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Pension Plan Issues in Bankruptcy

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The global economy is currently facing a financial crisis that Alan Greenspan has called “the most wrenching since the end of the Second World War.” In 2007 and 2008, sharp declines in the housing market and hundreds of billions of dollars in mortgage-backed securities have become virtually worthless. Once venerable institutions such as Bear Stearns, Lehman Brothers, and Merrill Lynch failed or were acquired. The government was forced to seize AIG, the United States’ largest insurance company. Finally, domestic automobile and parts manufacturers are suffering through the largest post World War II contraction and the continued survival of many is in doubt. These dramatic events have tightened the credit market and have made it difficult for companies of all sizes to borrow money vital to sustaining their operations.

Many companies have been forced to file for bankruptcy protection. Businesses of all sizes have begun to consider exactly what a bankruptcy filing would entail and whether it is their best option for restructuring their balance sheet or operations. Similarly, employees are questioning the effect that their employer’s bankruptcy will have on their retirement benefits. In many companies considering a

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bankruptcy filing, the liabilities associated with underfunded pension plans may be one of the larger liabilities.

If an employer declares bankruptcy, it will generally take one of two forms: reorganization under Chapter 11 of the Bankruptcy Code, or liquidation under Chapter 7. A Chapter 11 reorganization generally means that the employer continues in business under the bankruptcy court's protection while attempting to reorganize its financial affairs. Confirmation of a Chapter 11 plan generally discharges the employer from any debt that arose prior to the date of confirmation. In a Chapter 7 bankruptcy, the employer liquidates its assets to pay its creditors and ceases to exist. In a Chapter 7 bankruptcy proceeding an employer's pension plans usually will be terminated or assumed by the Pension Benefit Guaranty Corporation (PBGC).

The PBGC is a corporation established within the Department of Labor that is not funded by general tax revenues. The purpose of the PBGC is to ensure that benefits promised under defined benefit pension plans are paid, subject to certain statutory limits, if the plan sponsor is unable to meet its obligations to adequately fund the pension plan. The PBGC's benefit protection program consists of two insurance programs: the single-employer defined benefit pension plan program and multi-employer defined benefit pension plan program. As of 2008, the PBGC insured approximately 44 million participants and more than 29,500 defined benefit pension plans.¹ In fiscal year 2008, the PBGC paid approximately \$4.3 billion in benefits. Similar to plan sponsors, the PBGC suffers during periods of economic downturn as a result of the increased likelihood that pension plans will terminate with insufficient funding, coupled with the likelihood that the PBGC's funds will suffer reduced earnings and investment losses.

Assets of qualified pension plans are excluded from a debtor's estate and thus are not subject to the claims of the plan sponsor's creditors.² Further, employee contributions held in the employer's general assets for any period are excluded from the employer's estate.³ However, claims in favor of the pension plan itself may be brought against the employer. For example, claims asserting failure to satisfy the minimum funding requirements for pension plans or claims arising as the result of the termination of an underfunded pension plan may be asserted by the plan sponsor or the PBGC. Claims in favor of a plan are typically asserted by the plan trustees if the plan is continuing and by the PBGC, as successor trustee of the plan, if the plan has been terminated. The PBGC will also bring "contingent claims" if the debtor has not terminated a pension plan.

In bankruptcy, certain claims against the employer are afforded higher priority status and are therefore more likely to be paid or to

have a greater portion of the claim paid than lower priority claims. The first claims to be paid are secured claims asserted by creditors. After secured claims are paid, Section 507 of the Bankruptcy Code provides that certain claims of unsecured creditors are given the next ten levels of priority, with administrative claims of the estate receiving second priority status. Most claims that are not secured and are not provided priority status under Bankruptcy Code Section 507 are commonly referred to as general unsecured claims and are the last claims (other than subordinated claims) to be paid from a debtor's estate. Creditors with general unsecured claims may receive only a small portion of the total amount of their claim, may be issued equity of the reorganized debtor, or may not be paid. The priority status given claims asserted on behalf of a pension plan is dependent on the nature of the claim itself.

More specifically, the priority of the PBGC's claims depends on a number of factors, including the type of claim, when the claim arose, and whether the PBGC perfected a lien with regard to the claim prior to the employer's commencement of the bankruptcy proceeding that is referred to as the "petition date." The priority of the PBGC's claim can have a significant impact on the employer's bankruptcy proceeding. If the employer terminates a pension plan with large unfunded benefit liabilities, the PBGC's claim may be so large that other creditors may be negatively impacted if the PBGC's claim is given a high priority. In the event that a large portion of the PBGC's claim is considered a general unsecured claim, any member of the employer plan sponsor's controlled group that has not filed for bankruptcy will feel the greatest impact because of their joint and several liability for any pension underfunding. Often, general unsecured creditors receive a small percentage of the value of their claims. To the extent the PBGC does not receive full payment for its claims against the plan sponsor it will seek payment for those claims against controlled group members who are by statute jointly and severally liable.⁴ The PBGC does not need to wait until the plan sponsor fails to pay the unfunded benefit liability before asserting a claim against a controlled group member. Those controlled group members that are not in bankruptcy will not be able to avoid the liability.

MINIMUM FUNDING REQUIREMENTS

An employer that sponsors a defined benefit pension plan is required to maintain the minimum funding standards for a plan year.⁵ If a plan has a funding shortfall at the beginning of a plan year (*i.e.*, plan funding target for the year exceeds the value of the plan assets), then the plan sponsor is required to make minimum contributions to the pension plan. Liabilities are calculated using interest rates derived

from a three-segment yield curve based on yields of high-grade corporate bonds averaged over two years. Any increase in the plan's funding shortfall will be amortized over seven years.⁶

Failure to pay a required minimum contribution in full for the plan year results in interest due (at the effective interest rate for the plan) on the amount of underpayment for the period of the underpayment.⁷ Pursuant to Section 4971(a) of the Code, an excise tax may be imposed on an "accumulated funding deficiency" (*i.e.*, failure to make required minimum contributions). In addition, the employer is required to notify the PBGC, participants, and beneficiaries upon a failure to make a required minimum contribution payment.⁸

Claims for contributions due and unpaid to a pension plan may be brought against the employer by the plan trustees or by the PBGC as trustee of the plan (on a contingent basis if the plan has not been terminated). The plan administrator may also have a fiduciary duty to file a claim for due but unpaid contributions, even if the PBGC files a claim on behalf of the plan.

If unpaid contributions are attributable to services rendered post-petition, claims for those contributions generally constitute administrative expenses under Section 503(b)(1)(A) of the Bankruptcy Code as "actual, necessary costs and expenses of preserving the estate." For the portion of its claims attributable to services performed by employee participants within 180 days prior to the commencement of the bankruptcy proceedings (subject to the \$10,950 per employee participant limit and payment of employee wage claims), the plan trustees or PBGC will likely receive fifth priority. The remainder of the plan trustees' or PBGC's claim will most likely be treated as a general unsecured claim of the bankruptcy estate. However, if an employer refuses to pay the unpaid contributions relating to pre-petition minimum required contributions, the PBGC may threaten or initiate plan termination, particularly if unpaid contributions equal or exceed \$1 million.

If a plan sponsor would like to continue its underfunded defined benefit pension plan, it could request a funding waiver from the IRS, or it could enter into negotiations with the PBGC to reach a settlement over plan funding and security. Such actions may avoid the institution of an involuntary plan termination by the PBGC. Settlement agreements may include an extended funding schedule for the sponsor and some form of guarantee or security for the PBGC. Further, if an employer wants to make the minimum required contributions attributable to past service, bankruptcy court approval to make such contributions should be sought. Creditor groups, most importantly the official committee of unsecured creditors appointed in the Chapter 11 case, may also need to be consulted if the employer seeks to make minimum required contributions.

Finally, if minimum contributions are not paid and the aggregate amount per plan of missed payments plus interest is \$1 million or greater, the PBGC may seek to impose a lien against the property of the employer and all of its controlled group members for the unpaid amounts.⁹ In the event of a plan termination, controlled group members can be subject to a lien in favor of the PBGC for the unfunded benefit liabilities.¹⁰

PBGC LIEN

The PBGC is able to take advantage of two different statutory lien schemes—Code Section 412(n) and ERISA Section 4068. The principal difference between the two is that Code Section 412 enables the PBGC to assert lien rights when a plan sponsor fails to make required minimum contributions to a pension plan, while ERISA Section 4068 generally restricts the PBGC's right to assert lien rights upon plan termination. Further, the Code requires that unpaid mandatory contributions to a plan exceed \$1 million before a lien arises, while ERISA provides that the lien may not be in an amount in excess of 30 percent of the collective net worth of all persons liable to the PBGC. Both types of liens however can be asserted not only against property of the specific plan sponsor, but also against any entity within a plan sponsor's controlled group. In general, the PBGC's liens are treated like judgment liens that arise "as of the time notice of such lien is filed."¹¹ The PBGC's lien rights will not interfere with the priority of properly perfected liens securing obligations that predate the filing of notice of the PBGC's liens.

PLAN TERMINATION

An important consideration for a company considering a bankruptcy filing is whether it wants to continue any defined benefit pension plans that it sponsors after emerging from bankruptcy. In addition to the significant role the PBGC and creditors may play in the decision, a number of factors may influence the plan sponsor. Such factors include the funding status of the plan, whether the plan sponsor can afford to continue funding the plan in the future, and the impact on employee relations. Keep in mind that if a plan is fully funded, the plan sponsor is free to terminate the plan at any time provided termination is permitted under the terms of the plan.¹²

In bankruptcy, the most likely plan termination scenarios are a distress termination or an involuntary termination by the PBGC.

Distress Termination

A debtor may seek to terminate an underfunded pension plan in a distress termination only if it and each member of its controlled group

satisfy one of the tests listed below. Each member of the controlled group must meet one of these tests, although they all do not need to satisfy the same test. In addition, the distress termination may only proceed if the termination will not violate the terms of a collective bargaining agreement.¹³

- *The Liquidation Test.* The employer has filed, or had filed against it, as of the proposed termination date, a petition seeking liquidation in a case under the Bankruptcy Code.¹⁴
- *The Reorganization Test.* The employer must currently be in Chapter 11 or a comparable state proceeding; the employer must submit to the PBGC a copy of its request for bankruptcy court approval of its distress termination; and the bankruptcy court must approve the distress termination through a finding of financial necessity.¹⁵ The approval of the termination is dependent upon a finding by the court that, without terminating the plan (1) the employer will not be able to pay all of its debts pursuant to a plan of reorganization, and (2) the employer will not be able to continue in business outside the reorganization process unless the pension plan is terminated.¹⁶
- *The Business Continuation Test.* The employer demonstrates to the satisfaction of the PBGC that, unless a distress termination occurs, it will be unable to pay its debts when due and will be unable to continue in business.¹⁷
- *The Pension Costs Test.* The employer demonstrates to the satisfaction of the PBGC that the costs of providing pension benefits have become unreasonably burdensome to the employer, solely as a result of a decline of its workforce covered as participants under all single employer pension plans for which it is a contributing sponsor.¹⁸

With the exception of the liquidation test, each of the above tests requires a demonstration of financial necessity. In order to meet the financial necessity test, “the statute clearly places the burden of proof for a distress termination on the sponsor of the plan.”¹⁹ In general, an employer must demonstrate that “but for” the pension obligations, the employer could pay its debts under a plan of reorganization and remain in business outside of bankruptcy.²⁰

To complete a distress termination, the employer must provide detailed information to the PBGC and issue a notice of intent to terminate to affected parties.²¹ The appropriate forms and instructions can be obtained through the PBGC’s Web site (www.pbgc.gov) or by contacting them directly. Upon plan termination, the PBGC will have a

claim against the employer and each member of its controlled group in an amount equal to the plan's unfunded benefit liabilities.²²

Termination Premium

In addition to claims that the PBGC will have with respect to unfunded liabilities for a plan that is terminated pursuant to a distress termination, Congress, and the Deficit Reduction Act of 2005, added a new provision to ERISA that provided for an additional termination premium to be paid by plan sponsors that terminate their plan under a distressed termination in Chapter 11.

This additional premium is equal to \$1,250 per participant for three years following plan termination, beginning at the time of emergence.²³ Recently, the debtor in *Oneida*²⁴ brought suit in Bankruptcy Court asserting that the premium was an unsecured pre-petition claim that is properly discharged pursuant to a plan of reorganization. The Second Circuit (April 2009) reversed the Bankruptcy Court's decision and found that the termination premiums were not claims that could be discharged by a Chapter 11 plan of reorganization²⁵ because the PBGC's right to payment did not arise pre-petition.

DISTRESS TERMINATIONS AND COLLECTIVE BARGAINING AGREEMENTS

Where a plan is maintained according to a collective bargaining agreement, a debtor cannot simply disregard that obligation and proceed to terminate the plan under the distress rules. ERISA establishes a provision known as the "contract bar." Under the contract bar, the PBGC will not proceed with a termination initiated by an employer if termination would violate the terms of an "existing collective bargaining agreement."²⁶ For example, because the United Airlines' pension plans were collectively bargained, United's bid to eliminate its pension funding obligations was planned as a two-step process. United first took steps to eliminate the contract obligation by bringing Bankruptcy Code Section 1113 proceedings against the labor unions representing its workforce. Each of the unions received bargaining proposals to modify the labor agreements by (among other things) removing the requirement to maintain the pension plan. United also made proposals for new defined contribution plans to take the place of the defined benefit plans.

Bankruptcy Code Section 1113

In general terms, under Bankruptcy Code Section 1113, a debtor must engage in collective bargaining over "necessary" modifications

to the labor agreement before filing an application in bankruptcy court to obtain court-ordered rejection of the agreement. The proposal must meet particular requirements, such as the requirement that it contain only “necessary” modifications and treat affected constituencies “fairly and equitably.” The debtor is required to provide financial or other information to the union sufficient to evaluate the proposal. Where pension issues are involved, actuarial information, in addition to financial information concerning the debtor’s ability to afford the plan, will also be relevant. In order to enable the union to become fully engaged in the process with the professional advice needed for complex financial negotiations, a debtor may decide to reimburse the union’s professional advisers as part of this process.

If the bargaining process over proposed modifications fails to result in a negotiated agreement, the debtor can apply for court-ordered rejection of the agreement. The debtor must meet statutory standards designed to establish more rigorous grounds for rejection than the legal standard that applies to the rejection of ordinary commercial executory contracts.

While Bankruptcy Code Section 1113 obligates the debtor to negotiate with the union, where pension issues are involved, third parties who are not party to the labor agreement may claim an interest and attempt to participate. One such party is the pension plan’s independent fiduciary. A company may face a conflict serving as the plan administrator subject to fiduciary duties under ERISA and a debtor in possession with fiduciary duties to the estate. In these circumstances, the US Department of Labor will enter into an agreement for the appointment of an independent fiduciary for the pension plan. The independent fiduciary will assume responsibility for plan funding decisions (but not for decisions such as whether to terminate the plans) and may claim a role in a Bankruptcy Code Section 1113 proceeding.

INVOLUNTARY TERMINATION BY THE PBGC

Under the following circumstances the PBGC has the discretionary authority to terminate a pension plan:

- The plan fails to satisfy the minimum funding standard under Code Section 412 and ERISA Section 302 or the plan has been notified that a deficiency notice has been mailed with respect to the tax imposed under Code Section 4971(a);
- The plan will be unable to pay benefits when due;
- A reportable event has occurred involving a plan asset distribution to a substantial owner; or

- The possible long-run loss to the PBGC is reasonably expected to increase unreasonably if the plan is not terminated.²⁷

Additionally, the PBGC is required to terminate a pension plan that does not have sufficient assets to pay benefits that are currently due.²⁸

To proceed with its decision to terminate a pension plan, the PBGC must apply to the appropriate district court/bankruptcy court for a termination decree and for appointment of a trustee for the plan. If the debtor's defined benefit pension plan is terminated during the course of the bankruptcy proceedings, the termination date is the date of commencement of the bankruptcy case.²⁹

Once a trustee is appointed, generally the PBGC, the trustee must give notice of the termination proceedings to the plan administrator, each participant and beneficiary, each employer who may be subject to liability for plan deficiencies, and each employee organization that represents plan participants.³⁰ Benefits under the pension plan will cease to accrue as of the termination date. Upon plan termination, each contributing sponsor and its controlled group members will be liable for the pension plan's unfunded benefit liabilities.³¹

After a pension plan is terminated and taken over by the PBGC, any individual or beneficiary claims against the former plan sponsor will likely be prohibited. In *United Steelworkers of America v. United Engineering, Inc.*,³² the court held that the PBGC is the sole source of recovery of payments to employees under an ERISA plan. When the PBGC takes over a plan, it "occupies the field, and only the PBGC can make claims against the terminated plan's sponsor."³³

INVOLUNTARY TERMINATIONS AND COLLECTIVE BARGAINING AGREEMENTS

In a distress termination, the existence of the contract bar requires the employer to address its contractual obligation to sponsor and fund a pension plan as part of the termination process. However, the contract bar does not prevent the PBGC from commencing an involuntary plan termination under Section 4042 of ERISA because the PBGC has determined that termination is warranted under one or more of the factors set forth in the statute. The PBGC and the plan sponsor can agree to an involuntary termination of the plan, which is then accomplished informally—without a court proceeding. The union (or the plan participants, if they are not represented by a union) can challenge the involuntary termination after the fact in an action against the PBGC under Section 4003(f) of ERISA.

While the contract bar does not apply to an involuntary termination, the union and the employer can agree that the employer will not enter into an involuntary termination agreement with the PBGC,

as part of the employer's obligation to maintain the plan. If for any reason the employer does not agree to an involuntary termination, the PBGC applies to a court for a decree adjudicating the termination under one of three statutory standards, including whether the termination will avoid an unreasonable increase in the PBGC's liability.

A controversial settlement reached between United and the PBGC resulted in the termination of United's four pension plans under involuntary termination proceedings initiated by PBGC.³⁴ Because the settlement provided for termination under the involuntary termination rules, United did not need to pursue Bankruptcy Code Section 1113 relief related to the pension plans because the contract bar is inapplicable to involuntary terminations. The PBGC received an allowed bankruptcy claim for the full amount of the termination liability as calculated under its regulations (PBGC estimated the unfunded guaranteed benefits covered by the plans at \$6.6 billion), plus additional consideration in the form of securities to be distributed under United's reorganization plan.

The settlement was unsuccessfully challenged by the unions who were still negotiating with United over plan termination. They contended that by reaching agreement with the PBGC to initiate involuntary termination proceedings, United had circumvented the requirements of Bankruptcy Code Section 1113 to bargain over United's proposal to end its contractual obligation to maintain the plans. However, because the PBGC can proceed with an involuntary plan termination notwithstanding the terms of an existing collective bargaining agreement, the settlement was said not to violate the debtor's Bankruptcy Code Section 1113 obligation to bargain over pension matters, even though the unions were bargaining with United over the very subject that was under discussion with PBGC. Instead, the unions were left to challenge PBGC in a separate lawsuit.

VALUATION OF UNFUNDED PENSION BENEFIT LIABILITIES

When a pension plan is terminated through a "distress" or "involuntary" termination, the PBGC has a claim against the debtor for the total amount of the unfunded benefit liabilities to all participants and beneficiaries under the pension plan.³⁵ An unfunded liability is a shortfall between the pension plan assets and its promised benefits. The amount is determined by taking the current value of the assets of the plan and subtracting that present value from the value of the accrued benefit liabilities under the plan.³⁶ Currently, there is some difference in the courts on whether the discount rate to be used in calculating the present value of the accrued benefit liabilities is determined based on the PBGC Statutory Rate (PBGC Valuation) or Prudent Investor Rate.

The Tenth and Sixth Circuits hold that the Prudent Investor Rate is the proper valuation for unfunded pension benefit liabilities. Their holdings are based on the interpretation that the Bankruptcy Code mandates: (1) the bankruptcy court's determination of a present value for future contingent claims; and (2) the equal treatment of all claims in the same class. The bankruptcy courts of Virginia and Georgia hold that the PBGC Valuation is the proper method to calculate the value. Their holdings are based on the interpretation that Congress has delegated authority to the PBGC to determine the amount of its claim for unfunded pension benefit liabilities, and that Congress has expressly created a present right in the PBGC to enforce its claim.³⁷

PRUDENT INVESTOR RATE

The Prudent Investor Rate is the return a "prudent investor" would likely obtain by investing assets in securities and bonds in a manner typical of large pension plans. The discount rate is often determined from a survey of investment expectations by professional fund managers. In some instances, the rate is tested by running a series of "stochastic" simulations to determine whether, given the random fluctuation in actual returns over a 30-year period, the plan assets would be sufficient to make the required payments when due.³⁸

The Tenth Circuit in *In re: CF & I Fabricators of Utah Inc.*,³⁹ held that the Prudent Investor Rate was the proper valuation of unfunded benefit liabilities. The Tenth Circuit rejected the PBGC position that Congress had expressly delegated to it the authority to determine the present value of its claims for terminated plans under ERISA Section 4062(b) and ERISA Section 4001. Although the PBGC argued that the delegation of rule-making authority had the force of law both outside and inside a bankruptcy proceeding, the court held that the PBGC Valuation applied only in an ERISA context. The court justified this subordination by using the preemption provision in ERISA Section 514(d).⁴⁰ The court found that the regulation conflicted with the Bankruptcy Code because the principle underlying Section 1123(a)(4) of the Bankruptcy Code required all claims in the same class be treated equally.⁴¹ The court opined that using the PBGC Valuation would violate the principle of Bankruptcy Code Section 1123(a)(4) since the discount rate would only apply to the PBGC and not to the other unsecured creditors. Calculating the discount rate using the Prudent Investor Rate, the court held, would be more consistent with the policy goals of the Bankruptcy Code.

The Sixth Circuit in *In re: CSC Industries, Inc.*,⁴² also rejected the PBGC's position that Congress had expressly delegated to it the authority to determine the present value of its claims for terminated plans under ERISA. Instead, the court held that the bankruptcy court had the power to determine the amount of claims in order ensure

the equal treatment of creditors, as mandated by Bankruptcy Code Section 502(b) and Bankruptcy Code Section 1123(a)(4).⁴³ These sections gave the bankruptcy court the authority to determine the amount of claims for unfunded benefit liabilities using the Prudent Investor Rate. The court briefly discussed a recent Supreme Court case, *Raleigh v. Illinois Department of Revenue*, which held that “[c]reditors entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor’s obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code.”⁴⁴ The Sixth Circuit interpreted the Supreme Court to mean that nonbankruptcy law governed the validity of the claim, but the bankruptcy courts had the statutory authority to determine whether to allow the claim as well as the amount of the claim. The authority granted to the PBGC under ERISA, the court explained, “did not extend so far as to subordinate the authority of the bankruptcy courts to value claims in bankruptcy proceedings.” It was the bankruptcy court’s province to determine the value using the Prudent Investor Rate.

PBGC VALUATION

The PBGC Valuation in a distress or involuntary termination tries to match pricing in the private-sector annuity market.⁴⁵ The PBGC first obtains a quarterly survey conducted by a third party to determine current prices for single premium annuities charged by various insurance companies. Generally, insurance companies do not publish the interest rates they use to determine such prices. The PBGC then averages those prices and calculates the rates for the specified ranges of years that would result in the average prices for such annuities. These specified ranges are obtained using mortality assumptions stated in the PBGC’s 1994 General Annuity Mortality Table.⁴⁶ The interest rate that generates a cost most closely matching the average report cost from the initial survey is adopted by the PBGC as the “discount rate.”

In 2003, the first decision appeared in which a court held the PBGC Valuation was proper in determining the amount of its claim for unfunded benefit liabilities. In *In re: US Airways Group, Inc.*,⁴⁷ the bankruptcy court was not persuaded by debtors’ reliance on the precedent established under the Tenth and Sixth Circuits. Instead the court, relying on the recent holding of *Raleigh*, reiterated that a creditor’s claim was a function of the nonbankruptcy law giving rise to the claim. Accordingly, the court held, nonbankruptcy law determines not only the validity of the claim but also the amount of the claim. As a court of equity, the bankruptcy court had the power to analyze the circumstances around a claim to ensure that no injustice or unfairness was done in administration of the estate. These powers, the court stated, must be exercised within the contours of the Bankruptcy

Code.⁴⁸ Although equity power, along with Bankruptcy Code Section 502(b), allowed the bankruptcy court to determine the present value of contingent future loss, it did not allow the bankruptcy court to determine the amount of presently enforceable rights. The claim for unfunded benefit liabilities, the court explained, was not a contingent future loss because Congress had statutorily given the PBGC a presently enforceable right to recover an amount determined in accordance with its regulatory valuation.

The bankruptcy court also examined whether the PBGC Valuation dramatically overstated its actual loss, thereby ensuring unequal treatment in violation of the Bankruptcy Code. In its examination, the court discussed the strong societal interest in protecting pension benefits and the need for a risk-free or nearly risk-free rate to value the pension liability. The court determined that the Prudent Investor Rate did not provide such protection against risk, in large part due to the volatility of the stock markets.⁴⁹ The PBGC valuation was preferable to a Prudent Investor Rate premised on uncertain projections of future stock market returns. Furthermore, the court analyzed whether the methodology of the PBGC's valuation was a rational way to implement the stated goal of the ERISA regulation: to determine a value for the unfunded benefit liabilities that approximates the costs of purchasing an annuity contract from a commercial insurer that would pay the same benefits. The court opined that considerable deference should be given to the PBGC as the agency responsible for carrying out a legislatively delegated function.⁵⁰ The PBGC Valuation, it held, sought to replicate the cost of a private-sector annuity paying the promised benefits. This was therefore a reasonable valuation that gave proper weight to Congress's goal of protecting the health of the private pension system.

Most recently, the bankruptcy court in Georgia held that the PBGC Valuation was proper. In *In re: Rhodes, Inc.*,⁵¹ the bankruptcy court relied on *Raleigh*, and on a more recent Supreme Court case, *Travelers v. Pacific Gas*,⁵² to determine that the PBGC Valuation was binding on the court as a matter of law. The court opined that the Bankruptcy Code contained no provision determining the liability for, or the amount of, a claim arising under nonbankruptcy law. As such, the court had to look to the law that gave rise to the claim in order to determine the amount. The court echoed *US Airways* in holding that Section 502(b) of the Bankruptcy Code did not apply because the PBGC claim was not contingent: The claim was not for future payments but for payment on a presently enforceable obligation. Provided the methodology was not arbitrary or capricious, the PBGC Valuation was legally binding on the debtors.

The interpretations by courts of the underlying statutes in bankruptcy law and ERISA have diverged significantly in the past ten years. Importantly, the genesis of the split may be traced to the Supreme

Court case, *Raleigh v. Illinois Department of Revenue*. Where the Bankruptcy Code is silent or not contradicted by state law, the non-bankruptcy law should prevail in a bankruptcy proceeding. Although there is little guidance on whether this holding also applies to federal non-bankruptcy law, it would appear that the Supreme Court intended that all rights, both state and federal, should not change due to the occurrence of bankruptcy. Therefore, it is likely that going forward more courts will rely on the PBGC Valuation to determine the amount of claims for unfunded benefit liabilities.

LIMITS ON DISTRIBUTIONS AND PLAN AMENDMENTS

During the period in which the plan sponsor is in bankruptcy, an unfunded defined benefit plan cannot distribute benefits in the form of a lump sum.⁵³ In addition, if a plan has a liquidity shortfall, it is prohibited from making certain payments, including lump sum payments.⁵⁴ Plan amendments that are effective prior to emergence are not permitted in bankruptcy if the amendment would increase liabilities to the plan as a result of any increase in benefits.⁵⁵

REPORTABLE EVENT FILING

When a public company initiates a bankruptcy case the event generally must be reported to the PBGC within 30 days.⁵⁶ Advance notice of the pending bankruptcy filing is required where neither the sponsor or a member of the employer's controlled group is a public company and the contributing sponsor is a member of a controlled group maintaining one or more plans that, in the aggregate, have (1) vested benefit amounts that exceed the actuarial values of plan assets by more than \$50 million and (2) a funded vested benefit percentage of less than 90 percent.⁵⁷ After receiving the reportable event filing the PBGC may request additional information. If the notice or any other information requested by the PBGC is not provided within the specified time period, the PBGC may assess a penalty of up to \$1,100 for each day that the failure continues. The PBGC also has the authority to pursue "any other equitable or legal remedies" otherwise available.⁵⁸

PBGC GUARANTEE

The PBGC guarantees "basic pension benefits," subject to certain statutory limits. These benefits include:

1. Pension benefits at normal retirement age;
2. Most early retirement benefits;
3. Disability benefits; and

4. Annuity benefits for survivors of plan participants.

The guarantee applies only to benefits earned before the plan terminates; however, if the plan terminates while the employer is in bankruptcy, the guarantee may be limited to benefits earned before the bankruptcy. The amount of pension benefit the PBGC pays depends on:

1. Provisions of the plan;
2. Legal limits;
3. The form of benefit;
4. Participant's age;
5. Plan assets; and
6. Amounts (if any) PBGC recovers from the sponsor or members of the sponsor's controlled group for plan underfunding.

The PBGC's maximum benefit guarantee is set each year under provisions of ERISA. The maximum guarantee applicable to a plan is fixed as of that plan's termination date except for cases where termination occurs during a plan sponsor's bankruptcy, in which case the maximum guarantee may be fixed as of the date the sponsor entered bankruptcy. For 2009, the maximum guaranteed amount is \$4,500 per month (\$54,000 per year) for workers who begin receiving benefits from the PBGC at age 65. The maximum guarantee is lower for workers who begin receiving payments from the PBGC before age 65 or if an individual's pension includes benefits for a survivor or other beneficiary. The maximum guarantee is higher if the worker is over age 65 when he or she begins receiving benefits from the PBGC. For certain disability benefits, special rules apply.⁵⁹

CONCLUSION

For years, traditional pensions—those that shield workers from market risk—have been in a slow decline, with troubled sectors such as aviation and steel shedding their plans in bankruptcy court as new types of individually managed benefits such as 401(k) plans have taken hold. However, the future of pension plans in the United States is becoming increasingly uncertain and may be dependent on whether Chrysler's and GM's pension plans survive. Recent developments with Chrysler's Chapter 11 filing demonstrate that the PBGC and UAW are committed to continuing Chrysler's pension plans upon emergence from Chapter 11.

NOTES

1. Joint Committee on Taxation, *present law and background relating to the Pension Benefit Guaranty Corporation* (JCX-67-08, September 17, 2008); Pension Benefit Guaranty Corporation, 2008 Annual Report (January 15, 2009).
2. 11 U.S.C. § 541(c)(2) provides that “a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title.” ERISA § 206(d)(1) provides that “[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated.”; and ERISA §403(c) provides that “the assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries in defraying reasonable expenses of administering the plan.”
3. 11 U.S.C. § 541(b)(7).
4. Code §§ 414(b), (c), (m) and (o); and ERISA § 4062(a).
5. Code § 412; ERISA § 302.
6. Code § 430; ERISA § 303.
7. Code § 430(j); ERISA § 303(j).
8. It is unclear whether this requirement applies to any failure, or failures over \$1 million. Code § 430(k)(4)(A); ERISA § 303(k)(4)(A).
9. Code § 412(n); ERISA § 302(f).
10. Code § 412(n); ERISA § 4068.
11. ERISA § 4068.
12. ERISA § 4041(b).
13. The plan sponsor must either reach an agreement with the applicable union to terminate pension obligations or must successfully petition the bankruptcy court to reject or modify the collective bargaining agreement under Section 1113 of the Bankruptcy Code. *See In re US Airways Group, Inc.*, 296 B.R. 734 (Bankr. E.D. Va. 2003) where the bankruptcy court approved a distress termination conditioned on the outcome of union arbitration procedures under the applicable collective bargaining agreement.
14. ERISA § 4041(c)(2)(B)(i).
15. ERISA § 4041(c)(2)(B)(ii).
16. ERISA § 4041(c)(2)(B)(ii)(IV).
17. ERISA § 4041(c)(2)(B)(iii)(I).
18. ERISA § 4041(c)(2)(B)(iii)(II).
19. *In re Wire Rope Corp.*, 287 B.R. 771, 777 (W.D. Mo. 2002).
20. *See, e.g., In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006) (applying the reorganization test on a plan aggregate basis, and affirming that but for the plans as a whole, the debtor could reorganize under a plan of reorganization and remain in business outside of bankruptcy).
21. ERISA § 4041.
22. ERISA § 4062.

23. ERISA § 4006(a)(7).
24. *Oneida Ltd. v. Pension Ben. Guar. Corp.* (In re *Oneida Ltd.*), 383 B.R. 29 (Bankr. S.D.N.Y. 2008), *rev'd*, *Pension Benefit Guaranty Corp. v. Oneida Ltd.*, No. 08-2964-bk (2d Cir. Apr. 8, 2009).
25. *Pension Benefit Guaranty Corp.* No. 08-2964-bk.
26. ERISA § 4041(a)(3).
27. ERISA § 4042(a).
28. *Id.*
29. ERISA § 4042(b). A court proceeding is not necessary if the plan administrator agrees to the termination or the appointment of a trustee and to the termination date.
30. ERISA § 4022(g).
31. ERISA § 4062(a); ERISA § 4064.
32. 52 F.3d 1386 (6th Cir. 1995).
33. *Id.* (citing *City of Milwaukee v. Illinois*, 451 U.S. 304, 317 (1981)).
34. *In re UAL Corp.*, 428 F.3d 677 (7th Cir. 2005).
35. ERISA § 4062.
36. ERISA § 4001.
37. The Prudent Investor Rate case law includes: (1) the Tenth Circuit's decision of, *In re: CF & I Fabricators of Utah Inc.*; and (2) the Sixth Circuit's decision of, *In re: CSC Industries, Inc.* The PBGC Valuation case law includes: (1) the bankruptcy court of Virginia's decision of, *In re: US Airways Group, Inc.*; (2) the bankruptcy court of Georgia's decision of, *In re: Rhodes, Inc.*; and (3) the district court of Delaware's decision of, *In re: Kaiser Aluminum Corp.*
38. *See generally In re: US Airways Group, Inc.*, 303 B.R. 784 (Bankr., E.D.Va. 2003).
39. *In re: CFE & I Fabricators of Utah Inc.*, 150 F.3d 1293 (10th Cir. 1998).
40. "Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States...or any rule or regulation issued under such law." Bankruptcy Code § 1144(d).
41. "Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall... provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest." Bankruptcy Code § 1123(a)(4).
42. *In re: CSC Industries, Inc.*, 232 F.3d 505 (6th Cir. 2000).
43. "[I]f such objection to a claim is made, the court . . . shall determine the amount of such a claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount..." *See* 11 U.S.C. § 502(b). For the language of Section 1123(a)(4), *see supra* n.8.
44. *See* *Raleigh v. Illinois Department of Revenue*, 530 U.S. 15, 20 (2000).
45. *See* "PBGC's "Termination Liability, Mortality Assumptions," ERISA Compliance and Enforcement Strategy Guide, BNA ERISA—GUIDE 200430, Westlaw.
46. Prior to December 2005, the PBGC used a 1983 General Annuity Mortality table. *See Id.*

47. *See generally In re: US Airways Group, Inc.*
48. Quoting *Pepper v. Litton*, 308 U.S. 295, 308 (1939).
49. The Court elaborated on the volatility of the markets by remarking that the Prudent Investor Rate of 12.3% in *CF&I* was determined during the “euphoric” climate of 1992 and few investors could have foreseen the drastic change in the market only a few years later.
50. Referencing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.D. 837 (1984). The Court stated that, under the Administrative Procedure Act, the agency’s decision should be upheld unless it was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law.” *See The Administrative Procedure Act*, 5 U.S.C. § 706(2)(A).
51. *In re: Rhodes, Inc.*, 382 B.R. 550 (Bankr., N.D. Ga. 2008).
52. In that case, the Supreme Court held that a creditor was not precluded from filing an unsecured claim for contractual attorney fees, by virtue of the fact that the fees sought had been incurred in litigating an issue of federal bankruptcy law. The Court held that, although §502(b)(1) disallowed any claim that is unenforceable against the debtor and property of the debtor because such claim is contingent or “unmatured,” property interests were created and defined by state law. Unless federal interests required a different result there was no reason why such interests should be analyzed differently in a bankruptcy proceeding. *See Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 449–451 (2007).
53. Code § 436(d)(2); ERISA § 206(g)(3)(B).
54. ERISA § 303(j)(4). ERISA imposes a penalty on a fiduciary that make a prohibited payment during a liquidity shortfall. The penalty of the amount of the prohibited payment not to exceed \$10,000. ERISA § 502(m).
55. Code § 401(a)(33).
56. ERISA § 4043.
57. ERISA §4043.
58. *Id.*
59. www.pbgc.gov/workers-retirees/benefits-information/content/page789.html.

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