Marquette Benefits and Social Welfare Law Review

Volume 16
Issue 2 *Spring*

Article 2

2015

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THE PBGC WINS A CASE WHENEVER THE DEBTOR KEEPS ITS PENSION PLAN

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The Pension Benefit Guaranty Corporation, the federal agency charged with insuring private-sector defined benefit pension plans, has long had a prominent role in corporate bankruptcies. PBGC focuses its effort on the continuation of pension plans, in true reorganizations and in sales of businesses. To this end, ERISA has made it more difficult for a sponsor to terminate a plan in its own economic interest. For example, a sponsor's latitude to terminate an underfunded plan was limited to circumstances involving the sponsor's financial distress. Likewise, the termination premium, which was added to ERISA in recent years, is an obligation that survives bankruptcy and it may help to deter some unwarranted terminations. Unfortunately, in some cases, PBGC must seek plan termination, and PBGC then seeks to maximize its recoveries. These are blunt tools, however, and the case law has further dulled them. With plan continuation the preferred outcome, PBGC succeeds in its statutory mission whenever a sponsor emerges from bankruptcy with its pension plan ongoing.

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I. INTRODUCTION

The Pension Benefit Guaranty Corporation (PBGC or the Corporation) is the federal agency charged with insuring private-sector defined benefit pension plans. In carrying out its statutory mission, PBGC devotes much of its day-to-day attention to financially troubled plan sponsors who are either in bankruptcy or may enter bankruptcy.

Part I of this paper discusses the statutory framework governing the pension insurance system with a focus on PBGC's purpose and powers, termination of defined benefit pension plans, PBGC payment of benefits, and employer liability to PBGC. Part II is a primer on certain key bankruptcy concepts that apply to business reorganizations or liquidations and to the rights of creditors. Part III addresses PBGC's experience in bankruptcy, including some important judicial decisions that, for better or for worse, are part of the legal framework in which PBGC operates.

II. TITLE IV BASICS

A. OVERVIEW OF THE PENSION BENEFIT GUARANTY CORPORATION

1. History, Purpose, and Operation of the Corporation

Before 1974, the process for terminating a defined benefit pension plan was relatively unregulated.[1] Notably, an employer had no obligation to make up the funding shortfall after a plan was terminated.[2] As a result, companies facing financial difficulty could simply walk away from their pension liabilities, leaving participants without the retirement income promised to them.[3] It took a major crisis—the termination of the Studebaker Corporation pension plan in 1963, in which 4,000 auto workers lost some or all of their pension benefits—to prompt Congress to act.[4]

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1. *See* JEFFREY LEWIS ET AL., EMPLOYEE BENEFITS LAW 9-3 (3rd ed. 2012) [hereinafter EMPLOYEE BENEFITS LAW].
2. *Id.* at 9-5–9-6.
3. *Id.*
4. *History of PBGC*, PBGC, http://www.pbgc.gov/about/who-we-are/pg/history-

PBGC was established by the Employee Retirement Income Security Act of 1974 (ERISA).[5] It is a wholly-owned United States government corporation, and the federal agency charged with administering the termination insurance program under Title IV of ERISA.[6] The Corporation is governed by a Board of Directors composed of three members: the Secretary of Labor, the Secretary of the Treasury, and the Secretary of Commerce.[7] Daily operations are overseen by the Director, who is nominated by the President, with the advice and consent of the Senate, and serves a five-year term at the pleasure of the President and the Board of Directors.[8]

Congress declared Title IV to have three purposes to be carried out by PBGC:

> (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,
> (2) to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which [Title IV] applies, and
> (3) to maintain premiums established by the corporation . . . at the lowest level consistent with carrying out its obligation under [Title IV].[9]

In furtherance of these purposes, PBGC has the authority to adopt bylaws, rules, and regulations;[10] to exercise administrative subpoena powers;[11] to "sue and be sued" in its own name;[12] and to litigate disputes "through its own counsel" before all domestic courts and tribunals.[13]

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of-pbgc.html (last visited May 8, 2015).

5. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (2012)).

6. *See* 29 U.S.C. § 1302(a) (2012); *see also id.* § 1302(b) (providing that "the corporation has the powers conferred on a nonprofit corporation under the District of Colombia Nonprofit Corporation Act"), "Title IV" is the popular name of Subchapter III of Chapter 18 of Title 29 of the United States Code. 29 U.S.C. §§ 1301-1461.

7. 29 U.S.C. § 1302(d)(1).

8. *Id.* § 1302(a), (c); WILLIAM G. BEYER, ET AL., ABI'S PENSION MANUAL: A PRACTICAL GUIDE TO PENSION ISSUES ARISING IN BUSINESS BANKRUPTCY CASES 22 (Carol Connor Flowe et al. eds., 2006) [hereinafter BEYER].

9. 29 U.S.C. § 1302(a)(1)-(3).

10. *Id.* § 1302(b)(3).

11. *Id.* § 1303(a); BEYER, *supra* note 8, at 22.

12. *See* 29 U.S.C. § 1302(b)(1).

13. *Id.*; BEYER, *supra* note 8, at 22 (noting that PBGC's independent litigating

PBGC does not receive any general federal revenue to fund its insurance program.[14] Instead, its operations are funded by premiums, assets from terminated plans trusteed by PBGC, recoveries from firms formerly responsible for the plans, and investment income.[15] PBGC's annual premiums, both flat-rate and variable-rate, are collected from plan sponsors in amounts fixed by Congress.[16] In fiscal year 2014, PBGC derived $3.9 billion in revenue from premium collections.[17] Although the payment of premiums is required by law,[18] a plan sponsor's failure to pay premiums will not result in the loss of PBGC's guarantee for basic benefits.[19]

2. *Title IV Coverage*

PBGC does not insure all pension plans. Within the universe of employer-sponsored retirement plans, PBGC insures only benefits of private-sector, defined benefit pension plans subject to Title IV of ERISA.[20] To be covered under Title IV, a plan must: (1) be an "employee pension benefit plan;" (2) be established or maintained by an employer, employee organization representing employees, or both, engaged in commerce or industries affecting commerce; and (3) meet tax-qualification standards under the Internal Revenue Code (IRC).[21] A plan is generally deemed to meet the tax-qualification requirement if it has received a favorable determination from the Internal Revenue Service.[22]

Certain plans are expressly excluded from coverage under

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authority, "together with a broad grant of settlement authority, permits it to act independently and quickly without the multiple layers of government concurrences other agencies may need to work within").

14. 2014 PBGC ANN. REP. 20, *available at* http://www.pbgc.gov/documents/2014-annual-report.pdf; *see also* BEYER, *supra* note 8, at 22 (noting that "PBGC was designed to be financially self-sustaining and receives no funds from general tax revenues").

15. 2014 PBGC ANN. REP. 20, *supra* note 14; *see also* EMPLOYEE BENEFITS LAW, *supra* note 1, at 3-31 (describing sources of PBGC's funding and its investment authority).

16. *See* 29 U.S.C. § 1307.

17. 2014 PBGC ANN. REP. 88, *supra* note 14.

18. 2 9 U.S.C. § 1307.

19. *Id.* § 1307(d).

20. *See id.* § 1321.

21. *See id.* § 1321(a) (providing two alternative statutory tests a plan must meet or have met to be covered under Title IV).

22. EMPLOYEE BENEFITS LAW, *supra* note 1, at 9-7–9-8.

Title IV and therefore not protected by PBGC's guarantee.[23] Among these exceptions are "individual account plans,"[24] "governmental plans,"[25] and "church plans."[26] Thus, for example, PBGC does not cover defined contribution plans, including "401(k) plans."[27] PBGC also does not cover plans that are established and maintained by the federal government, or any state or municipality.[28] Also, it does not cover plans for employees of a church or church-affiliated hospital, school, or other organization unless the organization has elected to comply with the participation, vesting, and funding requirements of ERISA and the IRC.[29]

3. Types of Plans Covered

PBGC maintains two separate insurance programs: a *single-employer* program and a *multiemployer* program.[30]

Single-employer plans are the more numerous.[31] Simply defined as "a plan which is not a multiemployer plan,"[32] a single-employer plan is established and maintained by one employer (or a group of employers under common ownership) for the benefit of its employees.[33] A *multiple-employer plan*, a subset of

23. *See* 29 U.S.C. § 1321(b) (enumerating 13 statutory exceptions to Title IV coverage).

24. *Id.* § 1321(b)(1); *see also id.* § 1002(34) (defining term "individual account plan" to mean "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains, and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account").

25. *Id.* § 1321(b)(2).

26. *Id.* § 1321(b)(3); *see also* 26 U.S.C. § 414(e) (2012) (defining term "church plan" to mean "a plan established and maintained . . . for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under [IRC] section 501").

27. 29 U.S.C. §§ 1002(34), 1321(b).

28. 29 U.S.C. § 1321(b)(2).

29. *See id.* § 1321(b)(3).

30. EMPLOYEE BENEFITS LAW, *supra* note 1, at 9-6.

31. *See* 2014 PBGC ANN. REP. 5, *supra* note 14 (reporting that in 2014 PBGC's "single-employer program protect[ed] about 31 million workers and retirees in over 22,000 pension plans" while the "multiemployer program protect[ed] about 10 million workers and retirees in about 1,400 pension plans").

32. 29 U.S.C. § 1002(41).

33. *See Glossary*, PBGC, http://www.pbgc.gov/about/pg/header/glossary.html#S (last visited Feb. 17, 2015).

single-employer plans,[34] is sponsored by more than one unrelated employer, but is not maintained under a collective bargaining agreement.[35] PBGC has the authority to terminate, take over as statutory trustee, and insure the benefits of single-employer pension plans covered under Title IV.[36]

Multiemployer plans are maintained under collective bargaining agreements "between one or more employee organizations and more than one employer."[37] Commonly known as a Taft-Hartley plan, a multiemployer pension plan is administered by a board of trustees made up of an equal number of management and labor appointees.[38] Unlike single-employer plans, PBGC does not terminate and trustee multiemployer plans facing financial distress.[39] Rather, PBGC for decades has provided financial assistance in the form of loans to insolvent plans to enable them to pay benefits to the guarantee limit.[40] In 2014, faced with deepening financial distress in a minority of plans, potentially jeopardizing the solvency of the multiemployer insurance program, Congress enacted new legislation.[41] Those amendments, among other topics, are briefly summarized in the next section.

4. *Minimum Funding Standards, "Downsizing" and Withdrawal Liability, and Tools to Address Risk from Certain Deeply Troubled Multiemployer Plans*

Single-employer pension plans subject to Title IV of ERISA are required to maintain funding levels in accordance with

34. EMPLOYEE BENEFITS LAW, *supra* note 1, at 9-54.

35. COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 33 (3d ed. 2011) [hereinafter MEDILL].

36. *See* 29 U.S.C. §§ 1322, 1341, 1342.

37. *Id.* § 1002(37)(A).

38. *See id.* § 186(c)(5); *see also* MEDILL, *supra* note 35, at 33.

39. *See* 29 U.S.C. § 1341a.

40. *See id.* § 1431. The multiemployer guarantee limit is 100% of the first $11 of the accrual rate, plus 75% of the next $33, times years of credited service, or $35.75 per month per year of service. The maximum guarantee amount is sometimes summarized as $12,870 per year with 30 years of service. Benefit improvements less than five years old are not guaranteed at all. *Id.* § 1322a(a)-(c); *Multiemployer Insurance Plan Facts*, PBGC, http://www.pbgc.gov/about/factsheets/page/multi-facts.html (last visited Feb. 16, 2015).

41. *See* Multiemployer Pension Reform Act of 2014 [hereinafter MPRA], Pub. L. No. 113-235, Div. O, 128 Stat. 2130, 2773 (to be codified in scattered sections of 26 U.S.C. and 29 U.S.C.).

statutory standards.[42] These provisions are mainly set forth in the IRC.[43] In general, a plan sponsor must annually make a minimum required contribution to its pension plan.[44] The sponsor's minimum required contribution for a plan year "generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost."[45] The "funding target" for the plan year is defined as "the present value of all benefits accrued or earned under the plan as of the beginning of the plan year."[46] The term "target normal cost" for a plan year loosely means the present value of all benefits expected to be earned in the plan year plus the amount of plan-related expenses expected to be paid in the plan year.[47] Additional funding may be required if the plan's poor funding status causes it to be deemed "at-risk."[48] Funding rules are complex and a pension actuary must certify the required contribution.[49] Pension liability (the funding target) is inversely related to the assumed interest rate at which future benefits are discounted.[50] Since the minimum required funding contribution is directly related to the funding target, the lower the assumed interest rate, the greater the funding burden.

Congress provided PBGC with one important tool to enforce the minimum funding requirements for single-employer pension plans covered under Title IV. If a plan sponsor fails to make a required contribution and the aggregate unpaid balance of missed contributions exceeds $1 million, then the plan sponsor must report the delinquency to PBGC.[51] A lien in the amount of the aggregate unpaid balance arises in favor of the pension plan on all property of the plan sponsor and members of its "controlled group."[52] PBGC has sole authority to perfect and enforce this lien.[53]

Congress provided PBGC with one other tool to shore up

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42. *See* 26 U.S.C. § 412 (2012).

43. *See id.*; *see also* EMPLOYEE BENEFITS LAW, *supra* note 1, at 5-62.

44. *See* 26 U.S.C. § 430(a) (defining the term "minimum required contribution").

45. STAFF OF JOINT COMM. ON TAX'N, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006" 9 (Aug. 3, 2006).

46. 26 U.S.C. § 430(d)(1).

47. *See id.* § 430(b).

48. *See id.* § 430(i).

49. *See id.*

50. *See id.*

51. *Id.* § 430(k)(4)(A).

52. *Id.* § 430(k)(1). The concept of "controlled group" is discussed below.

53. *Id.* § 430(k)(5).

ongoing single-employer plans. This provision, which may be viewed as kind of "downsizing" liability, was amended in 2014.[54] The amended statute is much more intricate in its definitions and exemptions than the original, but generally it imposes liability in the event of a workforce reduction of sufficient size caused by a permanent cessation of operations at a facility.[55] Subject to certain exceptions, liability is triggered by a workforce reduction of more than 15% of the total number of employees who are eligible to participate in any employee pension benefit plan (including a 401(k) plan) maintained by the employer.[56] This provision cross-references another that addresses withdrawals from multiple-employer plans, which requires the employer to furnish a bond or escrow to secure liability in the event of termination.[57] Alternatively, the employer may elect to satisfy its liability by contributing an amount equal to the plan's "unfunded vested benefits" (using a funding-target measure) in seven annual installments.[58]

The funding rules governing multiemployer plans differ considerably from those for single-employer plans. Multiemployer plans enjoy more discretion in the choice of actuarial funding methods and assumptions.[59] Contribution rates for employers are established by collective bargaining agreements.[60] The plan must establish a "funding standard account," to which specified charges and credits are made each year.[61] If the total charges to the funding standard account are greater than the total credits, there is a funding "deficiency."[62] Generally, this will obligate employers to make additional contributions beyond the amounts required by their collective

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54. Consolidated and Further Continuing Appropriations Act, 2015 [hereinafter CFCAA], Pub. L. No. 113-235, Div. P, 128 Stat. 2130, 2822 (2014) (to be codified at 29 U.S.C. § 1362(e)).

55. *Id.* at § 1(a).

56. *Id.*

57. 29 U.S.C. § 1363 (2012).

58. CFCAA, Div. P, § 1(a), 128 Stat. at 2822. The obligation to pay additional annual installments may cease if plan funding meets a certain threshold. *Id.*

59. See DAN M. MCGILL, KYLE N. BROWN, JOHN J. HALEY, SYLVESTER J. SCHIEBER & MARK J. WARSHAWSKY, FUNDAMENTALS OF PRIVATE PENSIONS 638-39 (9th ed. 2010) [hereinafter MCGILL].

60. PBGC, DEP'T OF THE TREASURY, AND DEP'T OF LABOR, Multiemployer Pension Plans Report to Congress Required by the Pension Protection Act of 2006, at 25 (Jan. 22, 2013), http://pbgc.gov/documents/pbgc-report-multiemployer-pension-plans.pdf [hereinafter MULTIEMPLOYER REPORT].

61. 26 U.S.C. § 431(b) (2012).

62. *Id.*

bargaining agreements.[63]

The financial well-being of multiemployer plans also depends on collection of "withdrawal liability." When an employer withdraws from an underfunded multiemployer plan, a statutory obligation is triggered called withdrawal liability. Withdrawal liability is a duty requiring the employer to continue funding its share of the shortfall.[64] Withdrawal liability represents the employer's share of "unfunded vested benefits" and is determined under the method elected by the plan.[65] The plan is responsible for determining and collecting withdrawal liability.[66]

As mentioned above, in 2014 Congress gave certain deeply troubled multiemployer plans new tools intended to reduce systemic risk to participants and the multiemployer insurance program. In a complex set of statutory amendments, Congress gave multiemployer plans in "critical and declining" status authority to "suspend" benefit payments, subject to certain limitations (e.g., affecting benefits to participants over age 80 or based on disability).[67] Benefit suspensions are subject to specific conditions and require an application to the Department of the Treasury (which is to consult with PBGC) and a participant ratification vote.[68] These provisions built on concepts added to the statute in 2006. The latter called for multiemployer plans in "endangered" and "critical" status to adopt funding improvement or rehabilitation plans that could include reductions of future accruals and, for plans in critical status, suspensions of early retirement subsidies and ancillary benefits, and restrictions on lump-sum distributions.[69]

In addition, the 2014 amendments revamped PBGC's authority to approve a "partition" of a plan in "critical and declining" status, provided that the plan has taken all reasonable measures to avoid insolvency, including maximum benefit suspensions.[70] In essence, partition enables the old plan

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63. MULTIEMPLOYER REPORT, *supra* note 60, at 27.

64. *See* 29 U.S.C. § 1381 (withdrawal liability); *id.* § 1383 (complete withdrawals); *id.* § 1385 (partial withdrawals).

65. 29 U.S.C. §§ 1381(b)(1), 1391; MULTIEMPLOYER REPORT, *supra* note 60, at 19.

66. 29 U.S.C. § 1382.

67. MPRA, Div. O § 201(a)(6), 128 Stat. at 2798 (to be codified at 26 U.S.C. § 432(e) and 29 U.S.C. § 1085(e)).

68. *Id.*

69. *See* 26 U.S.C. § 432 (2012).

70. MPRA, Div. O § 122(a), 128 Stat. at 2795 (to be codified at 29 U.S.C. § 1413).

to transfer certain liabilities to a new, insolvent plan that will receive financial assistance from PBGC, whereas the old plan will be placed on a stronger financial footing going forward. Both the plan created by PBGC's partition order and the old plan will have the same private-sector administration as before.[71]

The rest of this paper will largely focus on PBGC and single-employer plans.

5. PBGC's Guarantee and Limitations

At the heart of Title IV's pension insurance program is PBGC's benefit guarantee. Subject to important limitations, PBGC guarantees the payment of "all nonforfeitable benefits (other than benefits becoming nonforfeitable solely on account of the termination of a plan) under a single-employer plan which terminates at a time when [Title IV] applies to it."[72] PBGC's regulations provide that it

> will guarantee the amount, as of the termination date, of a benefit provided under a plan . . . if: (1) The benefit is, on the termination date, a nonforfeitable benefit; (2) The benefit qualifies as a pension benefit as defined in [29 C.F.R.] § 4022.2; and (3) The participant is entitled to the benefit under [29 C.F.R.] § 4022.4.[73]

The term "nonforfeitable benefit" has a precise statutory definition, but it loosely refers to a benefit for which the participant satisfied the plan's vesting requirements before termination.[74] The term "pension benefit" is defined as "a benefit payable as an annuity, or one or more payments related thereto, to a participant who permanently leaves or has permanently left covered employment. . . ."[75] Therefore, PBGC does not guarantee health and welfare benefits, or certain lump-sum death benefits even if such benefits are promised under a plan subject to Title IV.[76]

The two principal limitations on PBGC's guarantee are set

71. *See id.*
72. 29 U.S.C. § 1322(a) (2012).
73. 29 C.F.R. § 4022.3(a) (2014).
74. 29 U.S.C. § 1301(a)(8).
75. 29 C.F.R. § 4022.2.
76. *Guaranteed Benefits*, PBGC (Feb. 17, 2015), https://www.pbgc.gov/wr/benefits/guaranteed-benefits.html.

forth in the statute.[77] The first is referred to in PBGC's regulations as the "maximum guaranteeable benefit."[78] It is described as the maximum monthly benefit provided by a plan that may be guaranteed, with the maximum determined using an "actuarial value."[79] The reference to "actuarial value" means, for example, that the maximum guarantee is reduced for those who begin to receive benefits from PBGC before age 65, because they will receive benefits for a longer time than if their benefits began at 65.[80] For a plan that terminates during 2015, the maximum monthly guarantee for a retiree aged 65 is $5,011.36.[81]

The second principal limitation is known informally as the "phase-in limit." It provides for a phase-in of PBGC's guarantee of any benefit increase adopted or effective (whichever is later) during the five-year period before a plan terminates.[82] The guarantee is phased in at the rate of 20% of the amount of the increase (or $20 per month, if greater) for each year the increase has been in effect.[83] For example, if a participant's monthly benefit was increased by $200 as a result of a plan amendment effective two years before termination, PBGC guarantees $80 of that increase.[84]

6. *PBGC Payment of Nonguaranteed Benefits*

PBGC pays guaranteed benefits, described above, regardless of the plan's funded level.[85] If the benefits under a plan are not fully guaranteed, PBGC may be able to pay a portion of the nonguaranteed amounts either from plan assets (asset-funded benefits) or from recoveries from employers (section 1322(c) benefits).[86]

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77. *See* 29 U.S.C. § 1322(b).

78. 29 C.F.R. §§ 4022.22-.23.

79. 29 U.S.C. § 1322(b)(3).

80. 29 C.F.R. § 4022.23(c).

81. *Maximum Monthly Guarantee Tables*, PBGC (2015), https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html#2015. The maximum monthly benefit is lower if a benefit will be paid to the retiree's surviving spouse or other beneficiary upon the retiree's death. *Id.*

82. 29 U.S.C. § 1322(b)(1), (7).

83. *Id.*

84. *See* 29 C.F.R. §§ 4022.24-.25.

85. *See* 29 U.S.C. § 1322(a).

86. *See id.*

Asset-funded benefits are nonguaranteed benefits that are payable from a terminated plan's assets.[87] The amount of a participant's asset-funded benefits depends on how well-funded the plan was at the termination date. Title IV provides a six-tier hierarchy for allocating assets among various categories of guaranteed and nonguaranteed benefits.[88] The better funded the plan is as of the plan termination date and the higher the priority of the participant's nonguaranteed benefit amounts, the greater the chance some or all of these amounts will be paid.[89]

Lastly, PBGC pays section 1322(c) benefits.[90] This provision enables a plan's participants to share a portion of PBGC's statutory claim for a plan's unfunded benefit liabilities, a topic discussed below.[91] These benefits are intended to cover a portion of participants' unfunded nonguaranteed benefits.[92]

B. PBGC AND PLAN TERMINATION

When a pension plan covered under Title IV terminates without enough assets to pay its promised benefits, PBGC typically becomes the trustee of the plan and pays plan participants their pension benefits up to statutory limits described above.[93] Title IV provides the exclusive means for a plan sponsor to terminate a single-employer pension plan.[94] This section will describe the methods by which a Title IV plan may terminate.

1. Voluntary Termination of Fully Funded Pension Plans

A plan sponsor of a single-employer plan may generally elect to terminate a pension plan that has enough assets to pay

87. 29 U.S.C. § 1344(a). PBGC's regulations describe the sum of guaranteed benefits and asset-funded benefits as "Title IV benefits." 29 C.F.R. § 4001.2.

88. *See* 29 U.S.C. § 1344(a).

89. Whether a participant will receive asset-funded benefits (and the amount of such benefits) depends on whether the plan assets reach the participant's nonguaranteed benefits in the asset-allocation hierarchy. For example, benefits of participants who retired (or could have retired) more than three years before termination are entitled to priority; if the plan has enough assets, these benefits may be paid even if not guaranteed. *Id.* § 1344(a)(3).

90. *Id.* § 1322(c).

91. *Id.* § 1362(b).

92. *Id.* § 1362(b)(1)(A).

93. *See id.* §§ 1321, 1322, 1361.

94. *Id.* § 1341(a)(1); Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 446 (1999).

all promised benefits.[95] Commonly referred to as a *standard termination*, the process for terminating a fully funded plan is prescribed in detail by ERISA and PBGC's regulations.[96] There are several fundamental obligations that must be met to complete a standard termination. First, the plan administrator must notify all participants, affected parties, and PBGC of its intent to terminate the plan.[97] Second, the administrator must distribute plan assets to the plan participants[98] either in the form of an annuity or a lump-sum payment.[99] Finally, the administrator must certify to PBGC that all benefit liabilities have been paid.[100]

If a plan administrator cannot locate a plan participant after a diligent search, it may either purchase an annuity in the participant's name (and provide that information to PBGC) or transfer to PBGC the value of that participant's benefit.[101] PBGC maintains a missing participant program and will pay participants who contact the agency seeking to collect their benefits or provide the name of the insurer from which their annuity was purchased.[102]

PBGC is required to audit a statistically significant number of standard terminations each year to ensure statutory compliance.[103] PBGC will also investigate a specific standard termination if it receives notice from a participant of an irregularity or otherwise has reason to believe that the plan may have been terminated improperly.[104]

2. *Voluntary Termination of Underfunded Pension Plans*

If a plan sponsor wants to terminate a single-employer pension plan that does not have enough assets to pay benefits

95. 29 U.S.C. § 1341(b).

96. *Id.*; 29 C.F.R. §§ 4041.21-.31 (2014).

97. 29 U.S.C. § 1341(b)(1)(A).

98. *Id.* § 1341(b)(2)(D).

99. *Id.* § 1341(b)(3)(A). Unless the benefit is *de minimis* (under $5,000), or the participant elects a lump sum, the benefit must be paid as an annuity under an "irrevocable commitment" from an insurer. *Id.*; *see also* 26 U.S.C. § 411(a)(11)(A) (2012).

100. 29 U.S.C. § 1341(b)(3)(B).

101. *Missing Participants*, PBGC (Feb. 2, 2015), http://www.pbgc.gov/prac/terminations/missing-participants.html.

102. *Id.*

103. 29 U.S.C. § 1303(a).

104. *Standard Terminations,* PBGC (Feb. 2, 2015), http://www.pbgc.gov/prac/terminations/standard-terminations.html.

when due, it must satisfy the requirements for a *distress termination*.[105] As the term suggests, a distress termination is permissible only in cases of severe financial hardship to the plan sponsor and each member of its "controlled group."[106] Although the exact meaning of "controlled group" is beyond the scope of this paper, a controlled group generally includes entities affiliated with the sponsor within prescribed degrees of ownership, such as an 80%-owned subsidiary.[107] As in the case of a standard termination, the plan administrator is initially obligated to notify all affected parties, as well as PBGC, of its intent to terminate the plan.[108] In addition, the administrator must provide information to PBGC sufficient to establish that the sponsor, and each of its controlled group members, meet at least one of four tests:[109] (1) the "Liquidation Test,"[110] (2) the "Reorganization Test,"[111] (3) the "Business Continuation Test,"[112] or (4) the "Pension Costs Test."[113]

A plan sponsor meets the Liquidation Test if it has filed (or has had filed against it) a petition to liquidate its assets under the Bankruptcy Code or any similar federal or state insolvency proceeding, and the case has not, as of the plan termination date, been dismissed.[114] The Reorganization Test requires a more searching analysis. To satisfy this test, the plan sponsor must file (or have filed against it) a petition seeking reorganization under the Bankruptcy Code or any similar federal or state insolvency proceeding.[115] The sponsor must then establish to the satisfaction of the bankruptcy court (or other appropriate court) that it "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside . . . the reorganization process" unless the pension plan is terminated.[116] A more detailed analysis of these two tests follows in Part IV.

In those instances where a distress termination is sought

105. 29 U.S.C. § 1341(c).
106. *Id.*
107. *Id.* § 1301(a)(14); 29 C.F.R. § 4001.2 (2014).
108. 29 U.S.C. § 1341(c)(1)(A).
109. *Id.* § 1341(c)(2)(B)-(C).
110. *Id.* § 1341(c)(2)(B)(i).
111. *Id.* § 1341(c)(2)(B)(ii).
112. *Id.* § 1341(c)(2)(B)(iii).
113. *Id.*
114. *Id.* § 1341(c)(2)(B)(i).
115. *Id.* § 1342(c)(2)(B)(ii).
116. *Id.*

outside bankruptcy or a similar insolvency proceeding, PBGC makes the initial determination whether the applicable test is met.[117] Under the Business Continuation Test, PBGC determines whether a plan sponsor "will be unable to pay [its] debts when due and will be unable to continue in business" unless the pension plan is terminated.[118] Under the Pension Costs Test, PBGC must determine that "the cost of providing pension coverage have become unreasonably burdensome . . . , solely as a result of a decline of the [plan sponsor's] workforce."[119]

A plan sponsor and each member of its controlled group must meet at least one of the distress tests described above,[120] but each need not meet the same test.[121] If one member of the controlled group does not meet the criteria for distress termination, PBGC will oppose termination.[122] PBGC will also oppose a distress termination if the plan sponsor or a controlled group member is able to "top up" the plan and complete a standard termination.[123]

3. *Involuntary or PBGC-Initiated Termination of Underfunded Pension Plans*

A third way a pension plan can terminate is by an involuntary or PBGC-initiated termination.[124] PBGC-initiated plan terminations can be mandatory or discretionary.[125] ERISA requires that PBGC terminate a single-employer pension plan "as soon as practicable," if the plan "does not have assets available to pay benefits which are currently due under the terms of the plan."[126] Put simply, if the plan runs out of money to pay current retirees, PBGC must terminate the plan.

The four grounds for a discretionary PBGC-initiated termination are as follows:

- "the plan has not met the minimum funding

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117. *Id.* § 1341(c)(2)(B).
118. *Id.* § 1341(c)(2)(B)(iii)(I).
119. *Id.* § 1341(c)(2)(B)(iii)(II).
120. *Id.* § 1341(c)(2)(B).
121. EMPLOYEE BENEFITS LAW, *supra* note 1, at 9-41.
122. *Id.* at 9-42.
123. BEYER, *supra* note 8, at 38.
124. 29 U.S.C. § 1342.
125. *Id.* § 1342(a).
126. *Id.*

standard required under section 412 of [the IRC] . . .;"[127]

- "the plan will be unable to pay benefits when due;"[128]
- "the reportable event described in section 1343(c)(7) has occurred;"[129] or
- "the possible long-run loss to the corporation with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."[130]

The three most common of these grounds are discussed in more detail in Part IV.

C. LIABILITY TO PBGC UPON PLAN TERMINATION

When an underfunded plan terminates,[131] the Corporation will seek to collect certain liabilities from the sponsor and members of its controlled group.

1. Unfunded Benefit Liabilities (UBL)

When a single-employer pension plan terminates, the plan sponsor is generally liable to PBGC for "the total amount of the unfunded benefit liabilities (as of the termination date) to all participants and beneficiaries under the plan," plus interest from the termination date.[132] The amount of UBL as of a certain date is "the excess (if any) of . . . the value of the benefit liabilities under the plan (determined as of such date on the basis of assumptions prescribed by the corporation . . . , over the current value (as of such date) of the assets of the plan."[133] PBGC has issued regulations prescribing the mortality and interest assumptions to be used when calculating the amount of benefit liabilities.[134] For clarity, PBGC often refers to UBL as

127. *Id.* § 1342(a)(1).
128. *Id.* § 1342(a)(2).
129. *Id.* § 1342(a)(3). This is a rarely invoked ground for termination involving certain distributions from a plan to a participant who is a "substantial owner." *Id.* §§ 1321(d), 1343(c)(7).
130. *Id.* § 1342(a)(4).
131. *See id.* §§ 1341(c), 1342.
132. *Id.* § 1362(a), (b).
133. *Id.* § 1301(a)(18).
134. 29 C.F.R. §§ 4044.52-.53 (2014); 29 C.F.R. pt. 4044 App. B (2014).

the underfunding "on a termination basis."[135] This is a joint and several liability of the sponsor and each member of the sponsor's controlled group.[136]

2. *Unpaid Minimum Funding Contributions*

The plan sponsor and members of its controlled group are also jointly and severally liable to the pension plan for contributions necessary to satisfy the minimum funding standards.[137] When the pension plan is terminated, this liability is owed to PBGC as statutory trustee of the plan.[138]

3. *Unpaid Annual Premiums*

A plan sponsor and its controlled group members are jointly and severally liable to PBGC for any unpaid insurance premiums, interest, and penalties.[139] This liability includes both the flat-rate and variable-rate premiums.[140]

4. *Termination Premium*

Under certain circumstances discussed in Part IV, the plan sponsor and members of its controlled group are jointly and severally liable for a termination premium.[141] The premium is due to PBGC in three annual installments beginning with the first month after the pension plan terminates.[142] The amount of each premium payment is equal to $1,250 multiplied by the number of participants in the plan immediately before the termination date.[143]

III. BANKRUPTCY BASICS

A. INTRODUCTION

Before delving into PBGC's involvement in bankruptcy, we

135. Liability pursuant to section 4062(3), 29 C.F.R. § 4062.8(b) (2013).
136. 29 U.S.C. § 1362(a).
137. 26 U.S.C. § 412(b)(2) (2012).
138. 29 U.S.C. § 1342(d)(1)(B)(ii).
139. *Id.* § 1307(e).
140. *Id.* § 1307.
141. *Id.* § 1306(a)(7).
142. *Id.* § 1306(a)(7)(C).
143. *Id.* § 1306(a)(7)(A).

will first explore some basic concepts of bankruptcy law. Article 1, Section 8, Clause 4 of the Constitution provides Congress with the authority to "establish . . . uniform laws on the subject of bankruptcies throughout the United States."[144] With that authority, Congress has enacted five major bankruptcy statutes: the Bankruptcy Acts of 1800, 1841, 1867, 1898,[145] and the present law, the Bankruptcy Reform Act of 1978 (the Bankruptcy Code or Code).

One major innovation of the Bankruptcy Code was Chapter 11, which facilitated consensual reorganization to preserve the going-concern value of business debtors.[146] The Bankruptcy Act of 1898 was mainly a creditor's remedy focused on liquidation and distribution of the debtor's estate, rather than rehabilitation or reorganization.[147]

The main goals of bankruptcy law are to: (1) provide a fresh start for debtors and (2) promote equality of distribution among creditors.[148]

B. FORMS OF BANKRUPTCY RELIEF

The Bankruptcy Code provides two forms of relief for businesses: (1) liquidation under Chapter 7 and (2) reorganization under Chapter 11.

In a liquidation under Chapter 7, a debtor generally gives up possession and control of all property owned at the time of the bankruptcy filing to the debtor's estate.[149] The debtor's estate is then administered by a trustee who is a disinterested person appointed by a United States trustee from a panel of private trustees.[150] The Chapter 7 trustee collects the debtor's

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144. U.S. CONST. art. I, § 8, cl. 4.

145. Bankruptcy Act of 1800, 2 Stat. 19; Bankruptcy Act of 1841, 5 Stat. 440; Bankruptcy Act of 1867, 14 Stat. 517; Bankruptcy Act of 1898, 30 Stat. 544.

146. DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 161, 181 (Princeton Univ. Press 2001). *See* Bank of Am. v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 457 (1999) ("[I]t was, after all, one of the Code's innovations to narrow the occasions for courts to make valuation judgments, as shown by its preference for the supramajoritarian class creditor voting scheme in § 1126(c)").

147. 1 WILLIAM MILLER COLLIER, COLLIER ON BANKRUPTCY § 20.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013).

148. JEFFERY T. FERRIEL & EDWARD J. JANGER, UNDERSTANDING BANKRUPTCY 1 (3rd ed. 2013) [hereinafter FERRIEL & JANGER].

149. *Id.* at 401. Courts exempt some of the debtor's possessions; nevertheless, the Chapter 7 process generally requires liquidation of the debtor's assets to repay creditors.

150. 11 U.S.C. § 701 (2012). A United States Trustee is a Department of Justice

property, converts that property to cash, submits a final report and accounting to the bankruptcy court, and makes distributions to creditors.[151] At the end of this liquidation process, a Chapter 7 debtor who is an individual may generally obtain a discharge from personal liability for certain prebankruptcy debts, and thus is given a "fresh start."[152] A business debtor, however, will not obtain a discharge under Chapter 7 because no business operations will remain post-bankruptcy.[153]

Chapter 11 governs the reorganization of business entities. Chapter 11 creditors for the most part look to the debtor's future earnings to satisfy their claims rather than to the debtor's property at the time of bankruptcy filing.[154] Businesses use Chapter 11 to restructure prepetition debt or rationalize their operations.[155] Unlike Chapter 7, the debtor's management in Chapter 11 usually continues to control the debtor's property and business operations. Such a debtor is known as a "debtor in possession."[156] The bankruptcy court may appoint a Chapter 11 trustee, but typically only after a showing of fraud or gross mismanagement by the debtor's current management.[157] For simplicity, this paper will generally use the term "debtor" to include an appointed bankruptcy trustee.

Chapter 11 requires the debtor to formulate an acceptable plan for payment or compromise of its prepetition debts.[158] The plan must meet certain standards to be confirmed by the court.[159] Depending on the facts and circumstances, however, the court may confirm a liquidating plan of reorganization, rather than a plan where the debtor emerges from bankruptcy as an operating entity. Upon plan confirmation, the debtor generally receives a discharge of all debts that arose before confirmation (unless the debtor liquidates through Chapter

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official appointed for a judicial district who performs certain administrative and enforcement roles in connection with bankruptcy cases. *See id.* § 307; 28 U.S.C. §§ 581-89b (2012).

151. *See generally* 11 U.S.C. § 704.

152. *See generally id.* § 727; FERRIEL & JANGER, *supra* note 148, at 455.

153. *See* 11 U.S.C. § 727.

154. FERRIEL & JANGER, *supra* note 148, at 711.

155. Troy A. McKenzie & Keith Sharfman, *Basic Program: Basic Concepts: Sources of Law, Structure of Code, Bankruptcy Courts, Legal Ethics and Estate Property*, 092111 ABI-CLE 5, at 17 (2011) [hereinafter McKenzie & Sharfman].

156. 11 U.S.C. § 1101(1).

157. *Id.* § 1104.

158. *Id.* § 1106(a)(5).

159. *Id.* § 1129.

11).[160]

C. *KEY BANKRUPTCY CONCEPTS*

Certain concepts are essential to understanding bankruptcy law. Among the most important for our purposes are (1) property of the estate, (2) avoidance powers, (3) the automatic stay, (4) claims, and (5) executory contracts.

1. Property of the Estate

A bankruptcy case is commenced by the filing of a petition with the bankruptcy court.[161] The filing may be either voluntary by the debtor or involuntary against the debtor by its creditors.[162] Upon commencement of bankruptcy, a debtor's property generally becomes "property of the estate," which is available to satisfy creditors' claims.[163] Property of the estate is subject to court supervision.[164] Property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[165] This broad definition includes not only tangible property interests, but contractually enforceable rights of the debtor at the time of bankruptcy filing.[166]

The Code provides two main exceptions: (1) excluded property and (2) exempted property.[167] Among the specific *exclusions* from property of the estate are educational savings accounts, tuition benefit funds, spendthrift trusts, and contributions to certain employee benefit funds and pension plans.[168] Although *exempted* assets initially become property of the estate, the debtor may "exempt them back out of the

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160. *Id.* § 1141. Under 11 U.S.C. § 1141(d)(3), plan confirmation does not discharge the debtor if (1) the plan is a liquidating plan, (2) the debtor does not engage in business after consummation of the plan; and (3) the debtor would be denied a discharge in a liquidation case under section 727(a) of the Code.

161. *Id.* §§ 301, 303.

162. *Id.*

163. *See id.* § 541.

164. DANIEL L. KEATING, BANKRUPTCY AND EMPLOYMENT LAW: BANKRUPTCY'S IMPACT ON EMPLOYERS, EMPLOYEES, UNIONS, AND RETIREES 27 (1995) [hereinafter KEATING].

165. 11 U.S.C. § 541(a).

166. KEATING, *supra* note 164, at 27.

167. 11 U.S.C. §§ 522 (exemptions), 541(a)(1), (b), (c)(2) (exclusions); McKenzie & Sharfman, *supra* note 155, at 20.

168. *See* 11 U.S.C. § 541(b).

estate."[169] Such exemptions give the debtor power to protect certain items of property from the reach of creditors.[170] One complication is that while the Code lists a standard set of federal exemptions, states are permitted to opt out of the federal exemptions and to use state-enacted exemptions.[171] Because most states have exercised this power, there is a wide disparity among the assets that may be exempted in the various states.[172]

2. Avoidance Powers

One concept closely related to the property of the estate is the debtor's avoidance powers. The power to "avoid" or unwind certain transactions enables a debtor to maximize the property of the estate for the benefit of creditors generally.[173]

a. Strong-Arm Power

The so-called "strong-arm" provision is designed to discourage secret liens.[174] The debtor has the power to invalidate any secured creditor's lien on the debtor's property if it is unperfected as of the bankruptcy filing date.[175] By exercising the strong-arm power, the debtor may transform an unperfected secured claim into a general unsecured claim for purposes of bankruptcy distribution.[176]

b. Preferences

Another power available to the debtor is to avoid "preferences."[177] The Code permits a debtor to recover certain transfers by the debtor to a creditor where payment on account of an antecedent debt occurred while the debtor was insolvent and within ninety days before the filing of the petition.[178] One condition is that the transfer enabled the creditor to receive

169. McKenzie & Sharfman, *supra* note 155, at 20.
170. FERRIEL & JANGER, *supra* note 148, at 402.
171. *Id.* at 404.
172. *Id.*
173. 11 U.S.C. § 926.
174. 11 U.S.C. § 544. *See also* KEATING, *supra* note 164, at 34.
175. *Id.*
176. *Id.* at 34-35. *See infra* Section III.C.4. for a discussion of claims.
177. 11 U.S.C. § 547.
178. *Id.* § 547(b)(4)(A).

more than it would have received in a Chapter 7 liquidation.[179] In the case of transfers to an "insider," the preference period may extend from 90 days to one year before the filing of the petition.[180] This power prevents a debtor from rewarding one creditor at the expense of others, or one creditor from gaining unfair advantage over other creditors. In effect, it bars creditors from exempting themselves from the bankruptcy process by receiving payment or collateral from the debtor on the eve of the filing.[181]

c. Fraudulent Transfers

The debtor also has the power to avoid certain transfers considered fraudulent. In particular, the debtor may avoid "actually fraudulent" transfers—those made or incurred within two years of filing "with actual intent to hinder, delay, or defraud" present or future creditors.[182] In addition, a debtor may avoid "constructively fraudulent" transfers, including those it made while insolvent for less than equivalent value within two years before filing.[183]

3. Automatic Stay

To conduct an orderly bankruptcy proceeding, it is important to stop all efforts to collect from the debtor.[184] Otherwise, creditors would inevitably race to collect the debtor's assets, which would quickly be dissipated.[185] The automatic stay provides a debtor with protection from creditors' collection efforts, including most forms of litigation.[186] Upon the filing of a bankruptcy petition, the automatic stay immediately enjoins nearly all other proceedings and acts that affect the debtor or property of the debtor's estate.[187]

The automatic stay has certain enumerated exceptions, and,

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179. *Id.* § 547(b)(5)(A).

180. *Id.* § 547(b)(4)(B). *Id.* § 101(31) (defining the term "insider").

181. KEATING, *supra* note 164, at 34-35.

182. 11 U.S.C. § 548(a)(1)(A).

183. *Id.* § 548(a)(1)(B).

184. BARRY E. ADLER, DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY 103-04 (4th ed. 2007) [hereinafter ALDER, BAIRD & JACKSON].

185. *Id.*

186. 11 U.S.C. § 362.

187. *Id.*

in some instances, the court may grant a party in interest relief from the stay. A court may grant relief by conditioning, annulling, modifying, or completely terminating the automatic stay.[188] In particular, creditors may seek relief from the automatic stay if they show “cause,” which can include a lack of adequate protection of an interest in property.[189] The Code enumerates a variety of automatic stay exceptions, but the so-called “police-powers” exception is especially relevant to PBGC and other government agencies.[190] This exception—together with an express provision of ERISA that applies to “any bankruptcy”—exempts from the automatic stay an action by PBGC to initiate termination of a pension plan.[191]

4. *Claims*

Once the bankruptcy case commences and the automatic stay takes effect, the bankruptcy process dictates the resolution of all debts and determines the distribution each creditor will receive.[192] Only creditors that have “claims” are eligible to receive distributions.[193] Indeed, many issues in bankruptcy hinge upon which parties have a “claim.”[194]

The Code defines “claim” as “any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured,” or a right to payment stemming from a “right to equitable remedy.”[195] This broad definition, for example, encompasses PBGC’s contingent claims for termination liability when a plan sponsor or controlled group member files for bankruptcy, even if the plan has not terminated.

Although the existence of a claim determines whether a creditor is eligible to receive a distribution, the type and seniority of the claim determines the amount and sequence of the creditor’s distribution. The general distribution scheme in bankruptcy is as follows: (1) secured creditors first take the

188. *Id.* § 362(d).
189. *Id.* § 362(d)(1). McKenzie & Sharfman, *supra* note 155, at 20.
190. 11 U.S.C. § 362(b)(4).
191. 29 U.S.C. § 1342(e) (2012).
192. ADLER, BAIRD & JACKSON, *supra* note 184, at 141.
193. FERRIEL & JANGER, *supra* note 148, at 312.
194. *Id.*
195. 11 U.S.C. § 101(5).

value of their security, (2) then administrative expenses and priority claims are paid, and (3) lastly general unsecured creditors receive any residue on a pro rata basis.[196] Holders of equity interests generally have no "claim" and in practice rarely receive a distribution.[197]

a. Secured Claims

Whether a claim is secured is determined by nonbankruptcy law. Typically state law, such as Article 9 of the Uniform Commercial Code for security interests in personal property, determines such claim security.[198] A creditor is secured only to the extent of the value of the collateral securing the claim.[199] Accordingly, if the value of the collateral is less than the amount of the claim, the amount of the deficiency is an undersecured claim.[200] An undersecured claim is thus effectively two claims: one secured and one unsecured.[201] If the collateral has value above the principal amount of the claim and expenses, postpetition interest is allowed.[202] The court has discretion to determine the value in light of the valuation's purpose and the proposed disposition or use of the property.[203] For example, either liquidation value or going-concern value may be appropriate, depending on the type of collateral and other facts and circumstances.[204]

b. Priority Claims

The Code enumerates ten categories of unsecured expenses and claims that are entitled to priority in distribution.[205] Among these types of expenses and claims are the following: first, priority for domestic support obligations; second, priority for "administrative expenses," an especially important category discussed below; third priority for so-called "gap" claims in involuntary bankruptcy cases; fourth, priority for employee wage

196. ADLER, BAIRD & JACKSON, *supra* note 184, at 11.
197. 11 U.S.C. §§ 507(a)(2), (7).
198. McKenzie & Sharfman, *supra* note 155, at 18.
199. 11 U.S.C. § 506(a)(1).
200. *Id.*
201. *See* FERRIEL & JANGER, *supra* note 148, at 338.
202. 11 U.S.C. § 506(b). *See* FERRIEL & JANGER, *supra* note 148, at 341.
203. 11 U.S.C. § 506(a)(1). *See* FERRIEL & JANGER, *supra* note 148, at 338-41.
204. *See* McKenzie & Sharfman, *supra* note 155, at 18.
205. 11 U.S.C. § 507(a).

claims; fifth, priority for claims for certain contributions to employee benefit plans; and sixth, priority for certain claims of governmental units, also discussed below.[206]

The second priority, or administrative expenses, includes "actual, necessary costs and expenses of preserving the estate," such as wages and salaries of employees, and certain taxes incurred by the estate.[207] "Administrative expenses" also include reasonable compensation for professional services rendered during the bankruptcy case.[208] Administrative expenses are not technically "claims" because they did not arise prepetition.[209] Because administrative expenses in business bankruptcies are paid immediately after secured claims, creditors generally have an incentive to keep administrative expenses as low as possible.[210] If the debtor has so few assets that administrative expenses cannot be paid in full, the estate is said to be "administratively insolvent."[211] Unless a potential investor arrives on the scene, an administratively insolvent debtor will generally shut down, and then liquidate. In such a case, administrative expenses will be paid pro-rata and lower-ranked creditors will receive nothing.[212] Likewise, if assets available for distribution run out in one of the lower priorities, then the creditors with higher priority claims will be paid in full. Creditors in the priority where the assets run out receive pro rata distributions, and creditors in lower priorities receive nothing.[213]

To round out this discussion of priorities, the eighth priority governs certain claims of "governmental units," mainly taxes.[214] In contrast to postpetition taxes, which are treated as administrative expenses, prepetition taxes are given eighth

206. *Id.* § 507(a)(1), (2), (3), (4), (5), (8). *See* McKenzie & Sharfman, *supra* note 155, at 18.

207. 11 U.S.C. § 503(b)(1)(A), (B).

208. *Id.* § 503(b)(4).

209. *See* McKenzie & Sharfman, *supra* note 155, at 18.

210. ADLER, BAIRD & JACKSON, *supra* note 184, at 11.

211. 11 U.S.C. §§ 507(a)(2), (b).

212. *See* Robert J. Keach, et al., *Concurrent Session: Business Track My Estate Is Administratively Insolvent: What Do I Do? What to Do When Your Case Turns Out Differently from How You Planned*, 120111 ABI-CLE 223 at 2 (2011) (describing the designation as "administratively insolvent" as a condition in Chapter 11 proceedings).

213. ADLER, BAIRD & JACKSON, *supra* note 184, at 11.

214. 11 U.S.C. § 507(a)(8); *id.* § 101(27) (defining "governmental unit").

priority.[215]

c. General Unsecured Claims

General unsecured claims are claims that are not secured and do not have a priority.[216] Creditors holding general unsecured claims receive a pro rata share of any assets remaining after distributions to secured claims, administrative expenses, and priority claims.[217]

5. Executory Contracts

The code does not define “executory contracts” even though it is an important concept. According to one widely accepted definition, a contract is executory if “the obligation of both the bankrupt and other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.”[218] For convenience, the term “executory contract” is used in this paper to include unexpired leases, which for the most part are handled like executory contracts.[219] The Code gives the debtor three options for treatment of executory contracts: (1) rejection, (2) assumption, or (3) assignment.[220]

If the debtor chooses to reject an executory contract, then rejection will be treated as if the debtor had breached the contract immediately before filing for bankruptcy.[221] The party to the rejected contract therefore will have a claim for damages, which is usually unsecured.[222] If the debtor assumes a contract, then the debtor binds the other party to future performance and also binds itself to cure any defaults under the contract.[223] If a debtor assigns the contract, any proceeds from the assignment of the debtor’s rights under the contract become property of the estate.[224] The trustee and estate are relieved from any liability

215. *Id.* § 503(b)(2)(B)(i). *Id.* § 507(a)(8).

216. McKenzie & Sharfman, *supra* note 155, at 57.

217. FERRIEL & JANGER, *supra* note 148, at 355.

218. KEATING, *supra* note 164, at 37 (quoting Vern Countryman, *Executory Contracts in Bankruptcy, Part 1*, 57 MINN. L. REV. 439, 460 (1973)).

219. 11 U.S.C. § 365.

220. *Id.* § 365 (a), (f).

221. KEATING, *supra* note 164, at 37.

222. *Id.*

223. *Id.*

224. *Id.* at 27.

for any breach of the executory contract that occurs after the assignment.[225] The other party to the contract must look to the assignee for satisfaction of post-assignment obligations.[226] Although the debtor's choice of how to treat an executory contract is subject to judicial approval, courts usually defer to the debtor's decision.[227]

The Code provides special rules for a Chapter 11 debtor to assume or reject collective bargaining agreements.[228] Collective bargaining agreements are strikingly different from ordinary contracts in that they set out the relationship between management and labor, which is regulated by the National Labor Relations Board under the National Labor Relations Act (NLRA).[229] In an effort to accommodate labor policy,[230] the Code prescribes strict standards and procedures that condition a debtor's ability to modify or reject its collective-bargaining agreements upon the expiration of a set time period during which the debtor and union are "to confer in good faith in attempting to reach mutually satisfactory modifications."[231] If the parties fail to agree, the court may approve the debtor's proposal. But the court must first make certain findings, including that the modifications are "necessary" and that "the balance of equities clearly favors rejection of such agreement."[232] Such proceedings are especially relevant to PBGC when debtors seek to modify collective-bargaining agreements that require them to maintain and fund a pension plan.

There are also special rules under the Code for a Chapter 11

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225. 11 U.S.C. § 365(k).

226. *Id.*

227. KEATING, *supra* note 164, at 38.

228. 11 U.S.C. § 1113.

229. 29 U.S.C. §§ 151-169 (2012); 1 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE § 3:14 (3d ed. 2015) [hereinafter NORTON]. The NLRA regulates private-sector collective bargaining rights.

230. Section 8(d) of the NLRA prohibits an employer from rejecting or modifying the terms of a collective bargaining agreement before its expiration date without first bargaining with the union. *See* 29 U.S.C. § 158(d). More generally, under section 8(a)(5) of the NLRA, it is illegal for an employer to "refuse to bargain" with the union. *See id.* § 158(a)(5).

231. 11 U.S.C. § 1113(b). *See generally* Daniel S Ehrenberg, *Rejecting Collective Bargaining Agreements under Section 1113 of Chapter 11 of the 1984 Bankruptcy Code: Resolving the Tension Between Labor Law and Bankruptcy Law*, 2 J.L. & POL'Y 55, 59 (1994); John D. Ayer et al., *The Intersection of Chapter 11 and Labor Law*, AM. BANKR. INST. J., May 2007, at 22; Andrew B. Dawson, *Collective Bargaining Agreements in Corporate Reorganizations*, 84 AM. BANKR. L.J. 103 (2010).

232. 11 U.S.C. § 1113(b)(1)(A), (c).

debtor to modify or not pay retiree insurance benefits.[233] These procedures are generally limited to employer-sponsored medical, disability, or death benefits, and do not apply to pension benefits.[234] The rules for modifying retiree insurance benefits have parallels to those for rejecting collective bargaining agreements, except that instead of a union, a committee of retired employees appointed by the court may serve as the authorized representative of retirees.[235]

6. *Discharge*

At the core of the "fresh start" objective of bankruptcy discussed above is the concept of discharge. Whether granted at the end of an individual debtor's Chapter 7 case or upon confirmation of a non-liquidating Chapter 11 plan, a discharge generally protects the debtor from any further liability on discharged debts.[236] A discharge voids a judgment on discharged debts and enjoins any legal "action" to collect such a debt from the debtor or property of the debtor.[237] A discharge also bars extrajudicial collection "acts" such as dunning letters or telephone calls to press for payment of discharged debts.[238]

D. OVERVIEW OF CHAPTER 11

Most of PBGC's activity in bankruptcy is in Chapter 11 cases. A Chapter 11 case proceeds as follows. First, a troubled company—but one with enough going-concern value to reorganize successfully—files a Chapter 11 petition. The debtor continues to run its business and at the same time seeks to propose a plan of reorganization that divides the claims of creditors into various classes and prescribes a treatment for each class. The debtor tries to negotiate key terms with important constituencies, including specific creditors and committees of creditors, in hopes of devising a comprehensive plan to which each claim class consents. Finally, if the debtor succeeds, all claim classes will vote in favor of the plan and the court will confirm it. The discussion below will briefly examine each of

233. *Id.* § 1114.
234. *Id.* § 1114(a).
235. *Id.* § 1114(b), (c).
236. *See generally* 11 U.S.C. §§ 524, 727, 1141(d).
237. *Id.* § 524(a).
238. *See* 3 NORTON, *supra* note 229, § 58:3.

these major phases.

1. Commencement of a Case

Like other bankruptcy proceedings, a Chapter 11 case commences with the filing of a petition.[239] The commencement of a voluntary case constitutes an "order for relief" and triggers the automatic stay.[240] As noted earlier, creditors may initiate bankruptcy through an involuntary petition.[241] The Code generally permits an involuntary petition to be filed by three or more creditors who hold claims of a specified type and amount.[242] If the debtor contests the involuntary filing, the creditors must show that the debtor was not generally paying its debts as the debts became due at the time of the filing.[243]

The debtor must make a number of initial filings such as a list of creditors, a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of financial affairs.[244] Debtors typically obtain "first-day" orders on an ex parte basis.[245] First-day orders may authorize the debtor to keep paying certain prepetition debts, such as utility payments and employee wages and benefits, and may also include approval of postpetition financing.[246] Once the case commences, a number of other parties will play major roles—some almost immediately, and others over time.

a. Debtor-in-Possession (DIP) Lender

The debtor's ability to survive more than a few days in Chapter 11 usually depends on its ability to line up postpetition financing. Ideally, before the filing of a petition, the debtor has negotiated preliminary financial terms with a lender to finance the debtor's postpetition operations for some specified period of time. Subject to objection by creditors, the court will decide whether or not to approve the DIP-financing package.[247] Failure to obtain any DIP financing nearly always leads to rapid

239. 11 U.S.C. § 301(a).
240. *Id.* §§ 301(b), 362.
241. *Id.* § 303.
242. *Id.* § 303(b)(1).
243. *Id.* § 303(h).
244. *Id.* § 521(a). *See also* FERRIEL & JANGER, *supra* note 148, at 176.
245. *See* 1 NORTON, *supra* note 229, § 3:14.
246. *Id.*
247. 11 U.S.C. § 364.

liquidation.

b. Committees

Also shortly after the petition is filed, the United States trustee appoints a committee of unsecured creditors.[248] Typically an unsecured creditors' committee consists of the seven largest creditors.[249] Committee members must be "representative of the different kinds of claims."[250] The United States trustee may also appoint other committees to represent secured creditors and equity holders if appropriate.[251] Because it would be impractical for a debtor to negotiate separately with hundreds or thousands of creditors, committees play a major role in formulating a plan of reorganization and sometimes in litigating major controversies.[252] Unsecured creditors' committee members have a fiduciary duty to the unsecured creditor body.[253]

c. Potential Sources of Exit Financing

To emerge from bankruptcy, the debtor must find a way to finance its reorganization plan. The DIP lender is often a leading candidate for exit financing, but the package will have to be negotiated and approved by the court as part of a reorganization plan. A competing lender, possibly one favored by the unsecured creditors' committee, may vie for this role. The unsecured creditors themselves—perhaps by accepting a smaller cash distribution on their claims in early postpetition years in favor of a potentially greater cash recovery in later years, or by agreeing to convert their debt holdings into equity in the reorganized debtor—may be a major source of financing. Employee groups may be asked to make wage concessions. Key suppliers may be asked for future price discounts. An outside investor may also play a pivotal role.

248. *Id.* § 1102(a)(1).
249. *Id.* § 1102(b)(1).
250. *Id.*
251. *See id.* § 1102(a)(1), 1 NORTON, *supra* note 229, § 3:14.
252. ADLER, BAIRD & JACKSON, *supra* note 184, at 679.
253. *See* 5 NORTON, *supra* note 229, § 98:36.

2. *The Plan of Reorganization*

At the heart of the Chapter 11 reorganization process is the plan of reorganization. To expand somewhat on our earlier overview, the plan of reorganization process is as follows: (1) the debtor (or any "party in interest" under certain conditions)[254] proposes a plan of reorganization; (2) the claims of the creditors and the interest of the shareholders are then placed in classes; (3) each class votes on the plan; (4) if all classes accept the plan and the plan satisfies other Chapter 11 requirements, then the court confirms the plan, or if a class dissents, then the court confirms the plan only if the plan is fair and equitable and does not discriminate unfairly; and (5) once the plan is confirmed, the debtor obtains a discharge from debts that arose before confirmation.[255]

a. First Stage: Proposal of Plan of Reorganization

One of a debtor's major advantages is the exclusive right to file a plan for the first 120 days of the case.[256] After expiration of the debtor's exclusivity period—which may be extended up to 18 months after the order for relief—any party in interest may propose a plan. Multiple competing plans may proceed to a confirmation hearing simultaneously.[257]

Debtors negotiate with the committees and other key constituents throughout the plan process because a consensual plan is often the quickest and cleanest way to confirmation.[258] In many cases, senior creditors give up value to junior classes to achieve a consensus, and recoveries may improve generally if major claims and controversies are settled rather than litigated to finality.[259]

b. Second Stage: Classification of Claims

Classification of claims is critical in formulating a plan as it

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254. A "party in interest" is defined to include "the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee." 11 U.S.C. § 1121(c) (2012).

255. ADLER, BAIRD & JACKSON, *supra* note 184, at 675.

256. 11 U.S.C. § 1121(b). KEATING, *supra* note 164, at 39.

257. 11 U.S.C § 1129(c).

258. ADLER, BAIRD & JACKSON, *supra* note 184, at 681.

259. *Id.*

can affect who gets what under the plan, and also directly affects confirmation if any degree of creditor dissent is expected.[260] A plan must classify claims and provide the "same treatment" for all claims within a class, unless the claimant agrees to less favorable treatment.[261] The Code governs classification of claims and provides that a plan may only place a claim in a particular class if it is "substantially similar" to other claims of such class.[262]

c. Third Stage: Voting on Plan

After the debtor proposes a plan, the debtor must then try to get the plan accepted.[263] To do this, the debtor must first submit a disclosure statement for court approval.[264] A disclosure statement explains the plan to those who must vote on it, and is reviewed by the court to ensure that it contains "adequate information."[265] "Adequate information is information "of a kind, and in sufficient detail, as far as is reasonably practicable" to enable a "hypothetical investor" to make "an informed judgment about the plan."[266]

Once the court approves the disclosure statement, the next step is to solicit votes for plan acceptance. Creditors vote on whether to approve a plan, with two key exceptions. First, any holder of a claim or interest that is not "impaired" is deemed to have accepted the plan and no solicitation of such holder is required.[267] Second, a class that is to receive nothing under the plan is deemed to have rejected the plan and again no solicitation of such class is required.[268] For classes that vote, at least two-thirds in amount of claims and more than one-half in number of claimants must vote in favor of the plan for the plan to be accepted by that class.[269]

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260. KEATING, *supra* note 164, at 40-41.

261. 11 U.S.C. § 1123(a)(4).

262. *Id.* § 1122.

263. FERRIEL & JANGER, *supra* note 148, at 760.

264. 11 U.S.C. § 1125.

265. *Id.* § 1125(b); FERRIEL & JANGER, *supra* note 148, at 760-61.

266. 11 U.S.C. § 1125(a).

267. *Id.* §§ 1124, 1126(f).

268. *Id.* § 1126(g).

269. ADLER, BAIRD & JACKSON, *supra* note 184, at 698; *see also* 11 U.S.C. §§ 1126(c), 1129(a)(8).

d. Fourth Stage: Confirmation of Plan

In addition to the voting classes' acceptance of the plan, the court must confirm the plan after a hearing.[270] To confirm a plan, the court must find the following: that the plan complies with applicable provisions of the Code; has been proposed in good faith; discloses the identity and salaries of officers, directors, and certain others; and has been either accepted by voting class or satisfies the "cramdown" rule (to be discussed below).[271] Another requirement for confirmation is called the "best-interests-of-creditors" test. It requires: that each holder of a claim or interest in an impaired class either (i) has accepted the plan, or (ii) receives as much under the plan as it would have received in a Chapter 7 liquidation.[272] This test applies to each individual creditor, including dissenting members of a class that approved the plan.[273] Still another standard to be met for plan confirmation is "feasibility": that the debtor can carry out the terms of the plan and will likely not liquidate or need further financial reorganization after confirmation unless the plan proposes such liquidation or reorganization.[274]

For the plan to be confirmed, each impaired class must accept the plan by the requisite majority vote.[275] For a nonconsensual plan, however, the Code provides an exception called the cramdown rule.[276] A nonconsensual plan may be confirmed if, among other things, the plan is "fair and equitable" and does not "discriminate unfairly."[277] The central concept behind this exception is the so-called "absolute priority" rule: that senior classes must be paid in full before any junior classes may receive any distribution.[278] If a dissenting class is not paid in full, no class junior to the dissenting class may receive a distribution.[279] Accordingly, a class of unsecured claims that is not paid in full may be crammed down as long as stockholders

270. 11 U.S.C. § 1129(a).

271. *Id.* § 1129(a)(1), (3), (5), (8); *see also id.* § 1129(b) ("cramdown" provision).

272. *Id.* § 1129(a)(7).

273. *Id.*

274. *Id.* § 1129(a)(11).

275. *Id.* §§ 1126(d), 1129(a)(8).

276. *Id.* § 1129(b); KEATING, *supra* note 164, at 41.

277. 11 U.S.C. § 1129(b)(1).

278. FERRIEL & JANGER, *supra* note 148, at 780-81; ADLER, BAIRD & JACKSON, *supra* note 184, at 681.

279. FERRIEL & JANGER, *supra* note 148, at 789.

receive no distribution.[280] Further, although the cramdown approach does not require acceptance by all classes, acceptance by at least one impaired class is still required.[281] Although cramdown is an option for a nonconsensual plan, the risk of a contested confirmation hearing usually makes a consensual plan the preferred course.[282]

e. Final Stage: Discharge Postconfirmation

Once a plan is confirmed, the debtor carries out the plan according to its terms and discharges all debts that arose before confirmation except where the plan provides otherwise.[283] The plan and its confirmation order are binding on the debtor and any creditor, equity security holder, or general partner in the debtor "whether or not such creditor, equity security holder, or general partner has accepted the plan."[284] Accordingly, a confirmed plan has res judicata effect in any claim dispute.[285]

3. Asset Sales

Chapter 11 is mainly designed for business reorganization, but debtors are increasingly using it to facilitate the sale of all or substantially all their assets.[286] Commonly, debtors seek to sell their assets through a process known as a "Section 363 sale," where a debtor may obtain court approval to sell property of the estate "other than in the ordinary course of business."[287] This is to be distinguished from the use, sale, or lease of property of the estate "in the ordinary course of business," which may generally take place without notice or a hearing.[288] Asset sales under Chapter 11 allow debtors to maintain control of the business operations and to sell their assets as a going concern, which generally results in a higher sale price.[289] Another attractive

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280. *Id.*

281. 11 U.S.C. § 1129(b)(1); *see also* KEATING, *supra* note 164, at 41-42.

282. *Id.* at 17.

283. 11 U.S.C. § 1141(d).

284. *Id.* § 1141(a).

285. FERRIEL & JANGER, *supra* note 148, at 800-01.

286. Douglas E. Deutsch & Michael G. Distefano, *The Mechanics of a § 363 Sale*, AM. BANKR. INST. J., Feb. 2011, at 48 [hereinafter Deutsch & Distefano].

287. 11 U.S.C. § 363(b).

288. *Id.* § 363(c).

289. *See* Deutsch & Distefano, *supra* note 286, at 48; Felton E. Parrish, Jo Ann J. Brighton & James E. Morgan, *Sales of Assets Under Section 363*, in COLLIER GUIDE

reason to sell assets under Chapter 11 is that the Code permits buyers to purchase assets "free and clear of any interest in such property" as long as certain conditions are met.[290]

The Code allows a debtor to complete a section 363 sale after notice and a hearing.[291] Such sales generally occur through a public auction process.[292] First, the debtor will attempt to find a "stalking-horse bidder" (one who sets the floor value through an opening bid).[293] Once the debtor either (1) agrees to a purchase agreement with the stalking-horse bidder, or (2) in the absence of a stalking-horse bidder, is ready to market the assets for sale, the debtor asks the court to approve a set of bidding procedures.[294]

A court's decision on bidding procedures is based on the following: whether the procedures will maximize the sale price, are necessary and made in good faith, and are beneficial to creditors.[295] The debtor may seek protections for a stalking-horse bidder such as breakup fees (payments to a potential purchaser in the event the transaction does not close), bidder qualifications (minimum requirements for potential purchasers to submit alternate bids), or overbid requirements (a minimum amount by which a subsequent bid must exceed the prior bid).[296] If another bidder ends up winning the competition, then such protections compensate the stalking-horse bidder for the costs of assuming that role. Bidding procedures also include a period for the debtor to approach other prospective buyers, a period for any interested parties in purchasing the assets to conduct due diligence, and a deadline for submitting additional bids.[297]

If interested parties (other than the stalking-horse bidder) timely submit bids, the debtor usually holds an auction where each of the bidders can increase their respective bids. At the end of the auction, the debtor selects the winning bidder and seeks court approval of the sale.[298] Often, the possibility of objections to the sale and the complexity of the terms of some bids require

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TO CHAPTER 11: KEY TOPICS AND SELECTED INDUSTRIES § 3.02 (Alan N. Resnick & Henry J. Sommer eds.).

290. 11 U.S.C. § 363(f).

291. *Id.* § 363(b)(1).

292. Deutsch & Distefano, *supra* note 286, at 48.

293. *Id.*

294. *Id.*

295. *Id.*

296. *Id.*

297. *Id.*

298. *Id.*

a searching analysis by the court.

IV. PBGC'S ROLE IN BANKRUPTCY

A. *INTRODUCTION*

One approach to examining PBGC's experience in bankruptcy would be to begin by discussing statistics on the number of active bankruptcies in which the agency participated in select years of its history. For example, in 2014, PBGC was involved in 319 active bankruptcy and state-receivership cases, the great majority of which were bankruptcy proceedings.[299] But a more practical introduction might be to illustrate favorable and unfavorable outcomes for PBGC in bankruptcy with anecdotes from two actual cases under Chapter 11. These examples are at the extremes. Most cases involve more routine rescues, or more routine abandonments, of a debtor's pension plan.

1. A Favorable Outcome: American Airlines

When companies enter bankruptcy, PBGC first seeks to preserve their plans if possible—as in the case of American Airlines. American and its parent, AMR Corporation, "entered bankruptcy in November 2011 and immediately announced plans to terminate American's four pension plans for its 130,000 workers and retirees."[300] In response, PBGC worked with the airline, its unions, and other creditors to show the airline that it could afford to maintain its pension plans.[301] American's plans were underfunded by $12 billion.[302] In 2012, the airline agreed with PBGC and moved to freeze, rather than terminate, its pension plans.[303] Throughout 2012 and 2013, PBGC collaborated with unions, the company, and others to help resolve many issues. One such issue was elimination of a lump-

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299. *See* 2014 PBGC ANN. REP., *supra* note 14, at 95. "Case" is defined here to count only the bankruptcy of the pension plan's sponsor, not every affiliated company that may file a separate petition.

300. *See* 2013 PBGC ANN. REP. ii, 12, *available at* http://www.pbgc.gov/documents/2013-annual-report.pdf.

301. *Id.*

302. *Id.*

303. Jerry Geisel, *American Airlines Freezes its Pension Plans*, WORKFORCE.COM (Nov. 2, 2012), http://www.workforce.com/articles/american-airlines-freezes-its-pension-plans.

sum option in the plan covering American's pilots, which is an unusual event discussed later in this paper.[304] AMR's proposed plan of reorganization involved a merger with US Airways. In August 2013, the Department of Justice brought a civil action under federal antitrust law to enjoin the planned merger.[305] The suit was settled in a way that allowed the merger and permitted AMR to emerge from bankruptcy in December 2013, with the pension plans frozen but not terminated.[306]

2. *An Unfavorable Outcome: Friendly Ice Cream*

In October 2011, Friendly Ice Cream Corporation and its subsidiaries, a retail restaurant chain, filed for bankruptcy.[307] Sun Capital private equity funds had acquired Friendly in a leveraged buyout.[308] Sun Capital created the capital structure, appointed the company's managers, and provided financing before bankruptcy and through DIP financing during the bankruptcy.[309] Shortly after filing for bankruptcy,[310] the debtors filed a motion to sell substantially all their assets to another Sun Capital affiliate. The latter declined to assume the pension plan.[311] The proposed buyer submitted a "credit bid" at the sale, which is a practice whereby a secured creditor bids for property of the estate using the debt it is owed to offset the purchase

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304. Edward Thomas Veal, *IRS Allows Elimination of Lump Sum Distributions as an Alternative to Termination of Bankrupt Employer's Underfunded Pension Plan,* ASSOCIATION OF CORPORATE COUNSEL: LEXOLOGY (Nov. 29, 2012), http://www.lexology.com/library/detail.aspx?g=8612bf14-5ed2-46a0-a310-e98da6917c5f.

305. Office of Pub. Affairs, *Justice Department Requires US Airways and American Airlines to Divest Facilities at Seven Key Airports to Enhance System-wide Competition and Settle Merger Challenge* (Nov. 12, 2013), JUSTICE.GOV, *available at* http://www.justice.gov/opa/pr/justice-department-requires-us-airways-and-american-airlines-divest-facilities-seven-key.

306. Jack Nicas & Brent Kendall, *Big Airline Merger Is Cleared to Fly: AMR, US Airways Agree to Limited Concession in Settlement with U.S.,* WALL STREET J. (Nov. 13, 2013), http://www.wsj.com/articles/SB10001424052702304644104579193804169829002; *see* 2014 PBGC ANN. REP. 6, *supra* note 14.

307. Hon. Joshua Gotbaum, *ABI Commission to Study Reform of Chapter 11: Statement of Hon. Joshua Gotbaum*, 4 (Mar. 14, 2013), http://www.pbgc.gov/documents/Gotbaum-ABI-Statement.pdf. [hereinafter Gotbaum Statement].

308. *Id.*

309. *Id.*

310. *Id.*

311. *Id.*

price.[312] In December 2011, less than three months after Friendly entered bankruptcy and before the debtors proposed any reorganization plan, the court approved the sale.[313] Faced with what would soon be an abandoned pension plan left behind with a liquidating corporate shell, PBGC reluctantly took steps to terminate it.[314] Active and retired participants suffered a loss of half a million dollars in nonguaranteed benefits.[315] PBGC assumed unfunded benefit liabilities of $115 million. To pave the way for court approval, Sun Capital paid a modest amount to settle litigation brought by PBGC and the unsecured creditors' committee in opposition to the sale.[316]

B. Creditors' Committees and PBGC Participation

Congress amended the Bankruptcy Code in 1994 to expressly allow a pension guarantor (i.e., PBGC) to be a member of a creditors' committee.[317] Before the amendment, some United States trustees took the position that appointment of PBGC to a creditors' committee was impermissible, or at least inappropriate. Because PBGC often holds the largest unsecured claims in a bankruptcy, the agency typically cites its strong interest in the fiscal integrity and successful reorganization of the debtor as a rationale for appointment. The agency also typically highlights its specialized knowledge in employee benefits, labor, administrative law, and taxation as useful expertise to contribute to the committee and bankruptcy process. Although PBGC membership on creditors' committees is now commonplace and advantageous to the agency, it does not become a committee member in every case. Because PBGC's resources are limited, it must be selective in choosing cases in which to seek committee membership.

C. Plan Termination in Bankruptcy

The reason for PBGC's involvement in bankruptcy is nearly

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312. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065, 2069 (2012).

313. Mike Spector, *Two Hats a Fit for Friendly's Owner*, WALL ST. J. (July 27, 2012), http://www.wsj.com/articles/SB10000872396390443477104577551000555121714.

314. *Id.*

315. *Id.*

316. *Id.*

317. 11 U.S.C. §§ 101(41)(B), 1102(b) (2012).

always the debtor's sponsorship of an underfunded pension plan. Especially for small debtors, the pension plan is often far down the list of concerns early in the case. PBGC will typically send a "shot-across-the-bow" letter to debtor's counsel with the aim of reminding the sponsor and plan administrator of their responsibilities for funding and maintaining the plan, including the strict criteria for terminating an underfunded plan. After some months, most debtors will have begun to focus on the future of the plan. In many cases, there is little question that the plan is affordable, and it will "ride through" the bankruptcy. The debtor may also favor continuing the plan as a tool to retain valued employees who may be tempted to look for new jobs rather than risk staying with a company in bankruptcy. Alternatively, maintaining the plan may be required by a collective bargaining agreement. Even if the debtor takes steps in bankruptcy to reject its agreement,[318] it may be unsuccessful, or the pension plan may be preserved as part of a settlement. On the other hand, the debtor, certain creditors, or potential investors may see bankruptcy as an opportunity to rid the company of "legacy costs," which may include pensions.

Throughout a reorganization, PBGC considers whether the interests of its insurance program, premium payers, and participants are better served by plan continuation or plan termination. While plan continuation is the preferred outcome, if PBGC believes the plan sponsor will be so weak after exiting Chapter 11 that it will not survive, PBGC may consider termination to cut its losses.

1. *Distress Termination*

Most plan sponsors who seek distress terminations do so in the context of a bankruptcy proceeding.

a. Liquidation

In a Chapter 7 bankruptcy of the plan sponsor, generally the pension plan terminates. Applying the Liquidation Test is usually straightforward.[319] This assumes, of course, that there is no member of the sponsor's controlled group still in business. If a court in a Chapter 11 case approves a liquidating plan of reorganization for members of the controlled group, PBGC

318. *See* 11 U.S.C. § 1113.

319. 29 U.S.C. § 1341(c)(2)(B)(i) (2012).

generally interprets the statutory test the same way as in Chapter 7 liquidation.

b. Reorganization

As discussed above, a distress termination involving a plan sponsor seeking to reorganize in bankruptcy requires a determination by the bankruptcy court.[320] At the very least, the debtor will have to submit declarations and documentary evidence and perhaps face a contested hearing. All controlled group members must demonstrate distress, because all controlled group members are liable for minimum funding contributions.

In practice, the debtor must show that its projected cash flow will be inadequate to support projected minimum funding contributions. The standard has been characterized as a "but for" test.[321] More precisely, the court must determine whether the debtor "will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process."[322] As one court explained: "The reference in the statute to 'a' plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan."[323] Relevant factors include whether the debtor has considered benefit freezes and other measures to reduce costs, trimmed other fixed costs, and identified discretionary spending.[324]

Distress terminations often turn on testimony as to the feasibility of the debtor's obtaining exit financing or an equity infusion if the pension plan were to continue. For example, one court approved a distress termination after being persuaded that the debtor would be unable, after debt service, to meet minimum funding requirements even if it devoted its entire "free cash flow" to the plan for three years after confirmation. In the court's view, it was not plausible that the debtor would attract post-confirmation financing or an equity investment.[325] By

320. *Id.* § 1341(c)(2)(B)(ii)(IV).
321. *In re* Resol Mfg. Co., 110 B.R. 858, 861-62 (Bankr. N.D. Ill. 1990).
322. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV).
323. *In re* US Airways Group, 303 B.R. 784, 798 (Bankr. E.D. Va. 2003).
324. *See In re* US Airways Group, 296 B.R. 734, 745 (Bankr. E.D. Va. 2003).
325. *In re* Wire Rope Corp., 287 B.R. 771, 780-81 (Bankr. W.D. Mo. 2002).

contrast, another court rejected a debtor's argument that plan termination was necessary merely because it insisted that a proposed investor would not close on a transaction if the pension plan were not terminated.[326] After the court considered the parties' negotiating history and what it termed "existential financial realities," it concluded that "the pension terminations were not necessary even though they were desired by the [i]nvestor."[327] In yet another case, where the only investor to submit a full and credible proposal to invest made termination of the pension plan a condition of its investment, the bankruptcy court approved the termination.[328]

Bankruptcies where a debtor sponsors multiple pension plans present another wrinkle. Financial projections may show that the debtor could afford to fund some, but not all, of its pension plans. A recent controversy concerns whether, in such cases, the bankruptcy court's analysis should be based on a plan-by-plan versus an aggregate approach. PBGC has interpreted ERISA to require the court to look at the affordability of plans one by one, that is, not considering the affordability of other plans. Some courts have disagreed, holding that where a debtor proposes multiple distress terminations, ERISA and "equitable" principles of bankruptcy preclude a bankruptcy court from favoring one group of workers over another by permitting some plans to be terminated while others continue.[329] The legal and policy questions are deep. As one court acknowledged in ruling against the agency, "We are not unsympathetic to [PBGC's] view. There is undoubtedly a tension between treating similarly situated workers alike and doing the least that is necessary for the company to emerge from bankruptcy."[330]

2. PBGC-Initiated Termination

Sometimes debtors, especially smaller ones, make no effort

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326. *Id.*

327. *In re* Philip Servs. Corp., 310 B.R. 802, 808 (2004) (Icahn-affiliated lender fails to establish grounds for distress termination).

328. *In re* Aloha Airgroup, Inc., Nos. 04-3063, 1524, 1629, 2005 WL 3487724, *2 (Bankr. D. Haw. Dec. 13, 2005), vacated as moot, Nos. 05-00777 JMS/BMK, 05-00778 JMS/KSC, 05-00778 JMS/KSC, 05-00779 JMS/BMK, 2006 WL 695054 (D. Haw. Mar. 13, 2006).

329. *In re* Kaiser Aluminum Corp., 456 F.3d 328 (3d Cir. 2006). *Accord* PBGC v. Falcon Prods., Inc. (*In re* Falcon Prods, Inc.), 354 B.R. 889 (E.D. Mo. 2006), *aff'd on other grounds,* 497 F.3d 838 (8th Cir. 2007).

330. *Kaiser*, 456 F.3d at 342.

to terminate a plainly unaffordable pension plan. Not only may the debtor be distracted by more immediate pressures, but applying for a distress termination requires it to incur more professional fees. In other instances, a collective bargaining agreement stands in the way of a distress termination. The union may resist plan termination as long as possible. The debtor's management may either be unwilling to face the facts about projected funding costs, or may fear a strike or costly court proceeding to reject its collective bargaining agreement, even when it recognizes the plan's unaffordability. In such cases, where PBGC is persuaded that termination is inevitable, the agency may initiate termination.[331] This procedure is often carried out by a written agreement between PBGC and the plan administrator that terminates the plan and appoints the agency as statutory trustee.[332] Termination by agreement takes place out of court. Moreover, the existence of a collective bargaining agreement whose terms prohibit the employer from seeking a distress termination does not bar PBGC from initiating termination.[333] Of course, the plan administrator may decline to sign a termination agreement with PBGC. If so, the agency files an action in the appropriate United States district court—not the bankruptcy court—to seek a decree of plan termination.[334]

The grounds for PBGC-initiated termination most relevant to bankruptcy are the following: (1) the plan has failed to meet the minimum funding standard, (2) the plan will be unable to pay benefits when due, or (3) PBGC's long-run loss may reasonably be expected to increase unreasonably.[335] The most common of these three grounds is the second. One court interpreted that criterion as follows: "[T]he test is not affordability, but rather whether the plan will be 'unable to pay benefits when due.' . . .The latter standard encompasses a range of factors that permit the exercise of discretion by the agency, whereas the concept of affordability within a § 1341 bankruptcy proceeding is far more demanding."[336]

Although the test of "will be unable to pay benefits when

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331. *In re* UAL Corp. (Pilots' Pension Plan Termination), 468 F.3d 444, 451-52 (7th Cir. 2006).

332. 29 U.S.C. § 1342(b)(3); id. § 1342(c)(1)(penultimate sentence).

333. *Compare* 29 U.S.C. § 1341(a)(3) *with* 29 U.S.C. § 1342.

334. *Id.* § 1342(b)(1).

335. *Id.* § 1342(a)(1), (2), (4).

336. Ass'n of Flight Attendants-CWA v. PBGC, No. Civ. A. 05-1036ESH, 2006 WL 89829, at 11 (D.D.C. Jan. 13, 2006) (citing 29 U.S.C. § 1342(a)(2)).

due" may be the most often cited rationale for a PBGC-initiated termination, the alternative "long-run loss" ground can be an important check against moral hazard.[337] For example, PBGC has successfully terminated plans in advance of a controlled-group breakup, where a transaction threatened to permit a financially strong company to escape liability for underfunding and leave behind a financially troubled sponsor.[338] Likewise, the agency succeeded in terminating plans to prevent additional losses from springing shutdown benefits agreed upon between the debtor and its union.[339] In another case, the court upheld a prompt PBGC-initiated termination to prevent six months of further benefit accruals that would have resulted from a compromise reached between the debtor and its union in the context of an inherently unsustainable plan.[340] In each example, the court upheld PBGC action to stop conduct by private-sector actors that would have harmed the agency and its premium payers.

D. TREATMENT OF PBGC CLAIMS IN BANKRUPTCY

In a best-case scenario, the debtor reorganizes successfully, the pension plan continues, and PBGC has no claims in bankruptcy. Instead, when the plan terminates, PBGC vigorously pursues recovery.

1. Unfunded Benefit Liabilities

PBGC's largest claim is typically its claim for unfunded benefit liabilities (UBL).[341] Under ERISA, if a liable party fails to pay the claim after demand, then a lien arises in favor of

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337. A leading treatise on pension plans explains: "The existence of the U.S. pension insurance system introduces an element of moral hazard. If pensions are guaranteed . . . , participants have less incentive to be vigilant in monitoring the plan. Guarantees of benefit payments . . . also give workers greater incentive to exchange future promises of pension payments for current wages." MCGILL, *supra* note 59, at 200.

338. PBGC v. FEL Corp., 798 F. Supp. 239 (D.N.J. 1992).

339. PBGC v. Republic Techs. Int'l, LLC, 386 F.3d 659 (6th Cir. 2004).

340. *In re* UAL Corp. (Pilots' Pension Plan Termination), 468 F.3d 444, 451-52 (7th Cir. 2006). The court rejected PBGC's view that the decision to terminate was agency action subject to limited review under the Administrative Procedure Act, 5 U.S.C. § 706 (2012), but upheld the decision on independent review. 468 F.3d at 449-52.

341. 29 U.S.C. § 1362(b).

PBGC as of the termination date of the plan.[342] The amount of the lien is limited to 30% of the collective net worth of all liable parties.[343] For purposes of the Bankruptcy Code, the lien is "treated in the same manner as a tax due and owing to the United States."[344] In practice, the plan sponsor almost invariably enters bankruptcy before the conditions are met, and the attachment of a lien—let alone its perfection—is barred by the automatic stay.[345] Thus, the UBL claim is almost always unsecured.

Somewhat more likely is the possibility that part or all of the UBL claim may be accorded priority treatment. PBGC's position is that the claim is an administrative expense entitled to priority as a tax incurred by the estate, in an amount up to 30% of the controlled group's collective net worth.[346] Independently, the claim may meet the definition of a "tax" for bankruptcy purposes because it is an involuntary pecuniary burden imposed on individuals or their property for public purposes, which includes the defrayal of the government's expenses.[347] Alternatively, this claim may be entitled to eighth priority as a prepetition tax, in an amount up to 30% of the controlled group's collective net worth.[348] However, there is contrary authority.[349] Any amount held not to be entitled to priority is asserted as a general unsecured claim.

The issue most often contested involving the UBL claim is the amount. Debtors and other creditors have challenged PBGC's reliance on its regulation defining the amount of the benefit liabilities.[350] The usual argument has been that a "prudent-investor" interest rate should be used instead of the regulation's interest factor in discounting future benefits. Two courts of appeal have agreed that a prudent-investor approach is permissible.[351] More recently, however, the tide has turned with

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342. *Id.* § 1368(a).

343. *Id.*

344. *Id.* § 1368(c)(2).

345. 11 U.S.C. § 362 (2012).

346. *Id.* §§ 503(b)(1)(B), 507(a)(2); 29 U.S.C. § 1368(a), (c)(2).

347. New York v. Feiring, 313 U.S. 283, 287 (1941).

348. 11 U.S.C. § 507(a)(8).

349. *In re* Bayly Corp., 163 F.3d 1205 (10th Cir. 1998), *aff'g* No. Civ. A. 95 N 901, 90-18983 SBB, 1997 WL 33484011 (D. Colo. Feb. 12, 1997) (denying administrative priority as postpetition tax to part of UBL claim, despite net worth in certain members of controlled group).

350. 29 C.F.R. §§ 4044.52-.75 (2014).

351. PBGC v. Belfance (*In re* CSC Indus., Inc.), 232 F.3d 505, 508-09 (6th Cir.

the help of a Supreme Court decision.[352] Although not directly addressing ERISA claims, the Court held that, "Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code."[353] In the past decade, PBGC has prevailed on the issue.[354] Other rulings have upheld settlements based on the regulatory method of defining the UBL amount.[355]

2. *Unpaid Minimum Funding Contributions*

Unpaid contributions are usually the second largest claim PBGC asserts in bankruptcy. Under a tax provision, a lien enforceable by PBGC may arise for the failure to pay required contributions in excess of $1 million.[356] Occasionally, when the lien is perfected before bankruptcy, this provision enables PBGC on behalf of the plan to assert a secured or partly secured claim for unpaid contributions. The "amount with respect to which a lien is imposed" is to be treated as taxes due and owing the United States under rules similar to those prescribed for the lien for unfunded benefit liabilities.[357] Another kind of secured claim PBGC infrequently asserts is one negotiated with the sponsor under what is commonly called a "minimum funding waiver" in certain cases of prebankruptcy business hardship.[358]

Early in the history of the Bankruptcy Code, one district court affirmed the decision of a bankruptcy court holding that the full postpetition contribution was entitled to administrative priority.[359] PBGC was thereby encouraged to believe that courts would treat the entire amount of unpaid contributions becoming due after the petition date as an administrative expense. Later

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2000); PBGC v. CF&I Fabricators of Utah, Inc. (*In re* CF&I Fabricators of Utah, Inc.), 150 F.3d 1293, 1300-01 (10th Cir. 1998).

352. Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000).

353. *Id.* at 20.

354. Dugan v. PBGC *(In re* Rhodes)*,* 382 B.R. 550, 560 (Bankr. N.D. Ga. 2008); *In re* High Voltage Eng'g, No. 05-10787, Order at 2 (Bankr. D. Mass. July 26, 2006); Transcript of Record at 32, *In re UAL Corp.*, No. 02-48191 (Bankr. N.D. Ill. Dec. 16, 2005); *In re* US Airways Group, 303 B.R. 784, 798 (Bankr. E.D. Va. 2003).

355. *See, e.g., In re* Wolverine Proctor & Schwartz, LLC, No. 06-10815-JNF, 2009 WL 1271953 (Bankr. D. Mass. May 5, 2009), *aff'd,* 436 B.R. 253 (D. Mass. 2010), *aff'd*, No. 10-1334 (1st Cir. Apr. 20, 2011).

356. 26 U.S.C. § 430(k)(1), (5) (2012).

357. *See id.* § 430(k)(4)(C).

358. *See id.* § 412(c).

359. Columbia Packing Co. v. PBGC, 81 B.R. 205, 208-209 (D. Mass. 1988).

decisions, however, took a much stricter view and granted administrative priority to only a small portion (the "normal cost") of each contribution that becomes payable postpetition. Even though under the funding rules of the IRC the entire amount becomes payable after the petition date, the courts have generally treated the lion's share of each contribution as a prepetition, general unsecured claim.[360]

The majority view today is that for contributions becoming due postpetition only the amount considered normal cost is entitled to treatment as ordinary-course business expenses, and thus accorded administrative priority.[361] Contributions "arising from services rendered within the 180 days before the date of the filing of the petition" (or cessation of the debtor's business if earlier) are entitled to fifth priority, subject to a cap.[362] Consistent with the treatment of postpetition contributions, the quoted language in the preceding sentence is interpreted to apply only to normal cost. Any contributions not entitled to priority are treated as a general unsecured claim.

3. Annual Premiums

Annual premiums—that is, flat-rate and variable-rate—are usually the smallest PBGC claim in bankruptcy. Probably for that reason there is a dearth of reported cases on their treatment.[363] In PBGC's view, unpaid premiums arising postpetition are entitled to treatment as an administrative expense.[364] Alternatively, this claim may be entitled to eighth priority as a tax.[365] Unpaid premiums arising before the petition

360. PBGC v. Belfance (*In re* CSC Indus.), 232 F.3d 505, 510 (6th Cir. 2000) (denying tax priority); PBGC v. CF&1 Fabricators of Utah, Inc. (*In re* CF & I Fabricators of Utah), 150 F.3d 1293, 1297-1300 (10th Cir. 1998) (denying tax priority and generally denying administrative expense priority); PBGC v. Sunarhauserman, Inc. (*In re* Sunarhauserman, Inc.), 126 F.3d 811, 819 (6th Cir. 1997) (generally denying administrative expense priority).

361. 11 U.S.C. §§ 503(b), 507(a)(2) (2012).

362. *Id.* § 507(a)(5).

363. *See In re* Kent Plastics Corp., 183 B.R. 841, 847-48 (Bankr. S.D. Ind. 1995) (denying administrative priority to postpetition PBGC premiums).

364. *See* 11 U.S.C. §§ 503(b), 507(a)(2).

365. *See id.* § 507(a)(8); New Neighborhoods, Inc. v. W. Virginia Workers' Comp. Fund, 886 F.2d 714 (4th Cir. 1989) (treating contributions owed to a workers' compensation fund as an eighth-priority excise tax). The structure and operation of state workers' compensation systems vary widely, so the case law must be carefully read in assessing the application of such decisions to the treatment of PBGC premium claims.

date are treated as a general unsecured claim.

4. *Termination Premiums*

Generally, a termination premium obligation arises on plan termination, in addition to any other premium due to the Corporation.[366] That would ordinarily make the termination premium a dischargeable "claim" in bankruptcy. In such a circumstance, the termination premium is treated as general unsecured claim. However, if the plan terminates during "any bankruptcy reorganization proceeding under [C]hapter 11," it is an obligation that springs only on emergence of the reorganized debtor.[367] As the leading case explains, "[A]n employer's obligation to pay a Termination Premium on a pension plan that is terminated during the course of the bankruptcy does not even arise until the bankruptcy itself is terminated."[368]

E. Disclosure Statement Issues

The debtor's filing of a proposed disclosure statement is often a key moment for PBGC to learn the debtor's intentions toward its pension plan. Especially in Chapter 11 cases where PBGC is not a member of the creditors' committee, the disclosure statement may be the first time the agency finds out how the debtor proposes to handle pension issues. Notwithstanding PBGC's efforts to focus the debtor's attention early on such matters, the disclosure statement—especially in smaller bankruptcies—is all too often silent on the subject of the pension plan. If so, PBGC routinely files an objection to the disclosure statement. In other cases, when the pension plan has already terminated or the debtor reveals its intent to seek a distress termination, PBGC may object to a disclosure statement because it fails adequately to inform creditors of the size of PBGC's claims or their proposed treatment under the plan of reorganization. In practice, such PBGC objections often induce the debtor to agree to address the omitted topics in an amended disclosure statement.

366. 29 U.S.C. § 1306(a)(7) (2012).

367. 11 U.S.C. § 101(5); PBGC v. Oneida Ltd., 562 F.3d 154 (2d Cir. 2009).

368. *Oneida*, 562 F.3d at 157.

F. Plan of Reorganization Issues

1. Prepackaged Plans

A prepackaged Chapter 11 plan is a bankruptcy plan of reorganization that has been negotiated and accepted by creditors before the filing of the bankruptcy petition. Prepetition solicitation and voting is permitted under the Bankruptcy Code.[369] A prepackaged plan differs from the typical plan under Chapter 11 in that the sequence of events is altered to move up the bargaining, solicitation of support, and submission of acceptances or rejections. Once the bankruptcy proceeding has commenced, then the debtor may move immediately for a hearing to confirm the plan. There is no requirement for a disclosure statement because the debtor already has enough votes to seek plan confirmation.[370]

Unless PBGC somehow has advance notice (for example, if the debtor needed PBGC's acceptance to obtain the necessary votes for approval), then the debtor may schedule a confirmation hearing before PBGC receives notice of the bankruptcy. This may occur, for example, because PBGC's name was omitted from the debtor's list of creditors entitled to notice. In such a case, the agency must take immediate action to gather information and to analyze whether the prepackaged plan may prejudice PBGC. For example, the prepackaged plan might result in the debtor's abandoning the pension plan as the debtor heads toward liquidation,[371] or PBGC's expected recovery in a hypothetical future plan termination might be reduced. In some prepackaged plans, the debtor intends to continue the plan's pension plan and there is no such prejudice. As in other cases where the pension plan is proposed to remain ongoing with the reorganized debtor, the agency may nevertheless seek to negotiate protective language in the reorganization plan and confirmation order, specifying that pension liabilities are not being discharged or otherwise altered.

2. Executory Contracts

Occasionally a debtor will try to "reject" its pension plan as

369. 11 U.S.C. § 1126(b), (g).

370. *Id.* § 1125(g); JOAN N. FEENEY, BANKRUPTCY LAW MANUAL § 11:46 (5th ed. 2013).

371. *See supra* Part III A. 2., at 292-293 (discussing the *Friendly Ice Cream* case).

an executory contract. PBGC routinely objects to such attempts, because Title IV of ERISA is the exclusive means of terminating a pension plan.[372] The legislative history of ERISA and current case law fail to support such a tactic.[373]

3. Classification

The Bankruptcy Code provides little guidance on claim classification beyond the general requirement that a plan may place a claim in a particular class only if it is "substantially similar" to other claims therein.[374] Unfairly applied, separate classification of similar claims in a plan of reorganization can be a tool to gerrymander voting or to give a greater recovery to some general unsecured claims at the expense of others. Because PBGC's claims are often the largest in a bankruptcy, the agency may be perceived by employees, trade creditors, or note holders as a less-deserving governmental creditor. Thus, there are sometimes attempts to place the claims of PBGC or other unpopular general unsecured creditors in a separate class. PBGC will object to a proposed plan of reorganization where it discerns the motive or effect of such treatment to be improper. The subject of abusive claim classification is largely governed by evolving case law.[375] Fortunately, PBGC has encountered fewer attempts to manipulate classification in recent years.

4. Substantive Consolidation

Substantive consolidation is an equitable remedy whereby the assets and liabilities of two or more debtors are consolidated. The upshot is that multiple debtors are treated as a single debtor for purposes of distribution.[376] The standard for permitting substantive consolidation varies from circuit to circuit, but there are two general approaches.[377] According to

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372. 29 U.S.C. § 1341(a)(1) (2012).

373. 1 Legislative History of the Comprehensive Omnibus Reconciliation Act of 1985, Pub. L. No. 99-272, 100 Stat. 83, 289 (1985), *reprinted in* 1986 U.S.C.C.A.N. 756, 940; *In re* Philip Servs. Corp., 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004).

374. 11 U.S.C. § 1122(a).

375. *See generally* 6 NORTON, *supra* note 229, at § 109:4 (discussing trends in interpreting 11 U.S.C. § 1122 (2012)).

376. *See generally* 2 NORTON, *supra* note 229, at §§ 21:3-4 (citing bankruptcy court's authority to exercise general equitable powers under 11 U.S.C. § 105(a) (2012)).

377. 2 NORTON, *supra* note 229, at § 21:4.

one approach, "The proponent must show not only a substantial identity between the entities to be consolidated, but also that consolidation is necessary to avoid some harm or to realize some benefit."[378] The second approach calls for the court to determine the following: "(i) whether creditors dealt with the entities as a single economic unit and 'did not rely on their separate identity in extending credit,' . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors."[379]

If members of the plan sponsor's controlled group are also in bankruptcy, often the great majority of claims are against the sponsor, which is usually the principal operating company. By contrast, PBGC is often the only significant creditor against other debtors, by virtue of its joint and several claims. Assuming the pension plan terminates and some debtors in the controlled group have significant unencumbered assets, substantive consolidation can severely harm PBGC by effectively eliminating its joint and several claims and diluting its recovery. Absent strong evidence that the requirements for applying this remedy are met, PBGC will generally oppose a motion or plan of reorganization calling for substantive consolidation. Unlike abuses of classification, ill-founded requests for substantive consolidation are as serious a threat to the agency's interests today as ever.

5. *Feasibility*

Before confirming a plan of reorganization, the bankruptcy court must find that the plan "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."[380]

Disputes over feasibility can take many forms. One troubling scenario for PBGC is where the debtor proposes to continue the pension plan, but under a proposed reorganization plan that poses a risk that the sponsor will be unable to fund its pension obligations upon emergence from bankruptcy. If PBGC concludes that the debtor's financial projections are unrealistic, it may object to the reorganization plan on the ground of

378. Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).

379. Union Sav. Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988).

380. 11 U.S.C. § 1129(a)(11) (2012).

feasibility. A different kind of feasibility issue may arise where the necessity for plan termination is undisputed. For example, PBGC may object to the proposed reorganization plan if it concludes that its claims cannot be paid in accordance with the bankruptcy priority rules.[381]

6. Third-party Releases

As part of a plan of reorganization, debtors sometimes ask the bankruptcy court to approve releases from liability for nondebtors. The Bankruptcy Code generally provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." [382] However, a substantial majority of courts have held that this provision does not negate a court's power to confirm plans that contain such provisions, especially if the confirmation order enjoins collection activity against certain nondebtors who are necessary to the successful reorganization of the debtor or if the releases are consensual.[383]

PBGC has learned to be vigilant about the use of broad language in third-party releases, which may shield fiduciaries of pension plans from liability for possible misconduct, or other parties with pension obligations. Whether or not the pension plan terminates during bankruptcy, evidence of a fiduciary breach may not be discovered until after confirmation.[384] In either case, it is important to preserve potential claims on behalf of the plan against wrongdoers. When overly expansive release language is proposed, PBGC generally objects. Not only does such language run afoul of the Bankruptcy Code's limitation of the effect of discharge, but ERISA provides that "any provision of an agreement or instrument that purports to relieve a fiduciary from responsibility or liability" to an employee benefit plan is "void as against public policy."[385] Finally, broadly drafted releases of third parties may shield nondebtors who are part of the debtor's controlled group and otherwise subject to PBGC's joint and several claims. In practice, such objections are usually resolved consensually when the debtor agrees to carve

381. *Id.* § 507(a).

382. *Id.* § 524(e).

383. *See generally* 6 NORTON, *supra* note 229, at § 114:4; 2 ROBERT E. GINSBERG & ROBERT D. MARTIN, GINSBERG & MARTIN ON BANKRUPTCY § 13.16 (5th ed. 2014).

384. *Id.*

385. 29 U.S.C. § 1110(a) (2012).

out such potential claims from the terms of the release provisions.

7. *Asset Sales*

The debtor, after notice and a hearing, may generally "use, sell, or lease, other than in the ordinary course of business, property of the estate."[386] Where the debtor proposes to sell substantially all its assets, most courts consider a list of factors to determine whether the debtor has shown a "good business reason" to justify such a transaction.[387] In recent years investors in bankrupt companies increasingly prefer to structure transactions as a purchase of assets, rather than a purchase of stock.[388] If the buyer does not agree to assume the pension plan as part of the transaction, the sale of all or substantially all the debtor's assets may result in abandonment of the pension plan with the debtor, which is left behind as a shell company.

Instead of renegotiating contracts and other obligations of the debtor under the formalities of a plan of reorganization, a motion for sale of substantially all of the debtor's assets may permit major issues affecting creditors, including the future of the pension plan, to be effectively decided with relatively few procedural safeguards. For that reason, PBGC and other creditors may object to such a motion on the ground that it amounts to what is often termed a *sub rosa*, or under-the-table, plan of reorganization.[389] Among the dangers posed by such a sale is the lack of sufficient disclosure for parties to determine whether the transaction is at arm's length or represents the highest and best offer. If the buyer does not propose to assume the pension plan, then the court is not required to make a finding as to whether the plan is affordable. Often there is too little time for PBGC and employee groups to negotiate with the buyer to assume the plan or to explore whether another form of restructuring might permit the plan to survive.

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386. 11 U.S.C. § 363(b) (2012).

387. *See* 2 NORTON, *supra* note 229, at § 44:17 (citing Comm. Of Equity Sec. Holders v. Lionell Corp. (*In re* Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983) (as the leading case).

388. Gotbaum Statement, *supra* note 307, at 3 (section 363 sales of all or substantially all assets in large, public company bankruptcies, as a percentage of all cases disposed, by year of case disposition, grew from 4% during 1990s to 21% since 2000).

389. *See* 2 NORTON, *supra* note 229, at § 44:17; *see also In re* Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983) (seminal case involving a PBGC objection).

V. CONCLUSION

PBGC-insured pension plans protect more than 40 million people. For decades, PBGC has sought to promote continuation of pension plans by sponsors who file for bankruptcy reorganization under Chapter 11. In bankruptcy, PBGC wins a case whenever the debtor keeps its pension plan.