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Mayday, Mayday!: How the Current Bankruptcy Code Fails to Protect the Pensions of Employees

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INTRODUCTION

For years the Pension Benefit Guaranty Corporation ("PBGC"), the federal insurer of pensions, has been in financial trouble, but it is rapidly approaching financial catastrophe. In 1990, the director of the PBGC, James B. Lockhart, spoke prophetically in estimating that the PBGC's exposure "could be as high as $20 billion to $30 billion in the event of a major recession that involved a downturn in the steel, automobile, and airline industries."[1] The bankruptcies of LTV Steel Corporation and Bethlehem Steel Corporation turned over $5.4 billion in unfunded pension obligations,[2] and the more recent turnover of US Airways' pilot pension plan threw another $2.1 billion of unfunded liabilities into the PBGC's lap.[3] The PBGC's deficit now stands at $9.7 billion dollars, but this deficit is likely to double, or even triple, given the bankruptcy of United Airlines and the potential bankruptcy of Delta Airlines.[4] It is predicted that the airline industry will hand over $80 billion in unfunded pension obligations to the PBGC within the next few years.[5] However, the real concern is that, due to its own structural

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[1] Daniel Keating, *Chapter 11's New Ten–Ton Monster: The PBGC and Bankruptcy*, 77 MINN. L. REV. 803, 809 n.30 (1993) [hereinafter Keating, *Ten–Ton Monster*].

[2] Editorial, *Peanut Futures*, ST. LOUIS POST DISPATCH, Sept. 20, 2004, at B6 [hereinafter Editorial].

[3] James R. Asker, *Pension Prudence*, AVIATION WEEK & SPACE TECHNOLOGY, Jan. 5, 2004, at 21.

[4] Kimberly Blanton, *Pensions Grounded?: Airlines Could Be Latest Industry to Terminate Plans*, BOSTON GLOBE, Sept. 28, 2004, at F1.

[5] *Id.*

problems, the PBGC will not have the funds to insure even the minimum guaranteed portions of these pensions.[6]

Current bankruptcy law allows a company in chapter 11 to reject its collective bargaining agreement by satisfying a nine-part test.[7] The most disputed element of the test is that the chapter 11 debtor must show that the proposed modifications are "necessary" to permit reorganization.[8] However, bankruptcy courts have recently been favoring a broad interpretation regarding what is "necessary" for reorganization.[9]

Once the bankruptcy court has found that termination of the pension plan meets the "necessity" prong, the PBGC assumes the pension obligations of the chapter 11 debtor.[10] Upon doing this, the PBGC secures the assets that are currently in the plan and, combining them with the money it has collected from premiums paid by participating employers, uses them to pay a statutorily set maximum.[11] This maximum amount usually pays only a fraction of the promised benefits to each of the covered participants.[12] With regard to the unfunded portion of its pension plan, the PBGC then becomes one of the chapter 11 debtor's unsecured creditors.[13]

The employees of United and US Airways face this situation right now. They have negotiated with their employers and accepted wage and benefit reductions, increased hours, and decreased vacation and holiday leaves in order to prevent the termination of their pension plans. Yet, it seems they may have made these sacrifices for naught;[14] both airlines are seeking to terminate all of their defined-benefit plans,[15] leaving many workers to collect mere cents on the dollar of what they were promised as retirement benefits.[16]

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[6] *See* Keating, *Ten-Ton Monster*, *supra* note 1.

[7] *In re* American Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

[8] 11 U.S.C. § 1113(b)(1)(A) (1984). For a discussion of the "necessary" element, see Jay M. Rector, *Bankruptcy—How Necessary is 'Necessary' Under Section 1113?* Truck Drivers Local 807 v. Carey Transportation, 13 J. CORP. L. 941 (1988).

[9] *See generally* Ellen Schultz, *Airlines in Trouble: Industry's Pension Maneuvers Raise Questions About the Law*, WALL ST. J., Sept. 14, 2004, at A17 (noting that some high-profile companies have recently convinced bankruptcy courts to accept a broad interpretation of "necessary").

[10] *See* 29 U.S.C § 1341 (1988).

[11] *See* Simon Kwan, *The Present and Future of Pension Insurance*, FRBSF ECONOMIC LETTER, No. 25, June 13, 2003, at 1.

[12] *See id.*

[13] 29 U.S.C. § 1362(b).

[14] *See* Susan Carey, *Airlines Keep Fighting for Viability*, WALL ST. J., Nov. 8, 2004, at A5 [hereinafter *Fighting for Viability*].

[15] *Id.*

[16] *See* Daniel Keating, *Pension Insurance, Bankruptcy, and Moral Hazard*, 1991 WIS. L. REV. 65, 66 (1991) [hereinafter Keating, *Pension Insurance*].

This note contends that the current Bankruptcy Code fails to provide an adequate remedy to the PBGC and to the employees of a chapter 11 debtor when a pension plan is terminated. Part I explores the development of the PBGC and assesses its effectiveness in light of its legislative purpose.[17] In addition, Part I examines the Bankruptcy Code, focusing on its impact upon an employee's ability to receive the maximum pension amount after a distress termination.[18] Part II discusses the current predicament of the airline industry as related to the PBGC and Bankruptcy Code.[19] Part III analyzes proposed solutions to the PBGC's financial issues.[20] The note concludes that, without a significant alteration in the priority status given to employees and/or to the PBGC under the Bankruptcy Code, employees will be left out in the cold.

I. BACKGROUND LEGAL CONCEPTS

A. *The Pension Benefit Guarantee Corporation (PBGC)*

There are two general types of employee benefit plans: 1) defined–benefit and 2) defined–contribution. In 1985, there were 114,000 defined–benefit plans; today, there are only 31,000[21] because new businesses have decided it is much easier financially to commit to a defined–contribution plan rather than to a defined–benefit plan.[22] In a defined–contribution plan, the company promises to contribute a percentage of an employee's income to an account plan,[23] making no promises regarding the benefits the employee will receive upon retirement.[24]

On the other hand, a defined–benefit plan places an obligation on the company to contribute the promised benefit.[25] Contributions are invested and any gain or loss affects the employer's obligation.[26] In the end, the

[17] *See infra* notes 21–41 and accompanying text.

[18] *See infra* notes 42–58 and accompanying text.

[19] *See infra* notes 69–101 and accompanying text.

[20] *See infra* notes 102–132 and accompanying text.

[21] Peter Krouse, *A Storm Is Brewing for U.S. Pension Agency; Terminated Plans, Old Rules Blamed*, PLAIN DEALER (Cleveland), Sept. 15, 2004, at C1.

[22] *See generally id.* (noting that defined–benefit plans are rapidly being replaced by defined–contribution plans, such as 401(k)s); *see also* Nanette Byrnes & Davis Welch, *The Benefits Trap: Old–line Companies Have Pledged a Trillion Dollars to Retirees. Now They're Struggling to Compete With New Rivals, and Many Can't Pay the Bill*, BUSINESS WEEK, July 19, 2004, at 64 (discussing the reasons for a shift from defined–benefit to defined–contribution plans).

[23] *See* 29 U.S.C. § 1002(34) (1988).

[24] *See* Keating, *Ten–Ton Monster*, *supra* note 1, at 806.

[25] *See* 29 U.S.C. § 1002(35).

[26] *See generally* Keating, *Ten–Ton Monster*, *supra* note 1.

only thing that matters in a defined–benefit plan is that the employee receives the benefit promised, regardless of the amount the employer had to contribute to meet that promise.[27]

In 1974, the Employee Retirement Income Security Act ("ERISA") Title IV established the PBGC to prevent workers from being deprived of retirement benefits due to underfunded defined–benefit plans.[28] Under ERISA, a pension plan is underfunded if the market value of a plan's assets is less than 90% of the plan's current liabilities.[29] When a defined–benefit plan terminates while underfunded, the pension obligations are given to the PBGC.[30]

When the plan is handed over to the PBGC, it ensures that each employee receives benefits up to the statutorily set limit.[31] Currently, the maximum payout the PBGC will allocate annually is $44,386 for a sixty–five–year old;[32] this amount is decreased if an employee has not yet reached age sixty–five. Additionally, the cap is set at the year the plan is terminated.[33] In fact, employees usually receive less than the maximum payout and also take a significant cut in pension benefits when a company hands its plans over to the PBGC.[34]

The PBGC's problems merely begin with the maximum payout. The corporation has only four financial resources: 1) insurance premiums paid to the corporation by defined–benefit pension sponsors; 2) assets of terminated pension plans; 3) recoveries in bankruptcy from former plan sponsors; and 4) earnings on invested assets.[35] Since the assets recovered from terminated plans are always insufficient to pay out the benefits, the PBGC must act as an insurer, making up the difference between the assets and the insured amount. Several problems arise at this stage.

First, the premiums are not risk–based like most insurance companies' premiums. Instead, PBGC premiums are variable based on underfunding rather than on the likelihood of termination.[36] In addition, with the trend away from defined–benefit plans to defined–contribution plans, in the past decade the PBGC has seen its premium income fall

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[27] *Id.*

[28] Kwan, *supra* note 11. ERISA does not cover defined–contribution plans. *See* Keating, *supra* note 16, at 69.

[29] *Nest Eggs Without the Yolk—Corporate Pensions*, ECONOMIST, May 10, 2003, at 59.

[30] *See* 29 U.S.C § 1341 (1988).

[31] *See id.*

[32] *See* Blanton, *supra* note 4.

[33] *Id.*

[34] Albert B. Crenshaw, *United Plan for Pensions Not Legal, Agency Says*, WASH. POST, Aug. 14, 2004, at E01.

[35] *See* Kwan, *supra* note 11.

[36] Pension Protection Act, Pub. L. No. 100-203, § 9331(a), (b), 101 Stat. 1330, 367–68 (1987).

substantially while its payout of benefits has more than tripled.[37] In 2003, for example, the PBGC paid out $2.5 billion in benefits but only took in $1 billion in premium income.[38] As of September 2003, the PBGC had a deficit almost three times what it was one year earlier.[39] Considering there is another $85 billion in unfunded pension liabilities from companies with junk bond ratings, the PBGC is in serious trouble.[40]

This unhealthy financial climate has created a situation where the PBGC may not be able to pay out the meager amount it insures for pension participants. The PBGC was created to prevent unfunded pension plans from leaving lifelong employees of companies without their promised retirement income.[41] Thus, the question presents itself: what must be done to achieve ERISA's original objective in creating the PBGC?

B. The Relationship between the PBGC and Bankruptcy Law

Beyond the PBGC's structural problems, the insurer faces additional problems regarding its claims in bankruptcy court. When ERISA was established in 1974, Congress failed to see the big picture. ERISA is a complex maze of legislation that becomes even more convoluted in light of the Bankruptcy Code.

Defined–benefit pension plans are nothing more than collective bargaining agreements. Over the years, employees have sacrificed wage increases in exchange for promises of retirement benefits.[42] However, these promises are repeatedly turning up empty. Old–line companies with defined–benefit plans are becoming unable to compete with the new companies in their industries that do not have the same pension

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[37] *U.S. Representative Peter G. Fitzgerald (R–IL) Holds Hearing On Benefit Pension Plans*, FDCH POLITICAL TRANSCRIPTS, Sept. 15, 2003 [hereinafter FDCH POLITICAL TRANSCRIPTS]. Junk bonds pay high yields to bondholders because the borrower has no other option. Their credit ratings are low and there is a greater risk of the company defaulting. The significance of the PBGC's $85 million in unfunded pension liabilities from companies with junk bond ratings is that these companies are more likely to enter bankruptcy and hand their pensions off to the PBGC.

[38] *Id.*

[39] *See* Byrnes & Welch, *supra* note 22, at 68.

[40] Paul Kangas & Susie Gharib, *Nightly Business Report*, CEOWIRE, Jan. 15, 2004, *available at* http://www.nightlybusiness.org/transcript/2004/transcript011504.html (last visited Mar. 23, 2005).

[41] Daniel Keating, *Bankruptcy Code § 1114: Congress' Empty Response to the Retiree Plight*, 67 AM. BANKR. L.J. 17 n.22 (1993), *citing* Rettig v. PBGC, 744 F.2d 133, 137 (D.C. Cir.1984) (noting that the incidence of such tragic cases of employees being left without pensions helped to spur the passage of ERISA) [hereinafter Keating, *Congress' Empty Response*].

[42] *See generally* Carey, *Fighting for Viability*, *supra* note 14.

obligations.[43] In order to be more competitive, these companies are seeking to do away with their pension promises and bankruptcy law is allowing them to do it.[44]

The Bankruptcy Code permits a company to terminate a collective bargaining agreement by satisfying a nine–part test.[45] If terminated, defined–benefit plans are handed over to the PBGC. The test requires that: 1) the debtor in possession make a proposal to the Union to modify the collective bargaining agreement; 2) the proposal be based on the most complete and reliable information available at the time of the proposal; 3) the proposed modifications be necessary to permit the reorganization of the debtor; 4) the proposed modifications assure that all creditors, the debtor, and all affected parties are treated fairly and equitably; 5) the debtor provide the Union with any information necessary to evaluate the proposal; 6) between the time the proposal is made and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor meet at reasonable times with the Union; 7) at the meetings the debtor confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement; 8) the Union refused to accept the proposal without good cause; and 9) the balance of the equities must clearly favor rejection of the collective bargaining agreement.[46]

Under this test, a company can present to a representative of its employees a proposal to modify or to terminate a defined–benefit plan.[47] That representative has the right to reject the modification or termination for good cause. However, if the representative chooses to reject the new plan, the company may go to a bankruptcy court to request an order terminating the plan. If the bankruptcy judge finds that the representative rejected the new plan without good cause and that the balance of equities clearly favors termination, the company will be allowed to terminate despite the representative's refusal.[48] A refusal to accept a modification that reduces employee benefits under a pension plan may lead to an even more inequitable plan under which employees may receive only a fraction of the benefits promised if handed over to the PBGC. As a

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[43] *See generally* Jerry Flint, *Solve the Pension Mess*, FORBES, Sept. 29, 2003, at 74.

[44] *See supra* notes 7 and 38 and accompanying text.

[45] 11 U.S.C. § 1113 (1984); *see also In re* American Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984) (establishing the nine–part test).

[46] *See In re American Provision Co.*, 44 B.R. at 909; *see generally* Jeffrey Berman, *Nobody Likes Rejection Unless You're a Debtor in Chapter 11: Rejection of Collective Bargaining Agreements Under 11 U.S.C. 1113*, 34 N.Y.L. SCH. L. REV. 169, 173 (1989) (noting that courts have uniformly followed this nine–part test).

[47] 11 U.S.C. § 1113(b)(2) (1984).

[48] § 1113(c).

result, this system places an undue burden on the employees' representative to make sacrifices on behalf of the employees.[49]

Once the bankruptcy court has found that the chapter 11 debtor satisfies the relevant nine–part test, the PBGC takes over the debt and acquires an unsecured creditor's claim against the company for the unfunded pension obligations.[50] Section 507(a)(3) of the Bankruptcy Code creates an unsecured priority for "wages, salaries, or commissions, including vacation, severance, and sick leave pay."[51] However, that priority only applies to wages earned within ninety days of either the employer's bankruptcy filing or the employer's cessation of business.[52] Furthermore, the priority attaches only to $2000 for each worker,[53] and § 507(a)(4) gives the PBGC a claim for unpaid minimum funding contributions.[54] Furthermore, this priority is also limited to contributions arising from services rendered within 180 days before the employer's bankruptcy filing or the employer's cessation of business, and it cannot exceed $2000 per employee.[55]

The priorities granted to the PBGC by the Bankruptcy Code are severely limited, but more importantly they fail to deal with claims arising under § 1113.[56] Thus, when a plan is terminated both employees and the PBGC are left without any heightened unsecured priority for the unfunded obligations.[57] In this situation, it is unlikely that the PBGC will see more than eight cents on the dollar on its unsecured claim.[58]

In sum, the PBGC fails to achieve the objectives for which it was created under ERISA. The mechanisms intended to safeguard employee interests are inadequate. Employee representatives are forced to accept disadvantageous pension plan modifications to avoid a more disadvantageous result—seeing the plans handed over to the PBGC. The Bankruptcy Code's priority for employee wages is too limited in time and dollar amount to offer protection, and as a result neither an employee nor the PBGC may adequately challenge the discharge of pension obligations sought by a business debtor. The following section discusses these problems in the specific context of the airline industry.

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[49] *See* Carey, *Fighting for Viability*, *supra* note 14.

[50] 29 U.S.C. § 1362(b) (1988).

[51] 11 U.S.C. § 507(a)(3) (1988).

[52] *Id.*

[53] *Id.*

[54] 11 U.S.C. § 507(a)(4).

[55] *Id.*

[56] Daniel Keating, *The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy*, 35 WM. & MARY L. REV. 503, 539 (1994) (explaining that the only claims enjoyed by workers are found in § 507) [hereinafter Keating, *Continuing Puzzle*].

[57] *Id.*

[58] Keating, *Pension Insurance*, *supra* note 16, at 66.

II. THE AIRLINES

A. Introduction

The airline industry has a $31 billion shortfall in its defined–benefit plans.[59] Predictably, the industry's crisis worsened after the September 11th terrorist attacks.[60] Increased security taxes placed a heavy burden on the airlines and the heightened fear among passengers led to decreased sales and other serious financial problems.[61] This year's drastic rise in oil prices has undoubtedly sealed the fates of several major carriers.[62]

In order to stay competitive with the cheaper airlines like AirTran and JetBlue, the old–line airlines are trying to either modify or terminate their pension obligations to pilots, flight attendants, mechanics, and management.[63] To acquire the loans needed to stay afloat, or simply to pay off existing debts, the airlines claim they must shed "the financial albatross" of pension liabilities.[64]

In August 2004, United Airlines followed in US Airways' footsteps, becoming the second old–line airline to seek bankruptcy protection.[65] Both companies seek to eradicate their pension obligations to pilots and all other employees.[66] In addition, Delta Air Lines and ATA Airlines have threatened to file for bankruptcy.[67] Given the recent trend, they will likely seek termination of their pensions as well.

B. US Airways

In March 2003, US Airways filed a motion seeking to terminate its airline pilot pension plans in order to successfully emerge from bankruptcy.[68] Applying the relevant nine–part test, the court approved the termination, finding it "necessary" for the airline to successfully reorganize.[69] The airline returned to the bankruptcy court, seeking court

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[59] Blanton, *supra* note 4.

[60] *Id.*

[61] *See* Amy Schatz & Susan Carey, *Airlines Take Their Problems to Congress*, WALL ST. J., June 3, 2004, at B2.

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] Schultz, *supra* note 9.

[66] *See* Carey, *Fighting for Viability*, *supra* note 14.

[67] Schultz, *supra* note 9.

[68] *In re* US Airways Group, 296 B.R. 734 (Bankr. E.D. Va. 2003).

[69] *Id.* at 748 (holding that the financial requirements for a distress termination had been met).

ordered employee wage cuts and threatening termination of all its remaining pension plans.[70]

US Airways' $2.1 billion in unfunded pilot pension obligations were given to the PBGC after the plans' termination in 2003.[71] The termination came after the pilots agreed to $565 million in annual concessions in order to aid the company in its chapter 11 reorganization and to prevent pension termination.[72] The termination left many pilots with a mere fraction of what they were promised in their original agreements. *Business Week* ran a story involving a nineteen–year veteran of US Airways, Captain Tim Baker.[73] Although Captain Baker was to receive a six–figure annual pension, when he retires he will get only $28,585 a year from the PBGC as a result of the pension termination.[74] Magnifying this injustice, US Airways honored employment contracts with its top three executives by paying them $35 million in lump–sum retirement benefits while it sought to terminate the pilots' pension plans.[75]

Now other US Airways employees find their employment contracts in jeopardy. The court approved US Airways' motion for temporary court–ordered wage cuts, pension decreases, increased hours, and decreased number of planes in the fleet.[76] This decision affects the collective bargaining agreements between the airline and the unions of its pilots, flight attendants, mechanics, fleet service, ramp workers, customer–service agents, reservation agents, and maintenance training specialists.[77] However, much like the $565 million per year concession the pilots made to US Airways, these cuts threaten to be a mere stepping stone toward complete plan termination.

Just one month after the bankruptcy court approved the requested cuts, US Airways confirmed that it would seek termination of its three

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[70] *See In re* US Airways, Inc., No. 04–13819, 2004 WL 2578966 (Bankr. E.D. Va. Oct. 15, 2004).

[71] *See* Asker, *supra* note 3, at 21.

[72] *See* Frank Reeves, *Airlines Pension Payouts Revealed; US Airways Paid $35 Million to Top 3 Former Execs*, PITTSBURGH POST–GAZETTE, Feb. 26, 2003, at A–1.

[73] Byrnes & Welch, *supra* note 22. Baker was voted out of his position as Union representative for his role in the agreement reached between the pilots' union and US Airways to "dump" their pension plan on the PBGC. *Id.*

[74] *See* Keating, *Ten–Ton Monster*, *supra* note 1, at 807. "[T]he insurance will not cover benefit increases that resulted from plan amendments adopted within the five years prior to termination, and employees do not continue to accrue benefits after plan termination." *Id.* Therefore, Captain Baker can only get what he was entitled to the year the plan was terminated, minus any increases in the last five years.

[75] Reeves, *supra* note 72.

[76] *In re* US Airways, Inc., No. 04–13819, 2004 WL 2578966 (Bankr. E.D. Va. Oct. 15, 2004).

[77] *Id.*

defined–benefit plans in January 2005.[78] These plans cover 53,000 active and retired workers and would bring $2.1 billion in unfunded pension obligations to the PBGC.[79] Once the plans are handed over to the PBGC, the other airline employees will find themselves in the same position as Captain Baker, collecting a mere fraction of what they were originally promised.

C. United Airlines

United Airlines has been under bankruptcy court protection for the last two years.[80] Already, United's employees have voluntarily agreed to cuts totaling $2.5 billion per year. But the airline claims that these cuts are insufficient, so it is asking a Chicago bankruptcy court to abrogate its labor contracts if an agreement cannot be reached with its workers.[81]

After receiving massive concessions from its employees, United now seeks labor savings, including $191 million from pilots, $180 million from machinists, $138 million from flight attendants, and $101 million from mechanics.[82] Moreover, even while seeking these concessions, United has confirmed that it intends to terminate four underfunded pension plans.[83]

United's four pension plans cover 123,000 active and retired employees.[84] If United is allowed to transfer its pensions to the PBGC, an estimated $8.3 billion in unfunded obligations will be loaded on the PBGC.[85] Much like the employees at US Airways, United's employees will likely collect, in some cases, less than fifty cents on the dollar of what they were promised.[86]

Since United confirmed it would seek termination of its pension plans, the PBGC has said it will ask a court to allow it to assume the pilot pension plan immediately in order to prevent further accumulation of

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[78] Susan Carey, *US Airways Moves to Force Cost Cuts*, WALL ST. J., Nov. 15, 2004, at A3 [hereinafter *US Airways*]; *see generally* Susan Carey, *By Assuming Plan for Pilots At United, Federal Insurer Hopes to Limit Liabilities*, WALL ST. J., Dec. 31, 2004, at A2. "The move (to terminate plans) comes amid labor tension at many carriers, including employee absences at US Airways Group Inc. last weekend that led to hundreds of canceled flights." *Id.*

[79] *Id.*

[80] *See* Susan Carey, *UAL Asks Bankruptcy Judge To Let It Void Labor Contracts*, WALL ST. J., Nov. 26, 2004, at A6.

[81] *Id.*

[82] *Id.* The Association of Flight Attendants is threatening to strike if its contract is voided. *Id.*

[83] Carey, *Fighting for Viability*, *supra* note 14.

[84] Carey, *US Airways*, *supra* note 78.

[85] Krouse, *supra* note 21.

[86] Byrnes & Welch, *supra* note 22.

unfunded obligations.[87] This plan currently has $2.8 billion in assets to cover $5.7 billion in liabilities.[88] The agency claims that assumption of the plan immediately will avoid an additional $140 million in liabilities, and United could thereby maintain three of its pension plans.[89] However, despite the actions of the PBGC the airline asserts that it will still seek termination of all four of its plans.[90]

D. Delta Airlines

Delta Airlines is now struggling to stay out of bankruptcy court. The airline has recently finished negotiations with its pilot union, and the pilots are currently voting on whether to take a 32.5% cut in pay.[91] However, even if the pay cut is approved, Delta plans on eliminating 7000 jobs to avoid bankruptcy.[92] This is a familiar pattern. In light of US Airways and United, it is highly unlikely that this will be the last concession Delta employees are expected to make. Instead, it seems these concessions are just the beginning. Delta has already threatened to file for bankruptcy, which could signal the potential termination of pension plans.[93]

As airlines continue to hand over their pension obligations to the PBGC, more airlines will attempt the same in order to remain competitive. Eleven airlines have $31 billion in pension plan underfunding[94] and it is estimated the "Big Six" airlines will not post a profit until 2005.[95] Even some discount carriers are seeking bankruptcy protection. In October 2004, for example, ATA Airlines filed for bankruptcy.[96] The airline industry appears bound to the same fate as the steel industry, which has handed over $5.4 billion in unfunded pension obligations to the PBGC.[97]

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[87] Carey, *US Airways*, *supra* note 78.

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] Evan Perez, *Airline Averts Chapter 11 As Labor Agreement Cuts $1 Billion in Pay, Benefits*, WALL ST. J., Oct. 28, 2004, at A3.

[92] Carey, *Fighting for Viability*, *supra* note 14.

[93] *Id.*

[94] *See* Caroline Daniel, *Airline Funds Plunge to Record $31 Billion Shortfall*, FIN. TIMES, Jun. 18, 2004, at 30.

[95] *Major Carriers May Not Survive Growing Pension Debt*, AIRLINE FINANCIAL NEWS, Dec. 15, 2003, vol. 21, no. 47. The Big Six airlines are American, Continental, Delta, Northwest, United, and US Airways. *Id.*

[96] Perez, *supra* note 91.

[97] *See* Editorial, *supra* note 2.

E. Other Industries

Concern over the plight of those employees whose plans are transferred to the PBGC is not restricted to the airline industry; this trend is an epidemic.[98] The automotive industry will be the next to suffer the fates of the airline and steel industries. With the growth of young automobile manufacturers like Toyota, U.S. competitors find themselves making significantly less per vehicle, partially due to the cost of their defined–benefit pension obligations.[99] For example, General Motors' pension obligations in 2003 totaled $1784 per vehicle, according to Morgan Stanley, whereas Toyota's were less than $200 per vehicle.[100] IBM and Verizon Communications are among others that must contend with new competitors that have chosen cheaper pension plans and can therefore provide cheaper products or services.[101] Unfortunately, it is too late for the employees of United and US Airways. Nonetheless, given the obvious trend, something can and should be done to protect the remaining 44 million Americans still covered by defined–benefit plans from facing undeservedly meager payouts from the PBGC. The following section presents potential solutions to this serious problem.

III. PROPOSED SOLUTIONS

A. Deferred Payments

Congress recently amended ERISA and the IRS Code to provide "relief" to the airlines and other companies that are "overburdened" with their pension obligations by allowing minimum payments to be deferred for two years.[102] This solution is as ineffective as putting a band–aid on a gunshot wound.

The problem with this amendment is that the pensions are already underfunded. There is tremendous risk that the plans may become even more underfunded as time passes, then when payment comes due the plan would have to terminate.[103] The PBGC would be saddled with even

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[98] Byrnes & Welch, *supra* note 22. "The escalating cost of retirement plans is a critical issue at a range of long–established companies from Boeing to Ford Motor to IBM, many of which compete against younger companies with little or nothing in retiree costs." *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *See generally* Pension Funding Equity Act, PL 108-218, 118 Stat 596 (2004).

[103] *See generally* FDCH POLITICAL TRANSCRIPTS, *supra* note 37 (analyzing the potential outcome of offering a moratorium to United Airlines on their required contributions).

greater liability than they would without the deferment. Given the current deficit of the PBGC and the likelihood of several more large–plan terminations, the risk is too great that the insurer would be unable to make payouts to the 44 million people affected.

B. Risk–based Premiums

Many have suggested that the solution to the PBGC's problems lies in switching to risk–based premiums.[104] Currently, ERISA does not allow for risk–based premiums, instead making premiums variable solely on the state of underfunding.[105] The premiums carry a flat rate of $19 per plan participant and a variable rate of $9 per $1000 of unfunded vested benefits.[106] Every other insurance company bases its premiums on risk.[107] Under a risk–based premium scheme, the PBGC would charge "varying premiums based on risks plan sponsors present to the agency, measured by the companies' credit ratings, asset allocation of the pension plans, exposure to interest rate changes and structural risk in a particular industry sector."[108] Theoretically, if the PBGC based its premiums on risk, its deficit would be much lower. As described previously, its current payouts are significantly higher than the premiums it receives from plan sponsors.[109] For example, United, if it terminates its plans, will have paid $50 million in premiums since 1974 in order to shed its $6.4 billion in obligations.[110]

Although this may seem like the best solution, there are several reasons why it will only worsen the position of the employees once a plan is handed over to the PBGC. First, risk–based premiums will increase the premiums of all the sponsoring employers of the PBGC, even those who are fully funding their plans. Those who are solvent and still supporting their defined–benefit plans will more than likely terminate sponsoring any future defined–benefit plans, thereby further

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[104] Vineeta Anand, *Ready to Work: New PBGC head set to fix system; Belt wants to end contradictions in pension regulations,* PENSIONS AND INVESTMENTS, May 17, 2004, at 2. The new executive director of the PBGC wants to be able to "charge varying premiums depending on the risks plan sponsors present to the agency, measured by the companies' credit ratings, asset allocation of the pension plans, exposure to interest rate changes and structural risk in a particular industry sector." *Id.*

[105] *See* 29 U.S.C. § 1344 (1988).

[106] Kwan, *supra* note 11.

[107] *See* FDCH POLITICAL TRANSCRIPTS, *supra* note 37.

[108] *See* Anand, *supra* note 104.

[109] Byrnes & Welch, *supra* note 22.

[110] Douglas McLeod, *Pension System in Need of Saving*, BUSINESS INSURANCE, Sept. 27, 2004, at 28.

decreasing the future premium income of the PBGC.[111] In addition, increased premiums will more than likely deter any companies considering establishing a defined–benefit plan from establishing one, thus preventing any increase in premium income.[112] As discussed previously, the PBGC's ability to pay out the insured amounts to participants depends on the amount of premiums taken in and the return the insurer gets on both the investment of those premiums and the investment of assets collected from underfunded pensions.[113] With plans being so underfunded, the insurer relies more and more heavily upon returns from the investment of premiums. Thus, if premiums dip even lower the PBGC will be even less able to pay out the insured amount to participants.

The government has been deterred from this option for a similar reason: it wants to encourage and preserve defined–benefit plans at what seems to be any cost.[114] The government's reasoning, though paternalistic, is that people do not plan effectively for their retirement under a defined–contribution plan, so companies should be responsible for insuring sufficient retirement incomes for employees.[115] Under a defined–contribution plan, the employee is guaranteed a specified contribution into the plan account;[116] beyond this, the employee must monitor whether his retirement benefits are going to be adequate in light of the contribution and how that contribution has fared as an investment in the plan. Many employees simply fail to monitor their plans effectively. Although the government would like to see defined–benefit plans continue for the good of the public, the reality is that, due to the enormous economic advantage of defined–contribution plans over defined–benefit plans, defined–benefit plans are becoming extinct.[117] Still, the government would like to see the defined–benefit plans in existence continue even though an increase in the premium price will cause healthy sponsors to stop establishing defined–benefit plans, thus preventing other companies from looking to defined–benefit plans as an option.[118]

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[111] Byrnes & Welch, *supra* note 22 ("Faced with higher insurance costs, they could opt out, rapidly accelerating the system's decline as the remaining health participants become overwhelmed by the needy.").

[112] *Id.*

[113] Kwan, *supra* note 11.

[114] *See generally* FDCH POLITICAL TRANSCRIPTS, *supra* note 37 (discussing the importance of maintaining defined–benefit plans for the welfare of the people).

[115] *Id.*

[116] *See* 29 U.S.C. § 1002(34) (1988).

[117] *See generally* Krouse, *supra* note 21.

[118] Byrnes & Welch, *supra* note 22.

A second, even larger problem with this solution is that companies that are already having difficulty contributing to their pension plans will have even greater difficulty if their premiums increase. Essentially, the companies attempting to salvage their underfunded pension plans are at a higher risk of terminating their plans due to underfunding, and under this proposal their premiums will increase the most. Given their already precarious position, these sponsors will likely be pushed over the edge by the cost of their pensions and will be forced to seek termination of their plans through bankruptcy. Since the PBGC is already overextended, if this took place it would likely be unable to pay out even the meager insured portion of the participants' pensions. Clearly, this is an inadequate result and an inadequate solution.

C. *PBGC and Employee Superpriority*

Another possible solution is to change the priority status of aggrieved employees and the PBGC through amendment of the Bankruptcy Code. Under current law, the PBGC and employees of the terminating company have unsecured creditors' claims against plan sponsors that terminate their plans, meaning they receive mere cents on the dollar value of their claim.[119] This could be changed; the Bankruptcy Code could be amended to provide the PBGC and employees with a superpriority unsecured claim. This possibility is explored in more detail in the following sections.

1. *PBGC Superpriority*

First, it is vital that the superpriority claim be subordinate to the claims of secured creditors. Otherwise, the benefits of seeking a secured loan would be eliminated. It would be as much an injustice to deprive a secured creditor of its secured status, the result of a bargained-for agreement, as it is to allow companies to deprive employees of their pension benefits through the bankruptcy process.

The superpriority unsecured claim would function similarly to the § 507 priorities now acquired by some unsecured creditors.[120] The problem with the claim currently offered to the PBGC under § 507(a)(4) is that it is limited to only $2000 per participant and must be made within 180 days of the plan's termination or cessation of business.[121] This leaves

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[119] 29 U.S.C. § 1362(b).
[120] *See generally* 11 U.S.C. § 507 (1988).
[121] § 507(a)(4).

the PBGC collecting less than eight cents on the dollar on its unsecured claim.[122]

Giving the PBGC a superpriority unsecured creditor's claim would help it regain solvency because the amount the PBGC would receive on the dollar value of its bankruptcy claims would increase dramatically. More importantly, it should allow them to pay out the full insured pension amount owed to plan participants of terminated plans.

The potential problem with this plan is the effect it will have on other unsecured creditors. However, the only standard by which chapter 11 reorganization is to be measured is whether the unsecured creditors are as well off as they would have been in a chapter 7 liquidation.[123] Therefore, so long as the unsecured creditors receive as much as they would have through liquidation, there is no legal impediment.

2. *Employee Superpriority*

The Bankruptcy Code fails to state whether the employees covered under a terminated plan have a right to damages for this termination.[124] The wage priority in § 507(a)(3) of the Bankruptcy Code and the sanctity of employees' rights in non–bankruptcy law together support the principle that employees are uniquely vulnerable in the marketplace and thus a high premium should be placed on ensuring that they receive at least a minimum of the wages and benefits on which they rely. It would accord with this principle to elevate employees' claims in bankruptcy to superpriority unsecured claims for the difference between the amount promised in collective bargaining agreements and the amount received from the PBGC insurance program.

Outside of bankruptcy, if a company backs out of a collective bargaining agreement, the employees have a contractual right to sue for damages.[125] However, this right is removed under the current Bankruptcy Code.[126] Granting employees superiority unsecured claims in bankruptcy would return to employees the right to receive damages for this breach of contract.

There are several reasons for granting employees favored status against their employer in bankruptcy. First, as compared with most investors, employees are less able to diversify their credit portfolio in

[122] Keating, *Pension Insurance*, *supra* note 16, at 66.
[123] *See id.* at 184.
[124] Keating, *Continuing Puzzle*, *supra* note 56, at 534.
[125] *Id.*
[126] *Id.*

order to minimize the impact of their employer filing bankruptcy.[127] In addition, employees are not investing disposable income as most investors do. If an employer goes bankrupt and terminates its pension plan, its employees lose an amount much greater than they would have been willing to risk in traditional investments. On the other hand, a general creditor usually has weighed the risks against the potential benefits of an investment and is prepared for a potential loss. Employees lose the majority of their retirement, an amount they had been promised and upon which they have relied throughout their careers.

Another reason employees should be given a superpriority unsecured claim is that when an employer is seeking to reorganize, the employees are a crucial element to its success and should be valued as such.[128] Under the current regime, an employee's wages and pension are used as a bartering tool in negotiations with a company's creditors to achieve reorganization.[129]

By allowing employees a superpriority unsecured claim against their employers for lost pensions, the Code would prevent millions of workers from retiring on only a fraction of what they had been promised. In addition, so long as the other unsecured creditors remain as well off as they would have been in a chapter 7 liquidation, there is no legal problem with this proposal.

Instead of burdening employees as the current system does, this proposal would force creditors to monitor the companies with which they do business, to make sure they lend to companies that sufficiently fund their pension plans.[130] It would be beneficial not only to the PBGC in collecting on the unfunded portion of pension plans but also to the overall funding of defined–benefit plans. It would provide an additional incentive for companies to maintain well–funded plans instead of taking large risks with the money that should have been contributed to the plan.[131]

It is possible that creditors simply will not take the time to effectively monitor how adequately their debtor companies fund pension plans. However, in a market economy, this possibility is not a sufficient reason to discount this option. Incentives in a free–market economy would simply reward the creditor for being informed about the loan it is making. If creditors choose to ignore this responsibility, the loss falls on them.

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[127] Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 ARIZ. L. REV. 905, 906 (1993).

[128] *Id.*

[129] *See supra* notes 14 and 90.

[130] Keating, *Ten–Ton Monster*, *supra* note 16, at 101.

[131] *Id.*

IV. CONCLUSION

The PBGC was created to provide greater protection to employees with defined–benefit plans. As the enactment of ERISA suggests, Congress did not want employees working their entire lives only to see what they had been working for disappear. However, the current system fails to achieve this goal. Instead, workers are finding themselves collecting only a fraction of what they were promised in collective bargaining agreements. It is even more disconcerting that many workers may not receive *any* of their pensions if something is not done to change the rights they are given after a company has terminated its plans.

Congress has recently proposed a lot of "quick fixes" regarding the current pension underfunding crisis. However, the proposed solutions do nothing more than delay the inevitable. Instead, Congress must look for a permanent solution to the plight of defined–benefit plans. They need to recognize that the weight of pension liabilities is heavy and that the PBGC can only withstand so much before it is too great for the insurer to handle because, at that point, the only remaining options will be either leaving millions of retirees without pensions or resorting to a government bail–out.[132]

PBGC and employee unsecured superpriority claims are the best solutions to avoid the bleak financial future currently facing defined–benefit pension plan participants. By giving the PBGC and employees a superpriority unsecured claim, the Congress could fulfill the original purpose of the PBGC—protecting the pensions of employees.

[132] Rector, *supra* note 8, at 951.