



Pensions and Benefits in Bankruptcy

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Pension Benefits

- The two kinds of pension plans are known as “defined benefit” plans and “defined contribution” plans.
- Defined benefit plans pay retired employees an annual pension, usually based on their salaries and years of service. See 29 U.S.C. § 1002(35).
- Defined contribution plans pay retired employees the balance of an account to which they contributed a percentage of their income while they were employed, and/or to which the employer contributed. See 29 U.S.C. § 1002(34).
- PBGC pension insurance under ERISA applies to defined benefit plans provided by private-sector employers, but it does not cover defined contribution plans. See 29 U.S.C. § 1321(b)(1). In a defined contribution plan, the employee's benefit is equal to the account balance, so, by definition, there is never a shortfall to insure. Employers meet their plan funding obligations when they make contributions, so there is also no additional liability upon termination.

Rejecting Collective Bargaining Agreements Bankruptcy Code Section 1113

- Section 1113 provides the exclusive means for debtors to reject or modify their CBAs. It requires the parties to participate in an orderly negotiation process, which is followed by an evidentiary hearing if no resolution is reached.
- Section 1113 was enacted in 1984 in reaction to NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984), which held that the debtor was not required to comply with the terms of a collective bargaining agreement in the interim period between the filing of the bankruptcy petition and the entry of an order finding that the balance of the equities favor rejection of the agreement.

Bankruptcy Code Section 1113 Requirements

- To obtain an order authorizing rejection of the agreement, the debtor must prove by a preponderance of the evidence that nine statutory requirements have been satisfied:
 - Debtor makes a proposal to the union;
 - Proposal is based on most complete and reliable information then available;
 - Proposed modifications are necessary to permit reorganization;
 - Modification treats all affected parties fairly and equitably;
 - Debtor provides the union with relevant information necessary to evaluate the proposal;
 - Debtor meets with union representatives at reasonable times after making the proposal;
 - Debtor negotiates in good faith with the union;
 - Union refuses to accept the proposal without good cause;
 - Balance of the equities clearly favors rejection of the contract.

In re: Family Snacks, Inc., 257 B.R. 884, 892 (B.R.A.P. 8th Cir. 2001);

In re American Provision Co., 44 B.R. 907 (Bankr. D. Minn. 1984).

Bankruptcy Code Section 1113

“Necessary” Requirement

- The “necessary” requirement is often the most contested. There is a split in the circuits as to the definition of “necessary.”
- Majority view. The majority of courts hold that modifications are “necessary” if they increase the likelihood of a successful reorganization. *Truck Drivers Local 807 v. Carey Transp., Inc.*, 816 F.2d 82, 88-90 (2d Cir. 1987); *In re Mile Hi Metal Systems, Inc.*, 899 F.2d 887, 892 (10th Cir. 1990); see *In re Royal Composing Room, Inc.*, 848 F.2d 345, 350 (2d Cir. 1988) cert. denied, 489 U.S. 1078 (1989) (holding that the debtor’s proposal “need not be limited to the bare bones relief that will keep it going”). The proposal may be based on whether the debtor will “complete the reorganization process successfully,” including the period after emergence from bankruptcy. *Carey Transp.*, 816 F.2d at 90.
- Minority view. The Third Circuit has held that “necessary” means “essential” to prevent liquidation and is not related to the “general long-term viability” of a debtor. *Wheeling-Pittsburgh Steel Corp. v. United Steelworkers*, 791 F.2d 1074, 1084-91 (3d Cir. 1986).

Bankruptcy Code Section 1113

“Necessary” Requirement

- Are proposed modifications viewed collectively or individually when determining necessity?

The Second and Tenth Circuits are split. Compare *In re Royal Composing Room*, 848 F.2d 345 (looking at employer’s proposed package and total dollar savings as a whole) with *In re Mile Hi Metal Systems*, 899 F.2d at 892 n.8 (suggesting that each item must be necessary).

- Are non-economic items “necessary”?

For a proposed item to be “necessary,” most courts require that it must have an economic value assigned. E.g., *In re Mile Hi Metal Systems*, 899 F.2d at 892; *In re Express Freight Lines, Inc.*, 119 B.R. 1006 (Bankr. E.D. Wis. 1990); *In re Sun Glo Coal Co., Inc.*, 144 B.R. 58, 63 (Bankr. E.D. Ky. 1992). Some courts, nonetheless, hold that the inclusion of non economic items, (e.g., grievance procedures, certain work rules, etc.), is not fatal to a proposal. E.g., *In re Hoffman Brothers Packing Co., Inc.*, 173 B.R. 177, 182-83 (9th Cir. BAP 1994).

Bankruptcy Code Section 1113

Recent Developments

- Is the denial of an 1113 motion a bar to later renewal?

One court has held that a denial of a Section 1113 application has a res judicata effect and bars a second application. *In re Fulton Bellows & Components, Inc.*, 301 B.R. 723 (Bankr. E.D. Tenn. 2003). However, a recent decision in *Delta Air Lines*, denying an 1113 application brought by Delta subsidiary Comair, expressly contemplates the debtor's renewal of the motion. *In re Delta Air Lines*, 312 B.R. 685 (Bankr. S.D.N.Y. 2006); see also *In re Mesaba Aviation Inc.*, 341 B.R. 693 (Bankr. D.Minn. 2006).

Bankruptcy Code Section 1113

Recent Developments

- Do third parties have the right to participate in an 1113 proceeding?

Section 1113(d) provides that all “interested parties” may appear and be heard at the evidentiary hearing on the debtor’s motion to reject. The Seventh Circuit held that the independent fiduciary appointed to enforce funding and contribution provisions of pension plans did not have standing to participate in a Section 1113 proceeding involving contractual provisions related to the plan. The Court held that “interested party” under Section 1113 means the parties to the collective party agreement. *In re UAL Corp.*, 408 F.3d 847 (7th Cir. 2005).

Bankruptcy Code Section 1113

Recent Developments

- Who are the parties to the collective bargaining agreement?

Section 1113(b) requires the debtor to make a proposal to and negotiate with “the authorized representative of the employees covered by such [collective bargaining] agreement.” In a case decided before Section 1114 was added to the Bankruptcy Code (which provides procedures for modifying retiree non-pension benefits similar to those under Section 1113), the Second Circuit held that vested retiree health beneficiaries are “parties” to a collective bargaining agreement within the meaning of Section 1113(b) and therefore entitled to representation and participation in the contract rejection process. *In re Century Brass Products, Inc.*, 795 F.2d 265 (2d Cir. 1986). Earlier this year, in yet another decision out of the United Airlines bankruptcy, the Seventh Circuit stated in dicta that the debtor may have been obligated during 1113 process to negotiate with retired pilots who were participants in the pension plan covered by the subject collective bargaining agreement. But the Court went on to hold that, even if the debtor had been so obligated, the fact that the pension plan already was terminated and the debtor’s plan of reorganization already approved, there was no remedy available as a practical matter. *In re UAL Corp.*, 443 F.3d 565, 571 (7th Cir. 2006).

Terminating Pension Plans

- There are three means for terminating pension plans: Standard, Distress, and Involuntary.

Standard Terminations

- An employer may effect a standard termination only if the pension plan has enough assets to pay all benefits. The employer may also make a “topping-up” contribution. See 29 U.S.C. § 1341(b); 29 CFR § 4041.21(b).
- Requirements:
 - The employer must issue Notice of Intent to Terminate to affected parties other than the PBGC at least 60 days, and no more than 90 days, before the proposed termination date. The employer must also must inform plan participants that PBGC’s guarantee of their benefits will cease upon distribution of plan assets;
 - The employer must inform retirees of the identity of the private insurer from whom an annuity is being purchased or the names of insurers from whom bids will be sought no later than 45 days before the distribution of plan assets.

Standard Terminations (cont'd)

- The employer must send each retiree a notice that includes the benefit the participant has earned and data the plan used to calculate the value of the benefit;
- The employer must submit a termination notice to the PBGC, which includes certified data on the pension plan's assets and liabilities as of the proposed date of distribution; and
- The employer must distribute plan assets to cover all benefit liabilities under the pension plan.

Distress Terminations

- If a plan doesn't have enough assets to pay all benefits, the employer may nevertheless terminate the plan in a distress termination if the employer (and each controlled group member) meet one of four distress tests. See 29 U.S.C. § 1341(c).
- This provision imposes the following requirements: (i) the employer must issue a notice of intent to terminate to affected retirees, including the PBGC, at least 60 days, and no more than 90 days, in advance of the proposed termination date, and (ii) the employer must issue a subsequent termination notice to the PBGC, which includes data concerning the number of participants and the pension plan's assets and liabilities. See 29 U.S.C. § 1341(c)(1)-(3).

Distress Terminations (cont.)

- In addition, the PBGC must make a determination that the employer has met one of four “distress criteria”. The distress criteria are: (i) the employer is liquidating in bankruptcy proceedings, (ii) the employer is reorganizing in bankruptcy proceedings and it demonstrates to the bankruptcy court, inter alia, that absent a termination, the employer will be unable to pay all of its debts pursuant to a plan of reorganization and will be unable to continue in business outside Chapter 11, or (iii) the termination is required (a) to enable the payment of debts while staying in business or (b) to avoid unreasonably burdensome pension costs caused by a declining workforce. See 29 U.S.C. § 1341(c)(2)(B).
- When a plan is terminated in a distress termination, PBGC assumes liability for benefits up to a statutory maximum. In 2006, the statutory maximum benefit is \$47,659 (\$3,971 per month). The employer becomes liable to the PBGC for the value of unfunded benefits under the terminated plan. See 29 U.S.C. § 1362(b)(1)(A)-(B).

Distress Termination Litigation

- A pension plan cannot be rejected as an executory contract. *In re Philip Services Corp.*, 310 B.R. 802, 808-09 (Bankr. S.D. Tex. 2004).
- The reorganization distress test has generally been construed as a “but for” test. That is, after all constituencies have made meaningful sacrifices and the debtor has explored all reasonable alternatives, the debtor would be able to reorganize “but for” pension funding requirements. *E.g., In re U.S. Airways Group, Inc.*, 296 B.R. 734 (Bankr. E.D. Va. 2003).

Distress Termination Litigation (cont)

- The question is whether the pension plan is unaffordable under "a" (i.e., any) reorganization plan. As one court put it, this is a matter of “existential financial reality,” not the reorganization plan that certain constituencies may prefer. *Philip Services*, 310 B.R. at 808. Among the factors considered are whether the debtor has considered funding waivers, benefit freezes, and other measures to reduce pension costs, trimmed other fixed costs, and properly identified discretionary spending. *U.S. Airways*, 734 B.R. at 745; *Philip Services*, 310 B.R. at 805, 808.
- Where the debtor argues that no plan is feasible because the exit lender or equity investor will not fund unless the pension plan is terminated, the debtor must show that the transaction has been market tested. The lender’s or investor’s “ipse dixit” does not suffice. *Philip Services*, 310 B.R. at 808.

Distress Termination Litigation (con't)

- Two courts have recently held that where the debtor seeks to terminate multiple plans, the bankruptcy court must apply the test to all of the debtor's plans in the aggregate rather than to each plan individually. *In re Kaiser Aluminum Corp.*, 456 F.3d 328 (3d Cir. 2006); *PBGC v. Falcon Products*, 2006 WL WL 2711640 (E.D. Mo. 2006).
 - These courts reasoned that any attempt to apply the test to each plan individually would be unworkable, because under that approach, approving the termination of one or more plans may make the remaining plans affordable; courts would be forced to make basic assumptions about the order in which the plans should be considered and the status of the employer's other plans; and a plan-by-plan test also inevitably would lead to unfair and inequitable consequences because bankruptcy courts would give preference to some similarly situated constituents over others.

Distress Termination Litigation (cont.)

- If the court makes the necessary findings, PBGC will be bound by a final and nonappealable order. 29 CFR § 4041.41(d)(iv). Of course, if the order is entered over PBGC's objection, PBGC may appeal. In any case, since the ultimate determination involves other ERISA requirements and may involve non-debtors, that determination is for PBGC. *In re Sewell Mfg. Co., Inc.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996); accord *In re Diversified Industries, Inc.*, 166 B.R. 141, 144-45 (E.D. Mo. 1993).

Involuntary (PBGC-Initiated) Terminations

- The PBGC may terminate a pension plan without the employer's consent. See 29 U.S.C. § 1342(a).
- The PBGC may seek to terminate a plan if it determines that: (i) the plan has not met the minimum funding standards, (ii) the plan will be unable to pay benefits when due, (iii) the "reportable event" set forth in 29 U.S.C. § 1343(c)(7) has occurred, or (iv) the possible long-run loss of the PBGC with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated. *Id.*
- ERISA requires the PBGC to initiate termination when PBGC determines that the plan does not have assets available to pay benefits "currently due." *Id.*
- As with a distress termination, when a plan is terminated in an involuntary termination, PBGC assumes liability for benefits up to the statutory maximum, and the employer becomes liable to the PBGC for the value of unfunded benefits under the terminated plan.

Calculating PBGC's Termination Liability Claim in Bankruptcy

- When a pension plan is terminated in a distress or involuntary termination, the employer (and controlled group) is liable to PBGC for the shortfall between the value of benefit liabilities and the value of plan assets. The value of liabilities is determined under ERISA and implementing PBGC regulations. 29 U.S.C. § 1301(a)(18); 29 C.F.R. § 4044.41 to 4044.75.
- The goal of the regulations is to calculate a value that reflects the cost of a single-premium group annuity contract that would pay the benefits promised under the terminated pension plan. See In re US Airways Group, Inc., 303 B.R. 784, 788 (Bankr. E.D.Va. 2003) (citing, 58 Fed. Reg. 5128). See also, 29 C.F.R. § 4044.71. The regulation values benefits, in part, based on anonymous surveys of insurance companies that underwrite annuities.
- The regulations apply in bankruptcy for purposes of calculating the PBGC's claim. See In re US Airways Group, Inc., 303 B.R. 784, 788 (Bankr. E.D.Va. 2003).

Recent Cases Involving Controlled Group Liability

- Under ERISA, all members of a controlled group are jointly and severally liable for minimum funding and for termination liability. As a result, parent and subsidiary companies (debtor or nondebtor, foreign or domestic) often are required to accept responsibility for pension costs in the context of a Chapter 11 case. Recent examples include:
- Enron filed for bankruptcy protection (S.D.N.Y.) in December 2001. PBGC filed joint and several claims against the more than 100 Enron-affiliated debtors, and had potential claims against the more than 2,000 non-debtor controlled group members (including a number of solvent entities). As a result, PBGC persuaded Enron to "top up" its four defined benefit plans and terminate them in standard terminations. Plan participants will receive the full amount of benefits due them, and the pension insurance system will suffer no Enron-related losses.

Recent Cases Involving Controlled Group Liability (cont.)

- WCI Steel filed for bankruptcy protection (N.D. Ohio) in November 2003. WCI was a wholly owned subsidiary of the Renco Group, which among other things owns a significant stake in A.M. General (maker of the Humvee). WCI and its lenders presented competing reorganization plans. The lenders' plan called for a change of control that could break the controlled group, leading PBGC to initiate involuntary termination proceedings. As part of a consensual resolution, Renco agreed to assume the WCI pension plan, which was underfunded by \$117 million.

Recent Cases Involving Controlled Group Liability

- Kaiser Aluminum and its subsidiaries filed for bankruptcy protection (D. Del.) in February 2002. The debtors included a major operating subsidiary, a number of subsidiaries that produce alumina, a trading company, and a number of holding companies that held shares of joint ventures. In a global settlement, PBGC received, as a result of its joint and several claims, \$200 million in cash from a sale of the alumina subsidiaries and a substantial share of the reorganized operating subsidiary.
- Techneglas and its subsidiaries filed for bankruptcy protection (S.D. Ohio) in September 2004. PBGC filed joint and several claims against the debtors, and had a potential claim against the Japanese parent, which was also a lender. As part of a global settlement, the parent relinquished some of the distribution on its claim so that one of the three pension plans could be "topped up" and terminated in a standard termination.

New Funding Rules Under Pension Protection Act of 2006

■ Background:

- Defined benefit plans may be funded over time. Under pre-PPA 2006 rules, each time, e.g., there is an investment loss or benefits are increased, there is a charge that must be amortized over a period of years (5 years for experience losses, 30 years for past service increases). There is also usually a charge for “normal cost,” a measure of benefits earned in the current year. Each year, the plan’s actuary calculates the charges and credits under “reasonable” assumptions she develops. If there is a net charge, there is a new amount to be amortized. There is an additional required contribution for severely underfunded plans, called the deficit reduction contribution (“DRC”).
- Under PPA 2006 these traditional concepts will generally be displaced by 7-year amortization toward a prescribed funding target under prescribed assumptions.

New Funding Rules Under Pension Protection Act of 2006

■ Funding Target:

- Funding target for all plans, including at-risk plans, is increased from 90% to 100% of the plan's ongoing liability. This is less than termination liability, so a plan that is at 100% of its funding target may still be underfunded on termination.

■ Calculating Liabilities:

- New interest rate based on a modified yield curve approach determines the applicable interest rate. The yield curve is derived from the 24-month average yield on the top three grades of corporate bonds.
- Plans must use a specified mortality table, as determined by Treasury regulations. A pension plan may use a plan-specific mortality table under certain circumstances, unless it is disapproved by the Internal Revenue Service (IRS).

New Funding Rules Under Pension Protection Act of 2006 (con't)

■ **Calculating Assets:**

- Plans must use either the market value of assets or, pursuant to Treasury guidance, the market value based on an unweighted average over the prior 24 months, but the result is limited to between 90 percent and 110 percent of market value as of the plan's valuation date.

New Funding Rules Under Pension Protection Act of 2006

■ At Risk Plans:

- For “at-risk” plans, the plan’s liability is increased by 4 percent plus \$700 per participant. Plans with 500 or fewer participants are excluded from the at-risk rules.
- A plan is in “at-risk” status if its funding target attainment percentage is both less than 80 percent on an ongoing basis (without regard to at-risk liabilities) and less than 70-percent counting at-risk liabilities. For purposes of determining these percentages, credit balances are deducted from assets.
- The 80-percent test is phased in over four years. The 70-percent test is phased in over five years.

New Funding Rules Under Pension Protection Act of 2006 (con't)

■ Minimum Contributions:

- Employers must contribute an amount sufficient to cover the year's normal costs (i.e., benefits accrued during the year) plus enough to amortize the shortfall between the plan's assets and its target liability over a 7-year period. New shortfalls may arise each year, e.g., due to poor asset performance, and each such shortfall is amortized over 7 years.

Minimum Funding Claims and Liens

- The plan sponsor and its controlled group members (80% commonly owned) are jointly and severally liable for the annual minimum contributions. IRC § 412(c)(11).
- If a plan fails the minimum funding standard, there is a 10% (and if not cured, 100%) excise tax on the sponsor and controlled group.
- If the sponsor and controlled group can show IRS that they are suffering merely a temporary business hardship, they may obtain a waiver of the year's funding contribution, which is then amortized over the next five years. 26 U.S.C. § 412(b)(2)(C), (d).
- If missed payments exceed \$1M, there is a lien on all property of the sponsor and the controlled group, which may be perfected and enforced by PBGC, for the missed contributions plus interest. IRC § 412(n)(1), (n)(3). Unlike a termination liability lien under ERISA § 4068(c), a funding lien is not limited by the sponsor's/controlled group's net worth.
- PBGC files notice of this funding lien in a manner similar to a federal tax lien under IRC § 6323. See IRC § 412(n)(4)(C), ERISA § 4068(c). Thus, it files in the office within the state designated for the filing of federal tax liens, or if none, in the U.S. District Court; for a party domiciled abroad, it files with the Recorder of Deeds for the District of Columbia. IRC § 6323(f)(1).

Minimum Funding Claims and Liens (con't)

- Though a perfected funding lien does not have priority over a prior perfected security interest, it does have priority over credit later extended or collateral later acquired. A security interest is considered perfected if: (1) the property exists; (2) the security interest is protected under state law against a subsequent judgment lien; and (3) the holder parts with money or money's worth. IRC § 6323(h)(1).
- A security interest and a funding lien may be perfected simultaneously, as where a lender has filed notice of a security interest in future inventory and accounts receivable and PBGC has subsequently filed notice of a funding lien against personal property. Both the lender's security interest and the pension plan's lien will be perfected upon the debtor's receipt of the inventory and generation of accounts receivable. In that case, the federal lien would be superior. *U.S. v. McDermott*, 507 U.S. 447, 449-450 (1993). Thus, as inventory turns over, the funding lien would generally prime an otherwise senior position in inventory and resulting accounts receivable.

Minimum Funding Claims and Liens (con't)

- IRC § 6323(c) protects certain future extensions of credit and after-acquired property, such as qualified property covered by a commercial transaction financing agreement or an obligatory disbursement agreement, within limits. The commercial financing exception, for example, is limited to credit extended before the earlier of the 46th day after the filing of the pension plan's lien and the time that the creditor received actual notice of the pension plan's lien. See I.R.C. 6323(c)(2). Thus, regardless of actual notice, a funding lien will prime disbursements made more than 45 days after the funding lien is perfected.
- Under Bankruptcy Code § 545, a perfected pre-petition funding lien will generally be unavoidable. In addition, funding liens may be perfected post-petition against non-debtor controlled group members. As a result, PBGC may often have significant leverage in negotiating favorable settlements.

Minimum Funding During Bankruptcy

- Two courts of appeals have held that minimum funding that accrues post-petition or during the 180-day priority period has no priority except for the normal cost, an actuarial measure that has some resemblance to the cost of benefits accrued in that year. Those courts have also rejected ERISA's rule that where unpaid contributions exceed \$1M they are entitled to tax treatment in bankruptcy. 29 U.S.C. § 1082(f). See *In re CF&I Fabricators of Utah*, 150 F.3d 1293 (10th Cir. 1998), and *Belfance v. PBGC (In re CSC Industries)*, 232 F.3d 505 (6th Cir. 2000).
- Nevertheless, debtors that intend to continue their plans often provide for quarterly and annual contributions under first-day motions, along with other employee benefit payments. Though a plan is a legal entity, and not an executory contract, debtors will often provide in the plan of reorganization for assumption of the pension plan. That of course entails a cure of any default under section 365. More commonly, there is simply a "ride through."

Minimum Funding During Bankruptcy (con't)

- In other cases, however, the issue has been hard fought. In WCI Steel, for example, the secured creditors asserted that required contributions would be post-petition preferences, avoidable under 11 U.S.C. § 549, and sought disgorgement by the pension plan and an injunction against future contributions. The court held otherwise, as the contributions in that case were required by a collective bargaining agreement, and were therefore required by 11 U.S.C. § 1113(f) and not prohibited by § 549. *Wilmington Trust v. WCI Steel (In re WCI Steel)*, 313 B.R. 414 (Bankr. N.D. Ohio 2004).

Benefit Restrictions Under PPA 2006

- A plan may not be amended to increase benefits if the plan is less than 80% funded (or would be less than 80% funded taking into account the amendment. (Various exceptions and phase-in rules apply.)
- A plan that is less than 60% funded, or is less than 100% funded and whose sponsor is in bankruptcy, may not pay benefits in a form other than a life annuity, i.e., no lump sums.
- If a plan is more than 60% funded but less than 80% funded, it may pay a one-time lump sum that is limited to the lesser of (i) the present value of the participant's maximum PBGC guaranteed benefit, or (ii) 50% of the amount that would otherwise be paid. (Other exceptions apply.)

Benefit Restrictions Under PPA 2006 (con't)

- A plan that is less than 60% funded must freeze all future benefit accruals as of the valuation date for the plan year, unless the plan sponsor makes contributions sufficient to satisfy the 60% threshold. (Various exceptions apply.)
- “Shutdown benefits” (enhanced benefits payable on shutdown of a plant or facility) may not be paid if a plan is less than 60% funded or would be less than 60% funded as a result of paying such benefits, unless plan sponsor makes contributions sufficient to satisfy the 60% threshold or to pay for the shutdown benefits.

Special Rules for Airlines Under PPA 2006

- Passenger airlines may elect to amortize plan's unfunded liabilities over 17 years, using an interest rate of 8.85%.
- To elect this provision, plan must be frozen, and must remain frozen for so long as the election is in effect.
- Alternatively, if airline does not wish to freeze its plan, it may elect to amortize the plan's unfunded liabilities over 10 years, starting in 2008, using the actuarial assumptions under the general funding rules.
- If a plan electing the 17-year amortization period is terminated within 10 years of the election, PBGC guaranteed benefits are determined as of the election date, (but benefits that would otherwise have been guaranteed have first call on plan assets).
- If such a termination occurs within 5 years of the election, the termination premium payable by the plan sponsor (discussed below) is increased from \$1,250 per participant to \$2,500 per participant

PBGC Guarantees Under PPA 2006

- If a plan terminates while the plan sponsor is in bankruptcy, the PBGC's guarantee (and which benefits have first call on plan assets) is determined as of the date the bankruptcy petition was filed.
- PBGC's guarantee of shutdown or other unpredictable contingent event benefits is phased in over a 5-year period beginning on the date the shutdown or unpredictable contingent event occurs.

PBGC Premiums

- The flat-rate premium is \$30 per participant (increased from \$19 by the Deficit Reduction Act of 2005).
- Variable-rate premium of \$9 per \$1,000 of unfunded vested benefits is payable even if plan is at the full funding limit, and unfunded vested benefits are calculated for this purpose using the actuarial assumptions under the funding rules (with minor exceptions).
- Plan sponsors who terminate an underfunded pension plan during bankruptcy are required to pay an additional “termination premium” of \$1,250 per participant per year for a 3-year period beginning after confirmation.
- The termination premium is payable after confirmation because it is intended to be paid in 100 cent dollars.
- Effective for plan terminations occurring on and after January 1, 2006.

Recent Developments in Airline Cases

■ United Airlines

- United exited bankruptcy in February 2006. United's four defined benefit plans terminated during the bankruptcy, resulting in a \$10 billion claim. PBGC and United settled nearly all issues, but litigation concerning two plans continues.
- PBGC sued in the district court to terminate the Pilot Plan, with a termination date of December 30, 2004. ALPA and a retirees association intervened, challenging the termination and the termination date. The case was referred to the bankruptcy court over PBGC's objection. Following a trial before the bankruptcy court and a decision by the district court, the Pilot Plan was terminated effective December 30, 2004.
- On appeal to the Seventh Circuit, ALPA and the retirees assert that the agency did not prove the Plan must be terminated as of the December date. On a cross-appeal, PBGC asserts that the case should not have been referred to the bankruptcy court, and that PBGC's termination decision should have been reviewed deferentially on the agency's administrative record. The appeal was argued September 26, 2006.

Recent Developments in Airline Cases (con't)

Delta

- In September 2006, the bankruptcy court approved Delta's distress termination motion for its Pilots Plan. Delta projected that when the Plan emerged from "liquidity shortfall," 800 to 1,000 senior pilots would retire to get lump sum benefits, crippling Delta's operations. Delta initiated its distress termination to avoid that outcome. The motion was opposed by two retired pilots groups.
- PBGC has appealed to the district court the bankruptcy court's approval of a modification to the pilots' collective bargaining agreement. Under the modified agreement, active pilots obtain a \$2.1 billion claim, and \$650 million in notes if the Pilots Plan terminates, and ALPA agrees not to object to the Plan termination. PBGC asserts that the agreement improperly compensates active pilots for unfunded nonguaranteed benefits, as the right of recovery belongs exclusively to PBGC.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

The Bankruptcy Abuse Prevention & Consumer Protection Act of 2005 added a new Section 503(c) to the Bankruptcy Code. The purpose of the amendment was to curtail excessive retention bonuses and severance payments paid out under KERPs in bankruptcy, and to undo certain executive compensation arrangements implemented prior to the petition.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Retention Bonuses

- Retention bonuses may not be paid to the debtor's insiders unless the court finds each of the following:
 - The payment is essential to retention based on bona fide offer from another business at the same or greater pay;
 - The person's services are essential to the survival of the business; and
 - The amount of the payment does not exceed either (i) 10 times the mean amount of similar transfers paid to nonmanagement employees for any purpose during the same calendar year, or (ii) if there are no such transfers, 25% of the amount of any similar transfer to the insider for any purpose during the preceding calendar year.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Severance Payments

- Severance payments to insiders of the debtor are prohibited unless the court finds both:
 - The payment is part of a program generally applicable to all full-time employees; and
 - The amount of the payment does not exceed 10 times the mean severance amount paid to non-management employees during the same calendar year.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Rejection of Dana Corporation Compensation Plan

- Dana Corporation sought approval under Bankruptcy Code Sections 363(b), 365 and 105(a) for proposed “incentive” compensation arrangements set forth in new employment agreements for CEO Michael Burns and five other top executives.
- The motion drew opposition from virtually every constituency in the bankruptcy: the U.S. Trustee, the Creditors’ Committee, the Ad Hoc Noteholders’ Committee, the Equity Committee, the UAW, and the USW. The objectors claimed the debtors’ package was a subterfuge to escape the strictures of Section 503(c).
- The critical issue was whether the compensation arrangements were part of a “Pay to Stay” plan covered by Section 503(c) or an incentivizing “Produce Value for Pay” plan, reviewable only through the business judgment lens under Section 363.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Rejection of Dana Corporation Compensation Plan

- The key features of the compensation plan were:
 - **Base Salary:** \$1,552,500 for Burns, from \$500,000 to 600,000 for others. These were unchanged from their pre-petition contracts.
 - **Annual “Incentive” Bonus Tied to Performance Goals:** \$2,070,000 for Burns, from \$336,000 to \$528,000 for others. These were unchanged from their pre-petition contracts.
 - **Completion Bonus:**
 - For Burns, \$3,100,000 minimum (untethered to performance) plus additional millions (examples in decision are \$4.1 million if the debtors’ enterprise value dips from \$2.6 billion to \$2 billion, and \$6.2 million if EV remains at \$2.6 billion).
 - For other executives: \$400,000 to \$560,000 minimum (untethered to performance) plus additional amounts tied to EV.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Rejection of Dana Corporation Compensation Plan

- The key features of the compensation plan were (cont'd):
 - *Severance/"Non-Compete" Package*: For Burns only, if he is terminated without cause or resigns for good reason, he receives \$166,666 per month. If he fails to complete a replacement employment agreement after good faith negotiations, he will execute an 18-month noncompete and receive the same monthly payments.
 - *Senior Executive Retirement Program*: Assumption by debtor upon Burns' termination or debtors' emergence from Chapter 11. Could result in administrative claims of \$6 million.

KERPs – Bankruptcy Code Section 503(c) Recent Developments

Rejection of Dana Corporation Compensation Plan

- Judge Lifland held that the compensation packages failed under Section 503(c):
 - The Completion Bonus includes a large amount payable for nothing more than the debtors' emergence from Chapter 11 and the executives' staying with the company. "If it walks like a duck (KERP) and quacks like a duck (KERP), it's a duck (KERP)."
 - As to the Severance/"Non-Compete" payments, the debtors failed to meet their burden of demonstrating that the payments in exchange for signing non-competes and the related payments on account of termination of employment were not "severance" under section 503(c). In particular, there was no showing that these payments were part of a program generally applicable to all full-time employees and that the amount was not more than 10 times the amount of mean severance paid to non-management employees.