plan's continued viability. Thus, before a plan may be restored, the PBGC should be required to make a showing that the employer can meet its funding obligations. Establishing a follow-on plan may demonstrate some degree of financial recovery, but it is not the equivalent of being able to fund the plan. Furthermore, in the context of a reorganization, the restoration of a plan that may threaten the viability of the company's reorganization borders on a reckless gesture by the PBGC.

It should also be noted that the Supreme Court's decision did not quite end the LTV dispute. After the Supreme Court decision, the PBGC moved for an order granting its 1987 summary judgment to enforce its restoration notice. LTV opposed this motion, arguing that the financial condition of one of the plans had so deteriorated during litigation over restoration that the PBGC should retain the plans pursuant to ERISA Section 4042(a)(2). On December 4, 1990, the United States District Court for the Southern District of New York rejected this argument and ordered restoration of the plans. LTV and the PBGC have reached a tentative settlement of
their dispute which must be approved by the bankruptcy court and LTV's other creditors. 576

V. A PROPOSED RAPPROCHEMENT BETWEEN PLAN PARTICIPANTS AND THE PBGC

While all creditors in a Chapter 11 reorganization face the burden of ending up with less than they originally claimed, this burden is especially difficult for former employees because workers cannot diversify their human capital as well as other creditors can diversify the sale of their goods and services. While other creditors may have extended credit to several debtors, employees can only work for only a limited number of employers long enough to obtain pension benefits. While other creditors may absorb or write off a loss, employees, particularly those that have retired or are close to retirement, cannot simply start over with a new employer. 576

Another unique aspect of pensions that must be considered is that they are often used as a form of deferred wage compensation. Under this view, employees may trade off higher wages today in ex-

575. LTV and the PBGC have reached a tentative settlement regarding LTV's pension liabilities. See LTV Corp. Reaches Agreement With PBGC That Includes $950 Million Initial Payments, 9 Employee Relations Weekly July, 22, 1991, at 790. Under the agreement, LTV, which has about $3.1 billion in unfunded liabilities, is to make a $950 million-dollar initial cash payment into the underfunded plans at the time the reorganization plan is approved. Id. LTV will then make fixed annual payments of $50 million until the plans are fully funded. Id. The settlement must be approved by the bankruptcy court and LTV's other creditors. Id.; LTV Reaches Agreement With PBGC Including $950 Million Initial Payment, 18 Pens. Rep. (BNA), July 22, 1991, No. 29, at 1239; LTV Reaches Pension Accord, L.A. Times, July 17, 1991 at D2, col. 1; Harlan and Ansberry, LTV Sets Preliminary Pact With U.S. Pension Insurer, Wall St. J., February 26, 1991 at A3, col. 1. Negotiations between the PBGC and LTV's other creditors have been rocky and on August 12, 1991, the PBGC ordered LTV to make funding contributions to its three restored plans. The Department of Labor brought suit in the U.S. District Court for the Southern District of New York to enforce the PBGC's order. See Bankruptcy Judge Criticizes PBGC For Ordering LTV To Make Contributions, 18 Pens. Rep. (BNA), Aug. 19, 1991, No. 33, at 1503.

576. See, e.g., Fischel, Labor Markets and Labor Law Compared with Capital Markets and Corporate Law, 51 Chi. L. Rev. 1061 (1984): "The three most important differences [between capital and labor markets] are that capital markets are closer to the ideal of perfect competition than labor markets; that possibilities of firm-specific investments exist in labor markets that do not exist in capital markets; and that participants in labor markets have less ability to diversify risk." Id. at 1065 (emphasis added); Posner, Some Economics of Labor Law, 51 Chi. L. Rev. 998, 1006-1007 (1984) (stating that "[y]ounger workers are more mobile than older ones. The older ones are more likely to have family obligations that make it difficult to relocate geographically, and their human capital may have become specialized to the particular job they are doing for their employer (assuming that the older worker on average, has worked longer for this employer than has the younger worker). . . . Being less mobile, the older workers are more at the mercy of the employer. . . .") See also, P. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW, 134-52 (1990) (arguing that there are "fundamental differences" between labor and commodity markets).
change for the expectation/promise of pension benefits in the future.577 Terminating plans and restricting benefits threaten to violate this implied agreement.

Under the current system, the losses suffered by participants of a terminated plan are the difference between what they would have received under the plan and the amount of benefits received from the PBGC.578 This fact takes on added significance when pensions are viewed as a form of deferred compensation.

Another aspect of the pensions conundrum is the underfunding of plans that must be made up by the PBGC. This underfunding is the source of the PBGC's debt. Bankruptcy compounds the problem because it reduces the greatest portion of this debt to general unsecured status. In light of the savings and loan bailout, it would not take great imagination to envision a public bailout of the pension plan deficit by shifting the burden to taxpayers.

One method to reduce this deficit would be to increase premium rates that plans must pay to the PBGC. Such an increase was made by the PPA.579 Another increase, however, could backfire to the extent that it might lead healthy plans to terminate and drop out of the system rather than paying increased fees. This approach could accelerate the trend away from defined benefit plans that has already been blamed on too much regulation. On the other hand, if plan sponsors can simply terminate or threaten to terminate plans to keep premiums below the level necessary to pay for their self-insurance system, it will continue to lead to the inefficient externalization of their costs. Such a view may support rethinking the entire framework for termination insurance.

Another solution within the current framework would be to refocus scrutiny on terminating underfunded plans and a heightened scrutiny of funding waiver applications. Funding waivers are particularly pernicious in the bankruptcy context because funds that are not collected are often lost forever as unsecured general claims.


578. The employees also lose employment and the ability to earn higher levels of benefits. For example, to the extent that a plan provides benefits based on the highest level of salary attained, the inability to remain employed and receive a salary raise cannot be made up for by the PBGC.

579. Trends, supra note 1, at 36-37.
It must be recalled that underfunding situations do not appear to the PBGC without warning. Sponsors of ERISA plans are required to file financial reports to keep the federal government apprised of their funding situation. Also, waiver applications must be reported to the PBGC, and a plan whose funding deficiency exceeds one million dollars must report such a deficiency within ten days after payment is due. Moreover, in today’s climate, where sufficient funding has become the rule, the exceptional underfunded plans can be well tracked. Since most pre-petition funding obligations do not have priority, the question that must be asked is whether good money is being thrown after bad by not terminating plans, or at least freezing the accrual of further benefits, when funding is in jeopardy. Since taxpayer dollars may be called upon to deliver the PBGC from its current status, the debate over the termination of marginal plans should be made public. Allowing such plans to continue to accrue additional benefits can only be justified if there is a reasonable expectation that sufficient funding will be achieved in the near future.

One difficulty with the outlined proposals is that history is not on their side. Efforts were made in the PPA to add rationality to employer’s funding obligations by cutting down on sponsor discretion in setting actuarial assumptions and funding levels. Moreover, the PPA made it more difficult to qualify for funding waivers. Yet the


583. While the PBGC generally follows such a policy, the focus must be tightened and extraneous factors must not be considered. The current approach of the PBGC in this connection was recently described as follows: “the general inclination of the PBGC [is] not to terminate plans in situations where the contributing sponsor is attempting in good faith to reorganize in order to avoid the creation of post-termination guaranty liability and for public policy reasons.” See generally Ippolito, The Economic Function of Underfunded Pension Plans, 28 J.L. & Econ. 611 (1985) (arguing that employers deliberately underfund pension plans so that workers will have a stake in maintaining the employer’s viability); Novikoff, supra note 12, at 120. With regard to freezing the accrual of further benefits, this is now a voluntary option accorded plan administrators. Perhaps the PBGC should be given the option of freezing benefit accrual.
PBGC debt hovers near $2 billion with several billion dollars more at risk.

The procedural refinements described above may be inherently flawed if they are implemented under the current termination insurance framework. A systemic irrationality in the current scheme is evidenced by the fact that the interests of the agency whose directive it is to protect pension rights is often at odds with the interests of pension participants. This tension is highlighted by the conflict over setting termination dates and the dispute over whether guaranteed benefits should be the upper limit on the amount participants may receive. This conflict is exacerbated by the fact that the PBGC is running at a deficit and every additional dollar in pensions that accrues by setting a termination date one day later is another dollar added to this deficit. Moreover, setting guaranteed benefits below promised benefits creates an inherent antagonism because when the PBGC sets a termination date that makes benefits non-guaranteed, it is not responsible for paying them.

A more rational solution to the present problem would be to rethink pension termination insurance and broadly expand its scope to have the PBGC pay all benefits promised under a plan, not only the reduced benefits that are currently guaranteed. This approach is feasible under the current statutory scheme because the PBGC is authorized to provide benefits that are not currently guaranteed. To effect this approach, the PBGC would examine the benefits being offered in a plan and set the insurance rate according to the risk of payment the plan posed to the PBGC, rather than the current system of setting premiums based on the number of participants. The PBGC would set its premium by rating the risk presented by each employer and evaluating the liabilities that would accrue under each plan. While this solution increases administrative burdens and expenses, it fosters the ability of employers to internalize the costs of their plans and reduces the conflict between the PBGC and plan participants. The current paradigm, not guaranteeing benefit increases made within five years of termination, serves to prevent employers from puffing benefits before termination and then having the PBGC pay for them. This is a laudable goal that could be incorporated into

584. ERISA § 4022(d), 29 U.S.C. § 1322(d) (1988) (providing that "[t]he corporation is authorized to guarantee the payment of such other classes of benefits and to establish the terms and conditions under which such other classes of benefits are guaranteed as it determines to be appropriate."). However, it would require an amendment of ERISA to eliminate the limit on the amount of benefits that can be received. See ERISA § 4022(b)(3), 29 U.S.C. § 1322(b)(3) (1988).
the proposed solution by providing that any time an employer amended a plan to increase benefits, the new benefits would not be insured for a period of three to five years.

The above proposal represents a plan which could alleviate many of the problems which exist under the current system, because:

1. Participants would not suffer the loss of promised benefits. As noted above, it is difficult if not impossible, for participants to recoup promised benefits which are not guaranteed. Retirees or near retirees are highly vulnerable and unable to make alternate arrangements to compensate for lost income.

2. Plan sponsors would not have as much incentive to switch to uninsured plans to evade ERISA requirements. Since all forms of benefits would be covered by insurance, sponsors would not gain by switching to currently non-covered benefits, thereby diluting the termination insurance base.585

3. Plan sponsors would not have as much incentive to terminate plans to avoid paying unfair levels of insurance. Since plan insurance would be more rationally related to the types of plans offered, safe plans that offered lower levels of benefits would not be paying to cover extensive unsafe plans. Sponsors of unsafe plans would continue to be limited by current restrictions on when terminations are available.

4. Because all benefits would be guaranteed, sponsors of terminated plans would not need to offer follow-on plans to make up for non-guaranteed benefits. The current conflicts between the PBGC, unions, and plan sponsors over follow-on plans would not exist.

5. The current conflict between plan participants and the PBGC would not exist. Since all benefits would be guaranteed, the PBGC would not have an incentive to define benefits as unguaranteed to avoid payment. Therefore, the PBGC's interests would thus be more aligned with the interests of the participants.

6. Forcing plan sponsors to internalize the costs of their plans would result in greater economic efficiency. When parties do not realize all the costs of their actions, a phenomenon known as an externality develops. In such a situation, parties that do not bear the costs of their actions act in economically inefficient manners. A common example of this is the polluter who does not pay for all the costs of its pollution and then pollutes more than it would if forced to pay all such costs. The goal of law should be to have parties recognize and

585. Switching to defined contribution plans, however, would enable employers to continue to avoid minimum funding requirements.
internalize their costs so that they act in a more responsible and efficient manner. Forcing plan sponsors to pay insurance premiums on all of their benefits should cause them to act in a more reasonable manner with regard to the level of benefits they offer.

VI. CONCLUSION

Taken alone, a pension plan termination or a bankruptcy can wreak havoc on concerned parties. However, when a bankrupt or reorganizing employer terminates a pension plan, particularly an underfunded plan, the debtor, its creditors, plan participants and the PBGC are affected.

Even where the debtor follows ERISA’s termination provisions, the vast majority of funding arrearages will not be based on postpetition labor and thus will not achieve priority status. Therefore, funding deficiencies and waivers should be viewed with particular alarm by the PBGC if a corporate bankruptcy seems imminent.

Another problem that emerges in this context deals with the potential conflict of interest between the PBGC and plan participants. As presented above, a solution to this problem would be to restructure the present insurance system to guarantee all pension benefits offered under a plan.

Experience with pension plans in bankruptcy will undoubtedly mute some of the current issues and create unforeseen dilemmas. In the meantime, the immediate crises can be alleviated by not allowing companies to incur underfunding debt that most likely will not be repaid, and by guaranteeing a higher level of benefits to eliminate conflicts of interest between the PBGC and the very individuals the PBGC is supposed to protect.