

# DEFINED BENEFIT PENSION PLANS IN BANKRUPTCY

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## I. INTRODUCTION TO ERISA

The Employees Retirement Income Security Act of 1974<sup>1</sup> (as amended, “ERISA”) was enacted to provide oversight of the management of funds in direct benefit plans and to protect the interests of plan beneficiaries. ERISA pre-empts all state laws relating to employee benefit plans. Among other things, ERISA establishes minimum funding standards for pension plans, provides guidelines for the conduct of plan fiduciaries, establishes the Pension Benefit Guaranty Corporation (the “PBGC”) to guaranty certain employee pension benefits, and provides remedies and access to the federal courts. Employers<sup>2</sup> must pay premiums so that their plans are covered by the PBGC. The termination of plans is also extensively regulated.

ERISA regulates employee benefit plans, defined under 29 U.S.C. § 1002(34) as including plans that provide retirement income or defer income to a post-retirement period, *i.e.* pension plans. Pension plans are of two principal types:

- Defined Contribution Plans - plans establishing an individual account for each participant, with benefits based solely on contributions to such account, profits and losses thereon and allocated forfeitures from individual accounts of other participants;<sup>3</sup> and
- Defined Benefit Plans – plans that provide systematically for the payment of a definitely determinable annuity to participants over a period of years, usually for life, after retirement. That is, future retirement benefits are mathematically projected and defined, generally based upon factors such as years of service and compensation received by each participant.

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<sup>1</sup> 29 U.S.C. § 1001 *et seq.*

<sup>2</sup> Employers are also referred to herein as “plan sponsors”.

<sup>3</sup> 29 U.S.C. § 1002(3)(34).

## **II. DEFINED BENEFIT PENSION PLANS**

A defined-benefit plan is one that sets forth a fixed level of benefits to be paid on a monthly basis to a participant in the plan upon the participant's retirement.<sup>4</sup> The primary focus of a defined benefit plan is the determination of a projected annual benefit that is generally payable upon the retirement of the plan's participants. Defined benefit pension plans are sometimes classified as either single-employer plans or multiemployer plans. A single-employer plan is a plan maintained by one employer. A multiemployer plan is typically maintained pursuant to one or more collective bargaining agreements and to which more than one employer contributes. Employer contributions are maintained in a trust fund and the multiemployer plans and funds are jointly administered and governed by a board of trustees. The trustees are required to act in the sole and exclusive interest of the plan and its participants. Accordingly, trustees often have a voice regarding issues concerning employer withdrawals and resulting claims.

- A. Minimum Funding Requirements - Under ERISA and the Internal Revenue Code (IRC), defined benefit plans are subject to minimum funding requirements.<sup>5</sup> In order to ensure that plan assets are sufficient to pay plan benefits when due, the minimum funding rules require employers to make annual plan contributions. The amount of contributions required for a plan year is generally the amount that is actuarially determined to be needed to fund benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit. The amount of

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<sup>4</sup> 29 U.S.C. § 1002(35).

<sup>5</sup> 29 U.S.C. § 1082; IRC § 412.

required annual contributions is determined under one of a number of acceptable actuarial cost methods.

- B. Contribution Amounts - While there is no requirement that a defined benefit plan be fully funded, the employer must contribute annually in amounts determined by an enrolled actuary.<sup>6</sup> The minimum funding rules require the plan sponsor to maintain a ledger account, called the “funding standard account”.<sup>7</sup> The plan sponsor’s annual contribution must be sufficient to eliminate any “accumulated funding deficiency” in the plan’s funding standard account.<sup>8</sup> Although liability for the minimum funding contributions accrues over the course of the plan year, the installment payments are due 15 days after the close of each quarter of the plan’s fiscal year, with a final payment due eight and a half months after the close of the plan year.<sup>9</sup> The minimum funding contributions equate to an installment payment on the liabilities accrued by the defined benefit plan, including benefit accruals and other costs as reduced by the plan’s investment experience. If a plan’s pre-existing investments do well in any given year, the plan’s minimum funding contribution may be negligible (or reduced to zero) even if benefits accrued during the year.

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<sup>6</sup> There are several actuarial cost methods approved under IRS rules. Under ERISA, the plan sponsor is entitled to select the method by which it wishes to fund its plans. 29 U.S.C. §1082(c). Plan sponsors may change actuarial funding methods from time to time, subject to approval of the Secretary of the Treasury. 29 U.S.C. § 1082(c)(5). These funding methods are used to determine the schedule of contributions necessary to fund plan liabilities. As a result, a plan’s apparent funded status may be a function of its chosen actuarial cost method.

<sup>7</sup> 29 U.S.C. § 1082(b)(1); IRC § 412(b)(1).

<sup>8</sup> 29 U.S.C. §1082(a)(2); IRC § 412(a)(2).

<sup>9</sup> 29 U.S.C. § 1082(c)(10) and (e); IRC § 412(c)(10) and (m).

- C. IRS Waiver of Funding Requirement - Within limits, the Internal Revenue Service (“IRS”) is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year.<sup>10</sup> A waiver may be granted if the employer responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. An employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS. The IRS has the ability to require security to ensure repayment of waivers of funding obligations in excess of \$1 million.<sup>11</sup>
- D. Special Funding Rules for Multiemployer Plans – Certain modifications to the funding rules apply to multiemployer plans that experience financial difficulties, referred to as “reorganization status.” A plan is in reorganization status for a year if the contribution needed to balance the charges and credits to its funding standard account exceeds its “vested benefits charge.” The plan’s vested benefits charge is generally the amount needed to amortize, in equal annual installments, unfunded vested benefits under the plan, over: (1) 10 years in the case of obligations attributable to participants in pay status; and (2) 25 years in the case of obligations attributable to other participants. A plan in reorganization status is eligible for a special funding credit. In addition, a cap on year-to-year contribution increases and other relief is available to employers that continue to contribute to the plan. Subject to certain requirements, a multiemployer plan in reorganization

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<sup>10</sup> IRC § 412(d); 29 U.S.C. § 1083(a).

<sup>11</sup> IRC § 412(d).

status may also be amended to reduce or eliminate accrued benefits in excess of the amount of benefits guaranteed by the PBGC.

- E. Mandatory PBGC Insurance - Under ERISA, defined benefit plans are subject to mandatory PBGC insurance and must pay annual premiums.<sup>12</sup> All covered single-employer plans are required to pay a flat per-participant premium and underfunded plans are subject to an additional variable premium based on the level of underfunding. As originally enacted in ERISA, covered plans were annually required to pay a flat premium to the PBGC of \$1 per plan participant. The annual flat-rate per-participant premium for single-employer plans has been increased several times since the enactment of ERISA and is currently \$30 per participant.<sup>13</sup> In the case of an underfunded plan, additional premiums are required in the amount of \$9 per \$1,000 of unfunded vested benefits (the amount which would be the unfunded current liability if only vested benefits were taken into account and if benefits were valued at the variable premium interest rate). The PBGC premium rate for multiemployer plans is \$8 per participant per plan year.<sup>14</sup> This flat-rate per-participant premium is the only premium paid to the PBGC for multiemployer plans. On May 31, 2006 the PBGC announced that effective July 1, 2006 sponsors of large plans (those with 500 or more participants) must file premiums electronically for plan years beginning on or after January 1, 2006.

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<sup>12</sup> 29 U.S.C. § 1306.

<sup>13</sup> 29 U.S.C. § 1306(a). See discussion at Section XII.

<sup>14</sup> 29 U.S.C. § 1306(a)(3).

### III. ROLE OF THE PBGC

The PBGC is a wholly owned U.S. government corporation within the Department of Labor, modeled after the Federal Deposit Insurance Corporation. Congress vested the PBGC with the authority to enforce and administer a mandatory government-insurance program that protects the pension benefits of workers who participate in defined-benefit pension plans that are governed by ERISA.<sup>15</sup> The PBGC guarantees benefits under both single-employer plans and multiemployer plans.

- A. Single-Employer Plan Guarantee - When a single-employer plan terminates in a distress or involuntary termination and benefits are insufficient to pay guaranteed benefits, the plan effectively goes into PBGC receivership. Generally, the PBGC becomes the trustee of the plan, takes control of any plan assets, and assumes responsibility for liabilities under the plan. The PBGC makes payments for benefit liabilities promised under the plan with assets received from two sources: assets in the plan before termination, and assets recovered from the employer. The balance, if any, of guaranteed benefits owed to beneficiaries is paid from the PBGC's revolving funds.<sup>16</sup>
- B. Multiemployer Plan Insurance - In the case of multiemployer plans, the PBGC insures against plan insolvency, rather than plan termination. PBGC provides financial assistance through loans to multiemployer plans that are insolvent. Accordingly, a multiemployer plan need not be terminated to qualify for PBGC financial assistance, but must be found to be insolvent.<sup>17</sup>

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<sup>15</sup> 29 U.S.C. § 1302.

<sup>16</sup> 29 U.S.C. §§ 1322(a), 1361.

<sup>17</sup> *Id.*

C. Maximum Benefit - The maximum annual guaranteed benefit for single-employer plans terminating in 2006 is approximately \$47,659 per year.<sup>18</sup> The PBGC guarantees benefits under a multiemployer plan of the same type as those guaranteed under a single-employer plan, but a different guarantee ceiling applies. The limit for multiemployer plans is the sum of 100 percent of the first \$11 of monthly benefits and 75 percent of the next \$33 of monthly benefits for each year of service.<sup>19</sup>

As of December 2005, the PBGC insured about 44 million participants in more than 30,300 defined benefit plans (including both multiemployer and single-employer plans).<sup>20</sup>

#### **IV. PLAN MODIFICATIONS IN BANKRUPTCY**

Under ERISA, a plan sponsor in a bankruptcy case, is prohibited from implementing plan amendments that increase plan liabilities by reason of any *increase* in benefits, any change in the accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan, with respect to its employees, prior to the effective date of such debtor's plan of reorganization.<sup>21</sup> Similarly, if the IRS has granted a waiver of the funding requirements for a particular year, the plan may not be amended during the term of the waiver in a manner that

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<sup>18</sup> <http://www.pbgc.gov/media/news-archive/2005/pr06-09.html>. PBGC normally requires two to three years from the date it takes over a plan to issue a formal benefit determination to each plan participant. In the interim, PBGC pays estimated benefits. Once final benefit determinations are made, the PBGC either repays any shortfall in the amount of the participants' interim benefits, with interest, or seeks to recoup any surplus. *See* 29 C.F.R. § 4022.81-.83. To the extent participants contest the benefit determinations; they must first exhaust administrative remedies within the PBGC before filing an action in federal court. *See Boivin v. U.S. Airways*, 2006 U.S. App. LEXIS 10875 (D.C. Cir. 2006).

<sup>19</sup> 29 U.S.C. § 1322(a), (c).

<sup>20</sup> <http://www.pbgc.gov/media/news-archive/2005/pr06-09.html>.

<sup>21</sup> 29 U.S.C. § 204(i); IRC § 401(a)(33).

increases benefits, changes the accrual of benefits or changes the rate at which benefits become nonforfeitable.<sup>22</sup>

It is more likely, however that a reorganizing debtor may desire to modify or terminate an existing pension plan. The protections of Bankruptcy Code Section 1113, discussed in Section IX below, apply to any pension plan covered by an existing collective bargaining agreement. If the pension plan in question does not fall under the umbrella of an existing collective bargaining agreement, the debtor need not confront the procedural and substantive hurdles of Bankruptcy Code Section 1113.

Bankruptcy Code Section 1114 prevents a chapter 11 debtor from unilaterally modifying certain retiree benefits during the case unless an authorized retiree representative is appointed and agrees to the modification, or the court authorizes the modification as necessary to the reorganization. Although it commands that the trustee or debtor-in-possession pay "any" retiree benefits as an administrative expense of the bankruptcy estate, the term "retiree benefits" is limited to

payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program . . . maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under this title.<sup>23</sup>

As such, Bankruptcy Code Section 1114 simply has no application to the modification of non-bargained-for pension plans in bankruptcy.

Pre-petition modifications to a pension plan may be avoidable in bankruptcy under certain conditions as a fraudulent transfer. In *Pension Transfer Corp. v. Beneficiaries under the*

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<sup>22</sup> 29 U.S.C. § 1084(b)(1); IRC § 412(f).

<sup>23</sup> 11 U.S.C. § 1114(a).

*Third Amendment to Fruehauf Trailer Corp. Retirement Plan No. 003 (In re Fruehauf Trailer Corp.)*, 444 F.3d 203 (3d Cir. 2006), a debtor designed a key employee retention plan (“KERP”) during its slide into bankruptcy. One element of the KERP granted salaried, non-union employees two separate pension benefit increases, regardless of vesting status on condition that the employees remained with the debtor for approximately six (6) months.<sup>24</sup> The pension amendment affected approximately 400 employees including senior executives. After liquidating, the debtor brought an action to declare the amendment to a pension plan a voidable fraudulent transfer pursuant to Section 548 of the Bankruptcy Code. The Third Circuit Court of Appeals affirmed a finding that the pre-petition plan amendment was a fraudulent transfer noting that the value gained by the debtor from the plan amendment was not “reasonably equivalent” to the value surrendered<sup>25</sup>.

## **V. STATUTORY REQUIREMENTS FOR VOLUNTARY DISTRESS TERMINATIONS OF SINGLE EMPLOYER PENSION PLANS**

- A. Voluntary Termination Options - A pension plan can be terminated by an employer in one of two ways: “standard” or “distressed.” In a standard termination, the plan assets are sufficient to fund future benefits to participants; the employer simply distributes the plan assets to plan participants in the form of annuities purchased from a private insurer.<sup>26</sup> In a “distressed” termination, the plan assets are insufficient to fund future benefits. The plan assets are turned over to the PBGC, the PBGC assumes responsibility for paying the promised benefits

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<sup>24</sup> *Fruehauf Trailer*, 444 F.3d at 203.

<sup>25</sup> *Id.*

<sup>26</sup> 29 U.S.C. §1341(b).

under the plan to the participants as such benefits become due, and the PBGC may assert a termination claim.<sup>27</sup>

B. Distress Termination Elements - A chapter 11 debtor may terminate its pension plan in a distress termination. 29 U.S.C. § 1341(c) provides that a plan may terminate under a distress termination only if the Plan Administrator: (i) provides a written notice of intent to terminate to the participants and other affected parties; (ii) files a distress termination notice with the PBGC providing all statutory and regulatory required information; and (iii) the PBGC determines that each contributing sponsor and each member of its controlled group satisfies one of the financial distress criteria.<sup>28</sup> In order to effect a termination based on reorganization distress, a debtor must satisfy the four requirements of 29 U.S.C. § 1341(c)(2)(B)(ii):

- (I) [the plan sponsor] has filed, or has had filed against [it], a petition seeking reorganization in a case under Title 11 or under any similar law of a State or political subdivision of a State....,
- (II) such case has not, as of the proposed termination date, been dismissed,
- (III) [the plan sponsor] timely submits to [PBGC] any request for the approval of the bankruptcy court (or other appropriate court in a case under such similar law of a State or political subdivision) of the plan termination, and
- (IV) the bankruptcy court (or other appropriate court) determines that, unless the plan is terminated, [the plan sponsor] will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in

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<sup>27</sup> 29 U.S.C. § 1341(c).

<sup>28</sup> 29 U.S.C. § 1341(c), 29 C.F.R. § 4041.41(a).

business outside the chapter 11 reorganization process and approves the termination.

- C. Bankruptcy Court's Limited Role in Distress Termination - To approve a distress termination, the bankruptcy court must determine whether the fourth requirement above is met.<sup>29</sup> The PBGC determines whether the other requirements for a distress termination are satisfied.<sup>30</sup> Accordingly, a bankruptcy court's role in the distress termination process is specific and limited to a determination of whether but for the termination of the pension plan, the employer's business will be liquidated.<sup>31</sup> The ultimate determination of whether a plan may be terminated in a distress termination rests with the PBGC.<sup>32</sup>
- D. Challenges to Plan Termination in Bankruptcy Court – Some parties have successfully mounted challenges to termination on the basis that the debtors have simply not made an adequate showing that reasonable alternatives to plan termination have been properly considered or explored. The court in *In re Resol Mfg. Co.*, 110 B.R. 858, 862 (Bankr. N.D. Ill. 1990) found that in a distress termination, “the appropriate standard of review . . . pursuant to [ERISA] Section 1341(c)(2)(B)(ii), is but for the termination of the pension plan, the debtor will not be able to pay its debts when due and will not be able to continue in business.” In making this determination, a bankruptcy court must inquire as to whether a

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<sup>29</sup> 29 U.S.C. § 1341(c)(2)(B)(ii)(IV); see also *In re US Airways Group, Inc.*, 296 B.R. 734, 744 (Bankr. E.D. Va. 2003); *In re Wire Rope Corp. of America, Inc.*, 287 B.R. 771, 777 (Bankr. W.D. Mo. 2002); *In the Matter of Sewell Manufacturing Company, Inc.*, 195 B.R. 180, 183 (Bankr. N.D. Ga. 1996).

<sup>30</sup> 29 U.S.C. § 1341(c)(2)(B).

<sup>31</sup> *In re Philip Servs. Corp.*, 310 B.R. 802, 807 (Bankr. S.D. Tex. 2004); *U.S. Airways*, 296 B.R. at 743; *Wire Rope*, 287 B.R. at 777.

<sup>32</sup> *Wire Rope*, 287 B.R. at 777; *US Airways*, 296 B.R. at 744; *Sewell*, 195 B.R. at 195.

debtor will be unable to pay its debts and continue in business under *any* plan of reorganization as 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) qualifies a debtor’s ability to pay in terms of “a” plan of reorganization, and not “its” plan of reorganization.<sup>33</sup>

In the context of a standard termination, at least one court has determined that it would be a violation of the plan sponsor’s fiduciary duties under ERISA to fail to explore all alternative means of termination including merger of a single-employer plan into a multiemployer plan.<sup>34</sup>

- E. Analyzing Viability of Plans in the Aggregate – Where a debtor maintains multiple defined benefit plans, a dispute may arise as to whether the debtor must demonstrate that the “reorganization in bankruptcy” test is met on a plan-by-plan basis or if the debtor may satisfy its burden by demonstrating that in the aggregate the plans are unaffordable. In *Pension Benefit Guar. Corp. v. Kaiser Aluminum Corp. (In re Kaiser Aluminum Corp.)*, 2005 U.S. Dist. LEXIS 5106 (D. Del. 2005) the PBGC argued that the bankruptcy court erred in aggregating all of the debtors’ pension plans for purpose of the “reorganization in bankruptcy” analysis. The district court affirmed the bankruptcy court and reasoned that although 29 U.S.C. 1341 used the term “plan” in the singular when setting forth the distress termination requirements, the court was not persuaded that the singular reference to the term “plan” mandated a plan-by-plan analysis.<sup>35</sup>
- F. Effect of Distress Termination – When a plan terminates in a standard termination and assets are sufficient to pay guaranteed benefits, the plan pays out benefits.

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<sup>33</sup> *Sewell*, 195 B.R. at 184; *Wire Rope*, 287 B.R. at 777.

<sup>34</sup> *Beck v. Pace Int’l Union*, 427 F.3d 668 (9th Cir. 2005).

<sup>35</sup> *Kaiser Aluminum Corp.*, 2005 U.S. Dist. LEXIS 5106 at \* 9.

When an underfunded plan terminates in a distress termination and benefits are insufficient to pay guaranteed benefits, the plan effectively goes into PBGC receivership. PBGC generally takes over as trustee and is responsible for paying benefits, subject to statutory limits.<sup>36</sup> The PBGC makes payments for benefit liabilities promised under the plan with assets received from two sources: assets in the plan before termination, and assets recovered from the employer. The balance, if any, of guaranteed benefits owed to beneficiaries is paid from the PBGC's revolving funds. In that event, the employer and all controlled group members are jointly and severally liable to PBGC for the shortfall between promised benefits and plan assets.<sup>37</sup>

- G. Bankruptcy Code Section 365 Rejection Unavailable – ERISA provides the exclusive means for terminating a defined benefit pension plan.<sup>38</sup> Courts have denied debtors' attempts to reject a pension plan as an executory contract.<sup>39</sup>

## **VI. INVOLUNTARY TERMINATIONS OF SINGLE EMPLOYER PENSION PLANS**

- A. Authority for Involuntary Terminations – PBGC has the power to institute involuntary proceedings to terminate a pension plan if it determines that a plan's assets are insufficient or in danger.<sup>40</sup> PBGC may institute involuntary termination proceedings during the pendency of a plan sponsor's bankruptcy case, without

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<sup>36</sup> 29 U.S.C. §§ 1322, 1342(c) and (d), and 1344.

<sup>37</sup> 29 U.S.C. § 1301(a)(18) and 1362(a) and (c); 29 CFR § 4044.

<sup>38</sup> 29 U.S.C. § 1341(a)(1); *Hughes Aircraft Co. v. Jacobsen*, 525 U.S. 423, 446 (1999); *Air Line Pilots Ass'n v. PBGC*, 193 F. Supp. 2d 209 (D. D.C. 2002); *Philip Services*, 310 B.R. 802.

<sup>39</sup> *Philip Servs.*, 310 B.R. at 808-09, citing 29 U.S.C. §1341(a)(1) and *In re Esco Mfg.*, 50 F.3d 315 (5th Cir. 1995).

<sup>40</sup> 29 U.S.C. § 1342.

regard to the automatic stay.<sup>41</sup> The PBGC may institute proceedings to terminate a plan for various reasons, including if it determines that the plan in question (i) has not met the minimum funding standards, (ii) will be unable to pay benefits when due, or (iii) may reasonably be expected to increase PBGC's long-run loss unreasonably.<sup>42</sup> The PBGC *must* institute proceedings to terminate a plan if the plan is unable to pay benefits that are currently due.

- B. Procedure for Involuntary Termination – As provided in 29 U.S.C. § 1342(c), PBGC typically effects the termination, trusteeship and establishment of a termination date of an underfunded plan by agreement with the plan administrator. If PBGC and the plan administrator cannot agree, ERISA authorizes PBGC to apply to the appropriate United States district court for a decree adjudicating that the plan must be terminated and appointing a trustee. The PBGC may be appointed the statutory trustee. Once PBGC files a termination action, the district court in which that action is filed has “exclusive jurisdiction of the plan involved and its property.”<sup>43</sup> In an involuntary termination action, the bankruptcy court may not enter a final order and must submit its proposed findings of fact and conclusions of law to the district court as required by 28 U.S.C. § 157(c)(1). In the United Air Lines case<sup>44</sup>, the PBGC determined that an involuntary termination was appropriate and filed the requisite action in the district court. The district court, over PBGC's objection, automatically referred the matter to the bankruptcy

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<sup>41</sup> 29 U.S.C. § 1342(e).

<sup>42</sup> 29 U.S.C. § 1384.

<sup>43</sup> 29 U.S.C. § 1341(f).

<sup>44</sup> *Air Line Pilots Ass'n Int'l v. Pension Benefit Guaranty Corp. (In re United Air Lines, Inc.)*, 337 B.R. 904 (N. D. Ill. 2006).

court. The bankruptcy court held a bench trial and entered final orders terminating the pension plan and fixing the termination date. On appeal, the district court held that the bankruptcy court was without jurisdiction to enter the challenged orders as the termination proceeding was not “core” within the meaning of 28 U.S.C. § 157.<sup>45</sup>

## VII. TERMINATION DATE

A. Importance of Termination Date - Establishing a termination date is crucial to the statutory scheme as it serves as the date on which the participants’ right to accrue benefits ceases and fixes PBGC’s liability for guaranteed benefits. The termination date marks the date on which benefits for plan participants cease to accrue.<sup>46</sup> It also serves as the date as to which an employer’s liability for the plan’s unfunded benefit liabilities is measured.<sup>47</sup> Additionally, the termination date is critically important for the determination of the controlled group. So long as a controlled group does not exist on the termination date, unfunded liabilities cannot be imposed upon any other entities or the owners of the plan sponsor. Although ERISA provides no guidelines to determine when a plan terminates, the notice of termination may be used to make such a determination as plan

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<sup>45</sup> *Id.* at 910. Ultimately, the United pension plans were terminated and the debtors shifted \$6.6 billion in unfunded liabilities to the PBGC. <http://www.pbgc.gov/media/news-archive/2005/pr06-09.html> In exchange for its claims, when United’s plan of reorganization became effective, PBGC received approximately \$1.5 billion of senior notes, contingent notes and aggregate liquidation value of convertible preferred stock and nearly 20 percent of the outstanding common stock of the reorganized UAL Corporation. Before United, the largest previous U.S. pension default was Bethlehem Steel’s in 2002. In Bethlehem Steel’s case, its plan was underfunded by \$4.3 billion and the PBGC became liable for about \$3.7 billion.

<sup>46</sup> *Pension Benefit Guaranty Corp. v. Broadway Maint. Corp.*, 707 F.2d 647, 649 (2d Cir. 1983).

<sup>47</sup> 29 U.S.C. §§ 1301(a)(18); 1322, 1362.

participants no longer have a justifiable expectation of receiving benefits after receipt of notice of plan termination.<sup>48</sup>

- B. Statutory Mechanisms for Determining Termination Date - 29 U.S.C. §1348(a) provides that, in a distress termination under Section 1341(c), the effective date of the termination is the date established by the plan administrator and agreed to by the PBGC or, if the plan administrator and PBGC cannot agree, the date fixed by “the court”.<sup>49</sup> Courts are not obligated to consider the financial interests of employers in setting a termination date.<sup>50</sup>
- C. Bankruptcy Court’s Jurisdiction to Fix Termination Date - In at least one case, the PBGC has taken the position that “the court” referenced in Section 1348(a)(4) is not the bankruptcy court, but rather the district court in which PBGC has filed a termination action under Section 1342.<sup>51</sup> In *Aloha*, the bankruptcy court rejected the contention of the PBGC that, because Section 1342 authorizes the PBGC to institute involuntary termination proceedings in the district court, that fact operates to preclude a bankruptcy court from deciding the date of plan termination under Section 1348(a)(4).<sup>52</sup>

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<sup>48</sup> *Berard v. Royal Electric, Inc.*, 795 F. Supp 519 (D.R.I. 1992).

<sup>49</sup> 29 U.S.C. § 1348(a)(2), (4).

<sup>50</sup> *Pension Benefit Guar. Corp. v. Republic Techs. Int’l, LLC*, 386 F.3d 659, 668 (6th Cir. 2004). In *Republic Techs* the court, at the instance of PBGC, selected a termination date that avoided the “shutdown benefits” agreed to between employer and union. Accepting the termination date requested by the union would result in the PBGC’s incurring an additional \$95 million in benefit liabilities. In ruling, the court balanced the expectation interest of the employees against the PBGC’s financial state and universal purpose.

<sup>51</sup> *In re Aloha Airgroup, Inc.*, Case No. 04-3063 (Bankr. D. Hawaii 2005).

<sup>52</sup> *Id.* The PBGC assumed responsibility for three pension plans upon their distress termination in *Aloha* and held a \$117 million claim for underfunding obligations. <http://www.pbgc.gov/media/news-archive/2006/pr06-46.html>.

## VIII. WITHDRAWAL FROM MULTIEMPLOYER PENSION PLANS

A single employer may withdraw from a multiemployer plan (either completely or in part) without triggering the general termination of the plan. In general, “complete withdrawal” means the employer has permanently ceased operations under the plan or has permanently ceased to have an obligation to contribute.<sup>53</sup> A “partial withdrawal” generally occurs if, on the last day of a plan year, there is a 70-percent contribution decline for such plan year or there is a partial cessation of the employer’s contribution obligation.<sup>54</sup> Whether an employer’s withdrawal is a “complete withdrawal,” as such term is described in 29 U.S.C. § 1383, or a “partial withdrawal,” as such term is described in 29 U.S.C. § 1385 determines the extent of the employer’s exposure for withdrawal liability (discussed in Section XI below)<sup>55</sup>. A number of decisions provide guidance as to whether a complete or partial withdrawal from a multiemployer pension plan has occurred, or would occur, based on the applicable criteria of the appropriate statutory provisions.<sup>56</sup> The expiration<sup>57</sup> or rejection<sup>58</sup> of a collective bargaining agreement constitutes a complete withdrawal from such plan within the meaning of 29 U.S.C. § 1383(a). Additionally,

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<sup>53</sup> 29 U.S.C. § 1383.

<sup>54</sup> 29 U.S.C. § 1385.

<sup>55</sup> 29 U.S.C. § 1383 creates exceptions for particular industries: the building and construction industry (§ 1383(b)); the entertainment industry (§1383(c)); and the trucking industry (§1383(d)). These exceptions modify the definition of “complete” and “partial” withdrawal and alter the calculation of withdrawal liability. A plan sponsor bears the burden of establishing the applicability of a claimed exception. *See Central States, Southeast & Southwest Areas Pension Fund v. United States Truck Co. Holdings, Inc. (In re United States Truck Co. Holdings)*, 2006 U.S. Dist. LEXIS 24732 (E. D. Mich. 2006).

<sup>56</sup> For example, on the question of what level of activity is deemed a cessation of operations as required to effect a complete termination, some courts have determined that 100% cessation is required. *See Trustees of Iron Workers Local 473 Pension Trust v Allied Products Corp.*, 872 F.2d 208 (7<sup>th</sup> Cir. 1989). Other courts have determined that it sufficient if “virtually all” covered operations come to a halt. *See Crown Cork & Seal Co. v. Central States Southeast & Southwest Areas Pension Fund*, 982 F.2d 857 (3d Cir. 1992).

<sup>57</sup> *Connors v. Peles*, 724 F. Supp. 1538, 1560 (W. D. Pa. 1989).

<sup>58</sup> *See Central States, Southeast & Southwest Areas Pension Fund v. Landvatter*, 1993 U.S. Dist. LEXIS 13, \*1 (N.D. Ill. 1993) (withdrawal liability incurred when collective bargaining agreement (“CBA”) rejected as part of Chapter 11 plan of reorganization).

decertification of a collective bargaining unit effects a complete withdrawal.<sup>59</sup> A partial withdrawal by an employer can occur in two different ways. First, an employer partially withdraws from a plan on the last day of a plan year if, as of the last day of such plan year, its contribution had declined seventy percent during a three-year period comprised of the plan year and the two prior years. Second, a partial withdrawal occurs if there is a partial cessation of the employer's contribution obligation under either one but not all of its collective bargaining agreements or at one but not all of its facilities.<sup>60</sup>

## **IX. COLLECTIVE BARGAINING CONSIDERATIONS**

A union may negotiate for the establishment of a pension plan for members. In such a case, the employer's obligation to create and fund the plan will be written into the collective bargaining agreement. Standard or distress terminations of pension plans that violate the terms and conditions of an existing collective bargaining agreement may not proceed and are subject to formal challenge.<sup>61</sup> If PBGC is advised of a formal challenge to distress termination, PBGC must suspend the termination proceeding.<sup>62</sup> Further, as noted by the court in *US Airways*, any approval of a distress termination "is necessarily subject to a separate determination that termination will not violate the collective bargaining agreement."<sup>63</sup>

Bankruptcy Code Section 1113 prohibits modification or termination of collective bargaining agreements except under that section's prescribed substantive standards and

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<sup>59</sup> *In re Lissner Corp.*, 115 B.R. 604, 606 (N. D. Ill. 1990).

<sup>60</sup> 29 U.S.C. § 1385(a)-(b).

<sup>61</sup> 29 U.S.C. § 1341(a)(3).

<sup>62</sup> 29 C.F.R. § 4041.7(a)(1).

<sup>63</sup> 296 B.R. at 746.

procedures.<sup>64</sup> Further, a debtor is statutorily obligated to comply with all provisions of a collective bargaining agreement<sup>65</sup>, including those provisions requiring the debtor to make payments on account of post-petition obligations, unless the court orders otherwise.<sup>66</sup> Accordingly, it is procedurally proper for a debtor to (1) bargain for an amendment to the existing collective bargaining agreement to remove any bar to plan termination; (2) arbitrate the meaning or application of a particular provision of the collective bargaining agreement that may operate to preclude termination; (3) wait for the expiration of the collective bargaining agreement or (4) reject the collective bargaining agreement before seeking to terminate the pension plan. Still, it should be noted that a split of authority exists with respect to a debtor's obligation to pay pre-petition pension obligations during the bankruptcy case.<sup>67</sup> Recently, US Airways, Delta, UAL and Northwest all took the position that their obligations to make minimum funding contributions to retiree pension plans were circumscribed by the mandate that pre-petition obligations are to be paid only in accordance with the Bankruptcy Code's priority

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<sup>64</sup> See *United Steel Workers of America v. Unimet Corp.*, (In re *Unimet Corp.*), 842 F.2d 879, 880-84 (6th Cir. 1988), cert. denied, 488 U.S. 828 (1988) (Section 1113 protects interests of retirees covered by collective bargaining agreement); *Shugrue v. ALPA* (In re *Ionosphere Clubs, Inc.*), 922 F.2d 984 (2nd Cir. 1990).

<sup>65</sup> Bankruptcy Code Section 1113(f) provides that “[n]o provision of this title shall be construed to permit a trustee to unilaterally terminate or alter any provisions of a collective bargaining agreement prior to compliance with the provisions of [Bankruptcy Code Section 1113]”. 11 U.S.C. § 1113(f). Section 1113 refers to the requirement that a debtor bargain in good faith with the union and if an agreement cannot be reached, for the court to approve (1) rejection of the CBA or (2) such modifications as are necessary to the reorganization. 11 U.S.C. § 1113. However, it should be noted that a union's duty to bargain collectively on behalf of the members of the bargaining unit that the union represents does not extend to retired workers. Retirees seeking to preserve a pension plan under a CBA are generally unable to require a debtor to bargain with retirees. See *United Retired Pilots Ben. Prot. Ass'n v. United Airlines, Inc.* (In re *UAL Corp.*), 443 F.3d 565 (7th Cir. 2006). Recently in *In re Delta Air Lines*, No. 05-17923 (Bankr. S.D.N.Y. 2006), a group of retired pilots attempted, without success, to block a union's agreement to enter into a wage concession deal with the Debtors.

<sup>66</sup> 11 U.S.C. § 1113. Pension plan payments made pursuant to Bankruptcy Code Section 1113 are not avoidable as unauthorized post-petition transfers. See *Wilmington Trust Co. v. WCI Steel, Inc.* (In re *WCI Steel, Inc.*), 313 B.R. 414 (Bankr. N. D. Ohio 2004).

<sup>67</sup> Compare *Unimet*, *supra* (debtor required to comply with all provisions of a collective bargaining agreement post-petition) with *In re Ionosphere Clubs, Inc.* (*Ionosphere II*), 22 F.3d 403, 407 (2d Cir. 1994) (Section 507 applies to claims arising under collective bargaining agreements, and claims relating to pre-petition services under a collective bargaining agreement will not be accorded administrative expense priority, absent assumption of the collective bargaining agreement.).

scheme. These debtors maintained that Section 1113 (f) does not confer super-priority status on pre-petition pension obligations and that they were only obligated to make pension contributions to the extent those payments were attributable to the postpetition services of their employees.<sup>68</sup> Conversely, several pension funds argued that Section 1113(f) requires that all pension-related obligations be accorded administrative expense priority as 1113(f) may be read to require a debtor to pay all bargained-for pension obligations pursuant to the governing CBA until the CBA is modified or rejected. This issue is presently before the bankruptcy court in the Delta Airlines case.

Notably, under 29 U.S.C. § 1342, PBGC can terminate a plan irrespective of any provision in a union's collective bargaining agreement.<sup>69</sup> Further, consistent with the national outlook of its mission, PBGC need not consult with a union before an involuntary termination.<sup>70</sup>

## **X. PBGC CLAIMS**

Upon the termination of a defined benefit plan, the debtor and each trade or business under common control with it for purposes of ERISA would be jointly and severally liable to PBGC for the underfunding of that plan.<sup>71</sup> In addition, the debtor and each controlled group member would be jointly and severally liable to PBGC, as statutory trustee of the plan, for contributions required under ERISA's minimum funding standards.<sup>72</sup> Finally, a debtor and each controlled group member may be jointly and severally liable for insurance premiums due PBGC under 29 U.S.C. § 1307. The PBGC generally files its three claims – for employer liability,

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<sup>68</sup> This issue mirrors the PBGC's administrative priority claim assertion discussed at Section X.C. below.

<sup>69</sup> See *In re UAL Corp.*, 428 F.3d 677 (7th Cir. 2005).

<sup>70</sup> See *Jones & Laughlin Hourly Pension Plan v. LTV Corp.*, 824 F.2d 197, 199-202 (2d Cir. 1987).

<sup>71</sup> 29 U.S.C. § 1362(b). A group of trades or businesses under common control, referred to as a "controlled group," includes for example affiliates such as a parent corporation, subsidiary, or brother-sister company. See IRC §§ 414(b), (c); see also 29 C.F.R. 4001.3; Treas. Reg. § 1.414(b) and (c).

<sup>72</sup> 29 U.S.C. §§ 1082(c)(11), 1362(c); IRC § 412(c)(11); Rev. Rul. 79-237, 1979-2 C.B. 190.

unpaid contributions, and unpaid premiums – for each plan with respect to each debtor to preserve its arguments that the claims should be satisfied on a joint and several basis.

A. Single-Employer Termination Claims – Upon the approval of a “distress” termination of a pension plan, the PBGC has a claim against the debtor (employer) for the amount of the unfunded benefit liabilities.<sup>73</sup> Under ERISA, the amount of unfunded benefit liabilities is defined as the excess of the value of the benefit liabilities under the plan over the current value of the assets of the plan.<sup>74</sup> The Internal Revenue Code and ERISA impose a statutory lien with respect to unpaid minimum funding contributions that exceed \$1,000,000.<sup>75</sup> The statutory lien attaches to all property of the plan sponsor and each member of its controlled group.<sup>76</sup> The amount of the lien is the aggregate unpaid balance of required installments and other payments required under Section 412 of the Internal Revenue Code and ERISA (including interest).<sup>77</sup> PBGC has the exclusive authority to enforce and collect amounts due under the statutory lien.<sup>78</sup> In the Delta Airlines case, for example, the PBGC estimates the Debtors’ pension plans to be underfunded by \$10.6 billion. In the event of a distress termination, the PBGC would be obligated to assume responsibility for the guaranteed benefits up

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<sup>73</sup> 29 U.S.C. § 1362(b)(1)(A)-(B).

<sup>74</sup> 29 U.S.C. § 1301(18)(A)(B).

<sup>75</sup> IRC § 412(n).

<sup>76</sup> *Id.*

<sup>77</sup> IRC § 412(n)(3).

<sup>78</sup> IRC § 412(n)(5); 29 U.S.C. §§ 1082(f)(5), 1303(e)(1).

to the statutory maximums or \$8.4 billion and could be expected to assert a claim in this amount.<sup>79</sup>

- B. Valuation Rates – If the plan is terminated, the calculation of PBGC’s claim is often the subject of litigation because the amount of PBGC’s claim can have a significant impact on the recovery of other unsecured creditors. PBGC’s employer liability claim is for 100 percent of the “unfunded benefit liabilities” under the plan and is equal to the present value of all accrued benefits as of the date of termination using the actuarial equivalence stated in the plan. PBGC determines the actuarial present value of the benefit liabilities pursuant to the assumptions prescribed by PBGC in its valuation regulation.<sup>80</sup> The interest rate assumption in PBGC’s valuation regulation can have a substantial effect on the amount of PBGC’s claims and therefore it is challenged in virtually every bankruptcy.<sup>81</sup> The Sixth Circuit in *In re CSC Industries*, 232 F.3d 505, 509 (6<sup>th</sup> Cir. 2000) and the Tenth Circuit in *CF&I Fabricators*, 150 F.3d 1292, 1302 (10<sup>th</sup> Cir. 1998) have both held that the bankruptcy court may value the liability using a “prudent investor rate,” the rate that a reasonably prudent investor would receive from investing the funds. The prudent investor rate applied by these courts has been significantly higher than the rates proffered by the PBCG in accordance with its regulations. The effect of the higher interest rate has been to decrease or even eliminate PBGC’s claim in certain cases. In direct conflict with the 6th and 10th Circuit decisions, the bankruptcy court in the first US Airways case recently

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<sup>79</sup> <http://www.pbgc.gov/media/news-archive/2005/pr05-61.html>.

<sup>80</sup> 29 C.F.R. Part 4044.

<sup>81</sup> IRS Rev. Rul. 79-237.

upheld PBGC's methodology for valuing its claim for unfunded liabilities.<sup>82</sup> PBGC determined the actuarial present value of the benefit liabilities pursuant to the assumptions prescribed by PBGC in its valuation regulation. Under PBGC's methodology, the unfunded liabilities were \$2.219 billion. US Airways, on the other hand, valued the benefits using the traditional "prudent investor" interest rate combined with a more stringent mortality table and an older assumed retirement age, resulting in underfunding of only \$894 million. The *US Airways* court determined that applicable non-bankruptcy law should be applied to determine the amount of the PBGC claims and accordingly accepted the PBGC's methodology and assumptions.

- C. Administrative Status of PBGC Claims – PBGC generally maintains that the unpaid minimum funding contributions due post-petition are entitled to administrative expense priority under Bankruptcy Code Section 503(b)(1)(A) because they are actual, necessary costs and expenses of preserving a debtor's estate. Under Bankruptcy Code Section 503(b)(1)(A), all actual and necessary costs and expenses of a debtor's bankruptcy estate are entitled to administrative priority. The PBGC has historically taken the position that termination claims arising from underfunding represent a statutorily required compensation-related expense that came due post-petition.<sup>83</sup> Accordingly, the PBGC maintains that post-petition minimum funding contributions are entitled to administrative expense priority because they are ordinary business expenses of a debtor's estate.

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<sup>82</sup> *In re US Airways Group, Inc.*, 296 B.R. 734, 743 (E.D. Va. 2003) ("US Airways I"). In the first US Airways bankruptcy case, a pilot's pension plan was terminated resulting in a \$726 million claim by the PBGC. As a result of the termination of additional pension plans in the second US Airways bankruptcy case, PBGC obtained an additional \$2.3 billion claim. <http://www.pbgc.gov/media/news-archive/2005/pr05-22.html>.

<sup>83</sup> *In re Columbia Packing Company*, 81 B.R. 205 (D. Mass 1988).

The majority of court courts considering this issue have reasoned that PBGC termination claims are precluded from priority status. Some courts have held that unpaid minimum funding contribution expenses were not specifically listed in Bankruptcy Code Section 503(b)(1)(A) as being entitled to administrative priority and are therefore excluded.<sup>84</sup> Other courts have found that the minimum funding claims did not arise from a post-petition transaction with the debtor, but rather from the pre-petition creation of the pension plan, and that there was no benefit to the estate to the extent that the contributions were attributed to pre-petition labor.<sup>85</sup> PBGC generally does not attempt to prove a direct and substantial benefit to the estate, but proposes that courts follow the line of cases that began with *Reading Co. v. Brown*, 391 U.S. 471, 88 (1968), and which recognized exceptions to the “benefit to the estate” requirement. In *Reading* the Supreme Court held that fundamental considerations of fairness and logic required that damages caused by the post-petition negligence of a receiver in a Chapter 11 case be treated as actual and necessary costs of administration of the estate, even if the estate received no substantial benefit.

- D. Priority Tax Treatment of PBGC Claims - PBGC also maintains that its claims for unpaid minimum funding contributions should be given the priority granted to tax claims under Bankruptcy Code Section 507(a)(8) because the Internal Revenue Code states that such claims shall be treated as taxes to the extent that they exceed \$1,000,000 and are secured by a lien. IRC § 412(n) directs that “any amount with

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<sup>84</sup> *CF&I Fabricators*, 150 F.3d at 1302; *In re Kent Plastics*, 183 B.R. 841, 847-48 (S.D. Ind. 1995).

<sup>85</sup> *Amalgamated Ins. Fund v. McFarlin’s, Inc.*, 789 F.2d 98, 103-104 (2d Cir. 1986); *See also In re HNRC Dissolution Co.*, 2006 Bankr. LEXIS 323 (Bankr. E. D. Ky. 2006); *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 160 B.R. 882 (Bankr. S.D.N.Y. 1993); *LTV Corp. v. PBGC (In re Chateaugay Corp.)*, 115 B.R. 760, 771 (Bankr. S.D.N.Y. 1990), *aff’d*, 130 B.R. 690 (S.D.N.Y. 1991).

respect to which a lien is imposed ... shall be treated as taxes due and owing the United States” and further provides that rules similar to those found in 29 U.S.C. § 1368(c), (d) and (e) shall apply to the lien amount.<sup>86</sup> 29 U.S.C. § 1368(c)(2) in turn, provides that “[i]n a case under title 11 of the United States Code or in insolvency proceedings, the lien imposed...shall be treated in the same manner as a tax due and owing to the United States for purposes of title 11.” These provisions present the basis for PBGC’s claim for its claim that unpaid minimum contributions owed to a pension plan must be treated as taxes and accorded priority under Bankruptcy Code Section 507(a)(8). According to the PBGC, this claim meets the definition of a “tax” because it is an involuntary financial burden imposed on entities or their property for public purposes, including defraying of the government’s expenses. Only two published opinions address the issue of treating the unpaid minimum funding contribution amounts as taxes. The Tenth Circuit in *In re CF&I Fabricators* concluded that the unpaid contributions were not entitled to tax priority because “there is no expressed congressional intent that the ‘tax treatment’ described in IRC § 412 was meant to apply in the bankruptcy context” and because the minimum unpaid contributions are not to defray the government’s expenses but rather the expenses of the PBGC<sup>87</sup> The Sixth Circuit in *CSC Industries* found that unpaid minimum funding contributions were not taxes, reasoning that tax treatment could only be accorded if there was a lien and

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<sup>86</sup> IRC § 412(n)(1).

<sup>87</sup> *CF&I Fabricators*, 150 F.3d at 1297-1298.

concluding that the automatic stay prevented the IRC § 412(n) lien from arising.<sup>88</sup> Thus, the Sixth Circuit did not reach the issue of whether the claim would have been accorded priority as a tax claim if the lien had arisen pre-petition.

- E. Calculating Post-Petition Funding Obligations – As noted in Section II.B above, a plan sponsor’s minimum funding contributions are not static. For purposes of calculating the portion of any unpaid minimum funding contributions entitled to administrative expense priority, it may prove necessary to determine the portion attributable to the actuarial cost of benefits earned post-petition. In *Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, the Sixth Circuit ruled that because the “debtor’s estate was benefited only to the extent that employees continued to work during the bankruptcy proceedings,” only the actuarial cost of “benefits earned by the employees during the post-petition period” was entitled to administrative expense priority.<sup>89</sup>

## **XI. MULTIEMPLOYER PLAN WITHDRAWAL CLAIMS**

- A. Withdrawal Liability – The substantive provisions of the Multiemployer Pension Plan Amendments Act of 1980, 29 U.S.C. §§ 1381-1453 (“MPPAA”) concern the ramifications for an employer if it chooses to withdraw from a multiemployer pension plan.<sup>90</sup> MPPAA, among other things, establishes and defines the liability of an employer upon its withdrawal from a multiemployer pension plan. Under ERISA, an employer that withdraws from a multiemployer plan in a complete or

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<sup>88</sup> *CSC Industries*, 232 F.3d at 509. Under the statute as in effect at the time of the litigation, the lien arose on the 60th day following the deadline for making the contributions. The law has since been amended, so that the lien now arises immediately on the contribution due date.

<sup>89</sup> 126 F.3d 811, 814-17 (6<sup>th</sup> Cir. 1997).

<sup>90</sup> 29 U.S.C. §§ 1382, 1391, 1399.

partial withdrawal is liable to the plan in the amount determined to be the withdrawal liability.<sup>91</sup> Specifically, an employer that ceases to contribute to a multiemployer pension plan is still liable for its share of vested, unfunded benefits.<sup>92</sup> This protects other employers in the plan from having to pay for those benefits. When an employer withdraws from a multiemployer plan, the plan sponsor is required to determine the amount of the employer's withdrawal liability, notify the employer of the amount of the withdrawal liability, and collect the amount of the withdrawal liability from the employer.<sup>93</sup> All disputes between the employer and the pension fund concerning this determination must be resolved through arbitration.<sup>94</sup> If the employer fails to initiate arbitration by the statutory deadline, the amount demanded by the pension fund is deemed to be due and owing.<sup>95</sup> The employer's withdrawal liability generally is based on the extent of the plan's unfunded vested benefits for the plan years preceding the withdrawal.<sup>96</sup> It is worth noting that a debtor may find itself compelled to continue to contribute to a plan while the details and implications of its withdrawal are adjudicated.<sup>97</sup> Where a single employer's withdrawal liability is discharged in bankruptcy upon confirmation of a plan, other members of the

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<sup>91</sup> 29 U.S.C. § 1381.

<sup>92</sup> 29 U.S.C. §§ 1381(a), 1383.

<sup>93</sup> 29 U.S.C. § 1382.

<sup>94</sup> 29 U.S.C. § 1401(a)(1).

<sup>95</sup> 29 U.S.C. § 1401(b)(1).

<sup>96</sup> 29 U.S.C. §§ 1389 and 1311.

<sup>97</sup> See *Galgay v. Beaverbrook Coal Co.*, 105 F. 3d 137 (3d Cir. 1997) where trustees of a plan were successful in compelling interim payments by an employer that had attempted to withdraw from a multiemployer pension plan while the employer's withdrawal liability was being arbitrated.

control group remain responsible for the withdrawal liability.<sup>98</sup> An employer that completely or partially withdraws from a multiemployer plan is liable to the plan for the employer's allocable share of unfunded vested benefits.<sup>99</sup> Withdrawal liability essentially forces employers to continue making payments on behalf of fully vested workers so that, even if company is no longer a going concern, all fully vested workers under the plan will receive the benefits they earned. As such, even where an employer is current in its required funding contributions, it can incur substantial liability. Withdrawal liability differs from a failure to satisfy monthly or annual funding requirements.<sup>100</sup> Each missed payment gives rise to an immediate right to payment by a plan, but withdrawal liability is premised on an employer's proportionate share of unfunded vested benefits at the time of withdrawal.<sup>101</sup>

1. *Calculating Withdrawal Liability* – An employer's withdrawal liability is its proportionate share of the plan's unfunded vested benefits, that is, the difference between the present value of vested benefits, which are benefits that are currently being paid to retirees and that will be paid in the future to covered employees who have already completed some specified period of service,<sup>102</sup> and the current value of the plan's assets.<sup>103</sup> ERISA permits

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<sup>98</sup> *I.A.M. Nat'l Pension Fund v. TMR Realty Co*, 2006 U.S. Dist. LEXIS 14901 (D.D.C. 2006).

<sup>99</sup> 29 U.S.C. § 1053.

<sup>100</sup> *In re United Merchants and Manufacturers*, 166 B.R. 234, 239 (D. Del. 1994); *see generally* 29 U.S.C. §§ 1132, 1145 (providing cause of action for delinquent contributions).

<sup>101</sup> 29 U.S.C. § 1393(c); *see also In re CD Realty Partners*, 205 B.R. 651 (Bankr. D. Mass. 1997).

<sup>102</sup> 29 U.S.C. § 1053.

<sup>103</sup> 29 U.S.C. §§ 1381, 1391.

multiemployer pension plans many options for calculating withdrawal liability. Most of the methods calculate withdrawal liability as a function of contributions made by the withdrawing employer, normally for the five [or ten] plan years ending with the year in which the unfunded vested benefits or change in the unfunded vested benefits is determined. Generally, a higher contribution history indicates a higher proportionate participation in a plan.<sup>104</sup>

- B. Administrative Status – In general, courts have accepted the proposition that withdrawal liability relates back to a pre-petition obligation and is a general unsecured claim, not entitled to administrative expense priority.<sup>105</sup> The rationale supporting such a holding is that withdrawal liability payments are designed to guarantee pension benefits already earned by the employees covered by the plan, and because the consideration supporting the withdrawal liability was the same as that supporting the pensions themselves, *i.e.*, the past, pre-petition labor of the employees, such claims are not entitled to administrative status. Accordingly, pension plans are able to obtain administrative expense treatment only upon the portion of withdrawal liability clearly attributable to post-petition labor.<sup>106</sup> Recently, in *HNRC*,<sup>107</sup> the pension plan argued that while an employer

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<sup>104</sup> *Central States, Southeast & Southwest Areas Pension Fund v. Nitehawk Express, Inc.*, 223 F.3d 483, 486 (7th Cir. 2000).

<sup>105</sup> *Trustees of the Amalgamated Insurance Fund v. McFarlin's, Inc.*, 789 F.2d 98 (2d Cir. 1986); *United Department Stores, Inc.*, 49 B.R. 462 (Bankr. S.D.N.Y.1985).

<sup>106</sup> *Chateaugay*, 130 B.R. 690 at 697; *In re Pulaski Highway Express, Inc.*, 57 B.R. 502 (Bankr. M.D. Tenn. 1986). Courts have struggled with the question of whether withdrawal liability may be divided into pre- and postpetition portions. The problem with the proration of the withdrawal liability is that often, by the mere passage of time in a case, more and more of the withdrawal liability is converted from a pre-petition claim to an administrative claim even if the withdrawal liability decreases during the administration of the case.

<sup>107</sup> *Supra*, n. 74.

participates in a multiemployer plan, the unfunded vested benefits increase over time as the employees accrue more pension credit. The pension plan maintained that it was entitled to an administrative claim for the sum by which the debtor's withdrawal liability increased post-petition as the employees continued to work.<sup>108</sup> In rejecting the plan's contentions that postpetition operations were sufficient to support an administrative status claim, the court held that the plan failed to demonstrate that the claimed withdrawal liability arose from a direct and substantial benefit to the Debtors' estates.<sup>109</sup> Further, the court noted that the liability may attributable in some significant part to other factors including poor investment performance.<sup>110</sup> Addressing the same issue, the court in *In re Sunarhauserman, Inc.*, 184 B.R. 279, 282 (Bankr. N.D. Ohio 1995) reached a different result. The *Sunarhauserman* court determined that a multiemployer pension plan's claim for withdrawal liability is entitled to administrative expense priority to extent that the value of pension benefits earned by a debtor's employees during postpetition operations is greater than the debtor's contributions to the plan for same period.<sup>111</sup> The court observed that the ERISA mechanism for calculating withdrawal liability focused on historical data and provided no real

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<sup>108</sup> This contention finds support in *In Matter of Cott Corp.*, 47 B.R. 487 (Bankr. D. Conn. 1984). In *Cott*, the fund trustees sought administrative expense status for the full withdrawal liability sum. The debtor opposed such treatment on the basis that the withdrawal liability was triggered by the rejection of the CBA which relates back to a pre-petition date under Section 365(g); hence, any liability arising from the rejection could only create a pre-petition claim. The court concluded that the withdrawal liability was properly apportioned into pre and postpetition sums. The court accorded administrative expense status for that share of the withdrawal liability claim which is proportional to a postpetition period. *Id.* at 495.

<sup>109</sup> 2006 Bankr. LEXIS 323 at \*3.

<sup>110</sup> *Id.* at \*5.

<sup>111</sup> 184 B.R. at 283.

basis for allocating the debtor's withdrawal liability for the postpetition period.<sup>112</sup> The court required actuarial calculations of the value of the pension plan's benefits earned by the debtor's employees postpetition, subtracted the debtor's actual contributions to the pension plan during that period and granted administrative expense status to the shortfall.<sup>113</sup>

## **XII. THE DEFICIT REDUCTION ACT OF 2005**

In response to the growing number of corporate bankruptcy cases seeking to transfer liability for underfunded pension plans to the PBGC,<sup>114</sup> President Bush recently signed the Deficit Reduction Act of 2005 (the "DRA") that, among other things: (i) increases certain premiums that defined benefit pension plans pay to the PBGC; and, (ii) for a company that terminates its defined benefit plan between January 1, 2006 and December 31, 2010, imposes an annual surcharge of \$1,250 per individual participating in the defined benefit plan immediately prior to its termination, payable for three years following the plan's termination. Special rules apply in certain cases involving bankruptcy: the three-year payment period begins after the debtor/employer receives a discharge or its Chapter 11 case is dismissed.<sup>115</sup> "The surcharge is designed to force non-liquidating employers that terminate their pension plans to shoulder some of the financial responsibility resulting from such terminations."<sup>116</sup>

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<sup>112</sup> *Id.* at 282.

<sup>113</sup> *Id.* at 283.

<sup>114</sup> The new termination premium is part of a package that is designed to address the PBGC's \$23 billion long-term deficit. Ann vom Eigen, *Pension Surcharge and Bankruptcy Filing Fees Become Law*, AMERICAN BANKRUPTCY INSTITUTE JOURNAL, pp. 61-62, March, 2006.

<sup>115</sup> DRA is applicable to bankruptcy cases filed after October 18, 2005. The bankruptcy premiums will not apply to plans terminated after December 31, 2010.

<sup>116</sup> Karol K. Denniston, J. Mark Poerio, Lynda M. Noggle, and Toronda M. Silas, *Lenders Beware! New Surcharge on Underfunded Pension Plan Terminations May Sink Distressed Companies...And Your Money*, STAY CURRENT, A CLIENT ALERT FROM PAUL HASTINGS, March, 2006.

The increases in premiums and the new plan termination surcharge are summarized below:

**Increase in Single Employer Premiums.** “DRA Section 8101(a)(1) amends [29 U.S.C. § 1306(a)(3)(A)(i)] by increasing the flat rate per participant premium amounts for single-employer plans to \$30 from \$19.”<sup>117</sup>

**Increase in Multiemployer Premiums.** “DRA Section 8101(a)(2) amends [29 U.S.C. § 1306(a)(3)(A)(iii)] to increase the multiemployer plan premium rate from \$2.60 per participant to \$8.00 per participant.”<sup>118</sup>

**Plan Termination Surcharge.** DRA Section 8101(b) adds a new paragraph in [29 U.S.C. § 1306(a)(7)] imposing a surcharge for plan termination. Now when an employer terminates a defined benefit plan by virtue of a distress termination in bankruptcy, insolvency proceedings under ERISA, or where the PBGC forces a plan termination, employers must pay a \$1,250 surcharge<sup>119</sup> for each participant in the plan just before termination payable annually for each of the three years following the plan’s termination date or, if later, the employer’s exit from bankruptcy.<sup>120</sup> Plans terminated in bankruptcy will be exempt from the premium until after the employer’s discharge is granted or its chapter 11 case is dismissed.

**Experts speculate on the effects of the DRA’s increases in plan termination premiums and the plan termination surcharge.** The new single employer and multiple employer premiums could raise an additional barrier to maintaining or establishing defined

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<sup>117</sup> BNA’S BANKRUPTCY LAW REPORTER, Vol. 18, No. 7, p. 163, February 16, 2006.

<sup>118</sup> *Id.*

<sup>119</sup> BNA’S BANKRUPTCY LAW REPORTER, Vol. 18, No. 7, p. 163, February 16, 2006.

<sup>120</sup> Formerly, an employer ceased paying premiums to the PBGC upon plan termination. Neela K. Ranade, *Budget Reconciliation and the PBGC*, CRS REPORT FOR CONGRESS, Order Code RS22315, November 10, 2005.

benefit pension plans. In the bankruptcy context, the “high ‘termination’ surcharge could have the perverse effect of forcing companies to liquidate, rather than reorganize in Chapter 11, thereby exacerbating PBGC’s ability to collect unfunded benefit liability.”<sup>121</sup> The termination surcharge “is particularly onerous on struggling companies and can represent an enormous financial burden. For example, Delta Airlines, which has approximately 28,000 retirees, would have to prove to the court that it could pay a termination surcharge of \$105 million within three years to exit bankruptcy.”<sup>122</sup>

If a reorganizing debtor terminates its plan and is forced to liquidate in a Chapter 7, a debtor’s retirees and current employees could suffer reduced retirement income/expectations of retirement income, and current employees would suffer the additional blow of losing their jobs.<sup>123</sup> The PBGC and the employees of the terminating company could wind up holding unsecured claims paying mere cents on the dollar. Thus, the practical effect of the DRA’s new plan termination fee may leave the PBGC just as broke but holding larger unsecured claims.

**Certain provisions of ERISA may conflict with the Bankruptcy Code.** If a plan is terminated during the pendency of a Chapter 11 case, the employer/debtor’s obligation to pay the termination surcharge arises only after a discharge is granted or the case is dismissed. Ergo, the surcharge obligation cannot be discharged or otherwise addressed in the Chapter 11 case, which stands in contrast to the “fresh start” principle that underlies Chapter 11 reorganization. The DRA ‘thus purports to create a new variety of ‘claim’ that, while tied to events that occurred

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<sup>121</sup> BNA’S BANKRUPTCY LAW REPORTER, Vol. 18, No. 7, p. 164, February 16, 2006.

<sup>122</sup> Ann vom Eigen, *Pension Surcharge and Bankruptcy Filing Fees Become Law*, AMERICAN BANKRUPTCY INSTITUTE JOURNAL, pp. 61-62, March, 2006. But note- as Delta’s bankruptcy case was filed prior to October 18, 2005, the termination penalty provisions in the DRA do not apply to Delta’s reorganization.

<sup>123</sup> Nicholas J. Brannick, *At the Crossroads of Three Codes: How Employers are using ERISA, the Tax Code, and Bankruptcy to Evade their Pension Obligations*, 65 OHIO ST. L.J. 1577, 1584-1585 (2004). This article provides an interesting commentary on the problem of pension underfunding and plan termination.

prior to a debtor's discharge (and which thus arguably constitutes a contingent claim that can be discharged in chapter 11), will be deemed to arise after, and remain unaffected by, the debtor's discharge."<sup>124</sup> This seemingly conflicts with Bankruptcy Code Section 1141(d) which grants the discharge of "any debt that arose before the date of such confirmation" to a company whose Chapter 11 plan of reorganization is confirmed.

While it is difficult to predict exactly how courts will resolve the apparent conflict between the Bankruptcy Code and ERISA, 29 U.S.C. § 1144(d) explicitly states that "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 any such law."

Thus, despite "the apparent intent of Congress, it is possible that the [DRA] will be ineffective in circumventing the broad discharge of Bankruptcy Code Section 1141, and the attempt to impose post-bankruptcy premium surcharges on companies that terminate pension plans in chapter 11 reorganization proceedings will be held invalid."<sup>125</sup>

### **XIII. HOT TOPICS AND UNRESOLVED ISSUES**

- Can a confirmed plan discharge a non-debtor member of a control group from withdrawal liability or other plan termination claims? See *I.A.M. Nat'l Pension Fund v. TMR Realty Co.*, 2006 U.S. Dist. LEXIS 14901 (D.D.C. 2006).
- In *Aloha Airgroup*, the Debtors changed the plan's funding methodology postpetition in an effort to alter the minimum funding claim liability. This shift in the Debtors' chosen actuarial method was challenged by the PBGC. Should pre-bankruptcy planning of this sort be acceptable?

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<sup>124</sup> Shearman & Sterling, LLP., *New Law Limits Ability of Distressed Companies to Shed Pension Liabilities in Bankruptcy*, February 13, 2006.

<sup>125</sup> *Id.*

- If a plan sponsor withdraws from a multi-employer plan post-confirmation, is withdrawal liability discharged?
- What is the appropriate standard of review which a court should apply to the PBGC's decision to invoke involuntary termination proceedings? *See Pension Benefit Guar. Corp. v. Rouge Steel Co.*, 2006 U.S. Dist. LEXIS 2685 (E. D. Mich. 2006) (noting unresolved conflict between the arbitrary and capricious standard embraced in *In re Pan American World Airways, Inc. Co-Op Retirement Income Plan*, 777 F. Supp 1179, 1182 (S.D.N.Y. 1991) and the de novo standard articulated in *Pension Benefit Guaranty Corp. v. United Air Lines, as Plan Administrator for the United Airlines Pilot Defined Benefit Pension Plan*, 2005 Bankr. LEXIS 2039 (Bankr. N.D. Ill. 2005)).
- Since withdrawal from a multiemployer plan is required to trigger a debtor's withdrawal liability, when must a pension fund file a proof of claim? At outset of case – even if contributions are current and withdrawal is not foreseeable? *See In re Crane Rental Co.*, 334 B.R. 73 (Bankr. D. Mass. 2005).