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A FAIT ACCOMPLI FOR THE PBGC AND US TAXPAYERS: HOW THE LAST HOPE FOR REDEMPTION WAS MISSED IN THE 2005 BANKRUPTCY CODE REVISIONS AND SUBSEQUENT COURT DECISIONS

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IF YOU HAVE BEEN living in a cave for the last five years, or have otherwise managed to miss the news, the traditional United States domestic airline industry has been decimated by the perfect storm of a 9/11-driven decline in air travel, dramatically rising fuel prices, and unrelenting competition from low-cost, no-frills regional carriers. In a last-ditch effort to respond to these changes and survive, albeit in a much altered form, the traditional hub-and-spoke carriers, such as United, US Airways, and Delta, slashed spending on in-flight amenities and negotiated reduced compensation packages with employees. These measures, however, were met with limited success. In the last four reported quarters alone, Delta Airlines has announced stunning losses of $2.2 billion, $1.1 billion, $382 million, and $1.1 billion.[1] UAL, the parent of United Airlines, fared slightly better, reporting losses for the same periods of $664 million, $1.1 billion, $1.4 billion, and $93 million.[2]

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* J.D., Southern Methodist University Dedman School of Law, 2006.

[1] Evan Perez & Melanie Trottman, *Losses Pile Up at Delta, Continental*, WALL ST. J., Jan. 21, 2005, at A3; Press Release, Delta Airlines, Delta Airlines Reports Results for June 2005 Quarter (July 21, 2005) (on file with author), *available at* http://www.delta.com/print_doc.cfm?article_id=9797; CNNMoney.com, *Bankrupt Delta Loss Tops $1 Billion* (Nov. 10, 2005), http://money.cnn.com/2005/11/10/news/update_bankrupt.dj.

[2] Press Release, UAL Corp., UAL Corp. Reports Fourth-Quarter Results (Jan. 27, 2004) (on file with author), *available at* http://ir.united.com/phoenix.zhtml?c=83680&p-irol-news&nyo=0; Press Release, UAL Corp., UAL Corp. Reports First-Quarter 2005 Results (May 11, 2005) (on file with author), *available at* http://ir.united.com/phoenix.zhtml?c=836&0&p=irol-news&nyo=0; Press Release, UAL Corp., UAL Corp. Reports Second-Quarter 2005 Results (July 28, 2005) (on file with author), *available at* http://ir.united.com/phoenix.zhtml?c=83680&p=irol-news&nyo=0.

Seeing that traditional cost-cutting measures and executive reshuffling would be unable to stem the tide of red ink, each of the above stalwarts of the American corporate world took the last, most desperate option available to them: Chapter 11 corporate reorganization. US Airways entered bankruptcy protection on August 12, 2002, for the second time.[3] UAL filed in Chicago on December 9, 2002.[4] Finally, citing competitive pressures caused by its rivals shedding liabilities in bankruptcy, an issue this comment will discuss in detail, Delta Airlines filed for bankruptcy on September 15, 2005.[5]

While some would say that these bankruptcies are a sign of a well-functioning capitalist society, where weak, unimaginative companies are disassembled to provide capital for strong, innovative firms that provide value, few would argue that the system in place to protect the pension plans of these large companies is functioning at all. The Pension Benefit Guaranty Corporation ("PBGC"), created as part of the Employee Retirement Income Security Act ("ERISA") in 1974, stands as the guarantor of many of this country's pension plans.[6] The federally funded agency, however, is heavily insolvent, with the fund reporting a fiscal 2005 year end deficit of $22.8 billion.[7]

The woes of the PBGC are well-reported, and sound recommendations to modify the system's operating parameters to shore up the system have been made for quite some time. Some argue for increased premiums for all plans and higher variable rate premiums for the most risky plans.[8] Others believe that giving the PBGC priority in bankruptcy above its current status as a standard unsecured creditor would allow the agency to recover

[3] Press Release, US Airways, US Airways to Complete Restructuring Plan in Chapter 11 Reorganization (Aug. 11, 2005) (on file with author), *available at* http://www.usairways.com.

[4] Press Release, UAL Corp., UAL Corp. Files for Chapter 11 Reorganization (Dec. 9, 2002) (on file with author), *available at* http://ir.united.com/phoenix.zhtml?c=83680&p=irol-news&nyo=0.

[5] Harry Weber, *Delta, N'west in Bankruptcy*, N.Y. DAILY NEWS, Sept. 15, 2005, at A1.

[6] Pension Benefit Guar. Corp., Who We Are, http://www.pbgc.gov/workers-retirees/about-pbgc/content/page1020.html (last visited Jan. 10, 2006).

[7] Pension Benefit Guar. Corp., Frequently Asked Questions, Understanding the Financial Condition of the Pension Program, http://www.pbgc.gov/media/key-resources-for-the-press/content/page15247.html (last visited Jan. 10, 2006) [hereinafter PBGC FAQ].

[8] Jonathon E. Collins, Comment, *Airlines Jettison Their Pension Plans: Congress Must Act to Save the PBGC and Protect Plan Beneficiaries*, 70 J. AIR L. & COM. 289, 306 (2005).

more from the bankrupt former plan provider, thereby reducing its asset-liability gap.[9] Each of these suggestions might have prevented the current crisis from occurring. However, given the gravity of the problem and the inherent deficiencies in the practical administration of these recommended solutions, a more honest, long-term approach is required. Indeed, the PBGC estimates the country's total plan underfunding at a staggering $450 billion, a sum which might lead to an economic disaster capable of dwarfing the savings-and-loan crisis.[10] Such a large deficit cannot be met with incremental changes but must be dealt with through wholesale change or abandonment of the entire system.

The purpose of this Comment is to discuss the current PBGC underfunding problem as it relates to today's airline bankruptcy mania, to describe two missed opportunities to partially avert the coming economic crisis, and finally to suggest that the only way to "repair" the agency is to terminate government involvement in pension-plan regulation and supervision and to judiciously allocate losses from the ill-devised plan among airline shareholders, creditors, pension enrollees and, inevitably, the taxpayers. The history of defined-benefit and defined-contribution retirement plans in general, and ERISA and the PBGC in particular, should be well known to readers by this time. Therefore, Part I will provide a summary of the three mechanisms by which pension payments can become the obligation of the PBGC and the financial ramifications of the PBGC's assumption of a terminated plan. Part II will then describe how the recent overhaul of the Bankruptcy Code, with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, and recent case law concerning the PBGC's power to barter with bankrupt airlines might have been the last opportunities to make meaningful incremental changes capable of correcting the PBGC's funding troubles. Finally, Part III will examine previous suggestions for repairing the PBGC and ultimately explain why the best option for dealing with the country's pension-funding issue is to address the problem head-on, distribute losses among all parties involved, and force companies and employees to use market-driven mechanisms for retirement-based income.

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[9] Amy Lassiter, *Mayday, Mayday!: How the Current Bankruptcy Code Fails to Protect the Pensions of Employees*, 93 Ky. L.J. 939, 953 (2004).

[10] PBGC FAQ, *supra* note 7.

I. HOW THE PBGC ACQUIRES A TERMINATED PLAN, AND WHAT THAT MEANS FOR ITS BOTTOM LINE

This section will describe the three methods by which the PBGC acquires terminated pension plans: "standard" termination, distress termination, and involuntary termination. It will then describe the effects that a typical plan from each acquisition type will have on the PBGC's balance sheet.

A. Standard Termination

The easiest method for a corporation to end its pension-plan obligations is through a voluntary termination of its pension program in compliance with the statutory requirements of notice and plan liquidity.[11] Standard terminations would apply where a corporation wishes to end its involvement with a fully funded plan, either because it no longer wishes to offer retirement plans or has chosen instead to offer more modern defined-contribution plans.[12] Two important provisions of a statutory standard termination make this option unattractive (and probably impossible) for distressed airlines. First, any standard termination requires that the corporation not "violate the terms and conditions of an existing collective bargaining agreement."[13] Each of the airlines, however, has been forced or has chosen to engage in extensive negotiations with its pilots' union, flight attendants' union, and mechanics' union in efforts to reduce operating costs.[14] These negotiations have invariably led to detailed collective bargaining agreements, thereby precluding the airlines from eligibility for standard plan terminations.[15] Even if this was not the case, however, the severe underfunding of the airline plans would also prevent standard termination. Standard terminations may only be undertaken in circumstances in which, "when the final distribution of assets occurs, the plan is sufficient for benefit liabilities."[16] The PBGC will

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[11] 29 U.S.C.A. § 1341 (West 2005).

[12] For a general description of plan types, see http://www.dol.gov/dol/topic/retirement (last visited Mar. 20, 2006).

[13] 29 U.S.C.A. § 1341(a)(3).

[14] *See, e.g.*, Associated Press, *Leaders of United's Pilots Union Recommends Tentative Agreement*, USA Today, Dec. 17, 2004, at D4; Associated Press, *United Airlines Continues Labor Talks*, May 31, 2005, http://www.wkyc.com/news/news_article.aspx?storyid=35673.

[15] 29 U.S.C.A. § 1341(a)(3).

[16] *Id.* § 1341(b)(1)(D).

then undertake to distribute assets according to the plan's distribution scheme.[17]

In general, standard terminations allow a corporation to end its defined benefit pension plan without abandoning its obligations to its employees and without financially burdening the PBGC and, through it, American taxpayers. As such, they have little effect on the PBGC's balance sheet and are not prevalent in standard airline terminations.

B. DISTRESS TERMINATION

Congress also provided a means for plan providers to terminate their obligations when the burden of continuing the plan threatens the continuing viability of the organization.[18] Perhaps fearful of giving the troubled corporation the power to declare itself so burdened, Congress entrusted the authority to make this decision to two different third parties: the PBGC and, if applicable, the bankruptcy judge presiding over the corporation's bankruptcy proceeding.[19]

In an ongoing liquidation, no further requirements for plan termination are required.[20] In an ongoing reorganization, the bankruptcy court must decide "that, unless the plan is terminated, such [corporation] 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 . . . ."[21] The bankruptcy judge must also determine that termination of the plan and the procedures used to affect the termination each meet strict requirements as described in the Bankruptcy Code:

> (1) the debtor or trustee must make a proposal to the employee representative based upon the most complete and reliable information available;
> (2) which provides for those necessary "modifications" to the benefit plan necessary to allow the corporation to reorganize;
> (3) that assures that all creditors, debtors, and other parties are treated fairly and equitably;
> (4) and confer with the employee representative after submitting the proposal in a good faith attempt to negotiate an agreement on modifications to the plan;

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17 *Id.* § 1341(b)(3)(A)(ii).
18 *Id.* § 1341(c).
19 *Id.* § 1341(c)(2)(B).
20 *Id.* § 1341(c)(2)(B)(i).
21 *Id.* § 1341(c)(2)(B)(ii).

(5) where the employee representative rejects the proposed modifications without good cause;
(6) and where "the balance of the equities clearly favors rejection of such agreement."[22]

Once these requirements are satisfied, the judge may terminate the plan.[23] Upon termination, employee pension expectations take a dramatic freefall in expected value. The PBGC officially takes over the pension obligations, with the now-bankrupt corporation becoming a debtor to the PBGC.[24] A small portion of the corporation's pension obligations may be given somewhat elevated priority under the Bankruptcy Code system of ranking creditors; however, this is limited to current workers and to an insubstantial portion of the total plan funding.[25] In comparison, the remainder of the PBGC's unsecured claim is lumped together with other general unsecured creditors without being afforded any substantive protection.[26] This gives the bankrupt corporation's trustee or the debtor-in-possession, as well as all other secured and unsecured creditors, perverse incentive to terminate pension plans and leave current and former employees to pay the costs.[27] Indeed, some academics have calculated average pension plan member recoveries at approximately 8% of their face value.[28]

Alternatively, the PBGC itself can find that either "unless a distress termination occurs, such [corporation] will be unable to pay such [corporation's] debts when due and will be unable to continue in business," or "the costs of providing pension coverage have become unreasonably burdensome to such [corporation], solely as a result of a decline of such [corporation's] workforce covered as participants."[29] A distress termination proceeding in which the bankrupt or insolvent corporation seeks PBGC approval for its plan termination should be distinguished

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22 11 U.S.C.A. § 1113(b)-(c) (West 2005).

23 *Id.*

24 29 U.S.C.A. § 1362(b) (West 2005).

25 11 U.S.C.A. § 507(a)(4).

26 Daniel Keating, *The Continuing Puzzle of Collective Bargaining Agreements in Bankruptcy*, 35 WM. & MARY L. REV. 503, 539 (1994) (current employee pensions have some very limited protection, but the remainder of current employee and former employee pensions are given neither administrative claim priority nor advanced general standing).

27 Daniel Keating, *Pension Insurance, Bankruptcy and Moral Hazard*, 1991 WIS. L. REV. 65, 66-67 (1991) [hereinafter Keating, *Pension Insurance*].

28 *Id.*

29 29 U.S.C.A. § 1341(c)(2)(B)(iii)(I)-(II).

from an involuntary plan termination, which will be discussed in Part I-C. It should be noted, however, that even though a presiding bankruptcy judge or the PBGC could utilize its powers to allow a distress termination under section 1341, the provisions of section 1341(a)(3) still prohibit the violation of a collective bargaining agreement for purposes of section 1341 voluntary corporate reorganization.[30] As explained in *Association of Flight Attendants-CWA, AFL-CIO v. PBGC*, "[t]his 'contract bar' provision was added in 1986 as part of a Congressional effort to address the preexisting 'termination insurance system [which] in some instances encourages employers to terminate pension plans, evade their obligations to pay benefits, and shift unfunded pension liabilities onto the termination insurance system and the other premium-payers.'"[31] In doing so, however, Congress had to walk a fine line between allowing troubled corporations too much latitude in deciding whether to keep their end of a pension system bargain and pushing them so hard that they would abandon defined benefit plans altogether.[32] As the Sixth Circuit aptly summarized,

> Though Congress was concerned chiefly with protecting the employees' expectations of pension benefits, it also realized that employers would not create, maintain, or expand pension plans if ERISA imposed too much cost. Consequently, the entire statute is a finely tuned balance between protecting pension benefits for employees while limiting the cost to employers.[33]

Part II discusses the issues of whether this "finely tuned balance" has been effective and whether the roles played by the courts and the PBGC are what were expected by Congress.

These three provisions allow the corporation, with approval, to terminate a plan even though the accrued obligations exceed the existing assets and to convey the underfunded burden onto the PBGC. The efforts of the airlines to take advantage of this provision are discussed in Part I–D.

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[30] *Id.* § 1341(a)(3).

[31] Ass'n of Flight Attendants-CWA, AFL-CIO v. PBGC, 372 F. Supp. 2d 91, 96 (D.D.C. 2005) (quoting *In re* Chateaugay Corp., 87 B.R. 779, 813 (S.D.N.Y. 1988), *aff'd sub nom.* PBGC v. LTV Corp., 875 F.2d 1008 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990) (discussing legislative history of 1986 ERISA amendments)).

[32] A-T-O, Inc. v. PBGC, 634 F.2d 1013, 1021 (6th Cir. 1980).

[33] *Id.*

C. INVOLUNTARY TERMINATION

In contrast to the above laundry list of ways in which a corporation can voluntarily seek the termination of its pension obligations, ERISA provides a method by which the PBGC can, on its own initiative, seek the termination of a plan in order to prevent continued losses to either the employees of the plan or to the long-term viability of the PBGC reserves themselves.[34] There are four main ways in which a plan becomes eligible for a section 1342 involuntary termination:[35]

> (1) The corporation might simply have not contributed the minimum funds as required by ERISA under section 412 of the IRC;[36]
> (2) The PBGC has determined that the plan "will be unable to pay benefits when due;"[37]
> (3). A distribution of greater than $10,000 to a corporate insider, as defined by section 1322(b)(6) of ERISA, has been made which renders the plan underfunded;[38] or perhaps most importantly,
> (4) "the possible long-run loss of the [PBGC] with respect to the plan may reasonably be expected to increase unreasonably if the plan is not terminated."[39]

Once the PBGC has made the determination that the plan should be involuntarily terminated pursuant to any of the above four criteria, the agency then begins the termination proceedings by notifying the plan sponsor as well as the representatives of the plan employees.[40]

While the PBGC is afforded great latitude in making and enforcing its decision to pursue an involuntary termination, the decision is nonetheless subject to at least modest judicial review.[41] As a federal agency, the PBGC is afforded substantial discretion under the Administrative Procedures Act.[42] The reviewing court shall set aside the agency's determination only if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[43] The court also is pre-

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34 29 U.S.C.A. § 1342 (West 2005).
35 *Id.* § 1342(a).
36 *Id.* § 1342(a)(1).
37 *Id.* § 1342(a)(2).
38 *Id.* § 1342(a)(3).
39 *Id.* § 1342(a)(4).
40 *Id.* § 1342(d)(2).
41 *Id.* § 1342(c).
42 *See* 5 U.S.C.A. § 706(2) (West 2005).
43 *Id.* § 706(2)(A).

cluded from substituting "its judgment for that of the agency"[44] and "must defer to 'the informed discretion of the responsible federal agenc[y],'" especially when the agency action in question is one that requires a high level of technical knowledge or subject matter expertise.[45] In essence, in involuntary termination review proceedings, the PBGC must only show that it "reached its decision on the basis of a reasonable accommodation of the policies underlying ERISA."[46]

This, in practical terms, asks simply whether Congress has given direct guidance on the subject, in which case it must be followed, or alternatively, where the issue is not discussed, whether the agency has taken action that is not otherwise impermissible.[47] This "Chevron Doctrine" therefore conveys great discretion upon the PBGC, as many of the express grants of power are defined in vague terms, especially given the detailed and expansive nature of the subject matter with which the agency contends.[48] Even a careful reading of the Congressional debate surrounding the passage of ERISA gives neither the PBGC, plan administrators, nor the courts charged with blessing agency decisions much guidance as to Congress's exact intent regarding the furthest reaches of PBGC authority.[49]

Further, viewing the discretion afforded the PBGC must be done through the lens of the "conflicting duties" of the agency's "mission:"[50]

> (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

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[44] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 43 (1983).

[45] Marsh v. Or. Natural Res. Council, 490 U.S. 360, 375 (1989) (quoting Kleppe v. Sierra Club, 427 U.S. 390, 412 (1976)).

[46] Rettig v. PBGC, 744 F.2d 133, 156 (D.C. Cir. 1984).

[47] Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 842-43 (1984).

[48] *Id.* at 843-44.

[49] *See Rettig*, 744 F.2d at 142-45 (quoting portion of the Legis. History of the Employee Ret. Income Sec. Act of 1974, Subcomm. on Labor of the S. Comm. on Labor and Public Welfare, 94th Cong., 2d Sess. (1976) (citing 120 Cong. Rec. 29931 (1974) (remarks of Sen. Williams)), *reprinted in* III. Legis. History 4741.

[50] Ass'n of Flight Attendants-CWA, AFL-CIO v. PBGC, No. Civ.A. 05-103GESH, 2006 WL 89829, at *4 (D.D.C. Jan. 13, 2006).

> (3) to maintain premiums established by [PBGC] under section 1306 of this title at the lowest level consistent with carrying out its obligations under this subchapter.[51]

Any duty on the part of the PBGC to protect its own solvency, and thereby prevent the need for a taxpayer-funded bailout of its obligations, must be inferred either from the duty to provide for continued payments to plan beneficiaries or from the "continuation" of voluntary private pension plans.[52]

A conflict between its express duty to plan participants and to the continued solvency of the fund, therefore, is apparent. Several courts have quoted the D.C. Circuit position that the agency is to "resolve the inherent tension created by the statute by 'accommodat[ing] the conflicting policies underlying ERISA.'"[53] This invariably will lead to occasions where the agency's need to protect its own long-term viability will override its statutorily defined purpose of protecting individual pensioners.[54] Such difficult balancing-test decisions are exactly the type of questions which the Supreme Court, in referring to the PBGC, has said must be left to the agency itself, despite the partially self-interested nature of the PBGC's decision.[55] This balancing act, in which the PBGC must continually engage, and its effects on the PBGC administration of terminated pension plans and airline pre-bankruptcy filing planning are discussed in Part II.

D. Effects of Airline Plan Termination on the PBGC

The events of 9/11 and the long-term effects of the country's progressively aging workforce on the healthcare and pension obligations of America's oldest and largest traditional employers have radically changed the outlook for the United States pension system's long-term solvency. The termination of traditionally defined benefit plans, whether distress or involuntary, is having a tremendous effect on the PBGC. But to understand exactly how these terminations translate from company-owned

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[51] 29 U.S.C.A. § 1302(a) (West 2005).

[52] *See id.*

[53] *Ass'n of Flight Attendants-CWA, AFL-CIO*, 2006 WL 89829, at *4 (quoting Rettig v. PBGC, 744 F.2d 133, 135 (D.C. Cir. 1984)).

[54] *See id.*

[55] PBGC v. LTV Corp., 496 U.S. 633, 651-52 (1990); *accord* Piech v. PBGC, 744 F.2d 156, 161 (D.C. Cir. 1984) ("Although it may in many ways be desirable for plan participants to have a trustee who is prepared to advocate their interests in opposition to the PBGC, Congress has evidently not envisioned such a role for the plan trustee").

liabilities to PBGC-owned liabilities and how much liability is actually incurred by the agency, one must look at the mechanisms by which the transfers take place.

As an initial matter, the PBGC assumes only those obligations that are considered "guaranteed."[56] For 2005, the maximum annual guaranteed pension benefit for plans terminated in 2005 was $45,613.68.[57] For employees that earned relatively high wages, including many airline employees such as pilots and mechanics, this figure is often far less than that originally guaranteed under the terms of their pension plan.[58] The effect on the total funding requirement due to the stripping away of this portion which is not "guaranteed" can be dramatic.[59] For example, upon bankruptcy court approval of United Airlines' request to terminate its pension plans on May 10, 2005, per the requirements of a distress termination, United's obligation to provide benefits for its pilots and mechanics unions was nullified.[60] At that time, United's pension obligations were underfunded by an incredible $9.8 billion.[61] Due to the PBGC's maximum benefit limitation, however, the total obligation accepted by the PBGC was $6.6 billion, resulting in a present value net loss of benefits to member pensioners of $3.2 billion.[62]

It must also be noted that the PBGC maintains its balance sheet according to United States Generally Accepted Accounting Principles ("GAAP").[63] GAAP requires an accounting entity to record liabilities currently that are reasonably certain.[64] The PBGC, therefore, includes a reasonably probable termination in its accounting data as of the date on which the agency makes the determination that the liability is reasonably certain, that is, when the agency becomes reasonably certain that the plan will be terminated, and in an amount for which the agency believes

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56 PBGC FAQ, *supra* note 7.

57 Am. Acad. of Actuaries, *PBGC and United Airlines: How Does United's Termination Affect the PBGC Deficit?* (2005), *available at* http://www.actuary.org/pdf/pension/pbgc_051205.pdf [hereinafter *PBGC and United Airlines*].

58 *See id.*

59 *Id.*

60 *Id.*

61 *Id.*

62 *Id.*

63 PBGC FAQ, *supra* note 7.

64 USING CASH FLOW INFORMATION AND PRESENT VALUE IN ACCOUNTING MEASUREMENTS, Statement of Fin. Accounting Concepts No. 7 (Fin. Accounting Standards Bd. 2000).

it will be responsible.[65] The PBGC, in the case of United Airlines, included $16.9 billion for its expected liability for United's "certain probable terminations."[66] The agency has therefore already booked the expected liabilities with respect to the plans of United, US Airways, and Delta, even though those plans have not been officially terminated by the PBGC or a bankruptcy judge.[67] Ironically, because the PBGC is not allowed to book uncertain *assets* that they might acquire upon plan terminations under current Financial Accounting Standards Board standards, any subsequent involuntary termination or agreement with the airlines to consent to distress termination, will actually result in an increase in the PBGC's accounting solvency.[68]

Any positives which may be gleaned from examining the method by which the PBGC accounts for pension shortfalls, however, are dwarfed by the magnitude of the liabilities the airlines are foisting upon the agency. Total PBGC exposure to pension underfunding, as determined by total United States pension-plan underfunding at the end of fiscal year 2005, remained in excess of $450 billion.[69] While the official net-present-value capital deficit at the PBGC declined from $23.3 billion in 2004 to $22.8 billion in 2005, this figure only masks the true impending insolvency of the agency.[70] The agency's calculation of "'reasonably possible' exposure" increased from $96 billion in 2004 to $108 billion in 2005.[71] Notably, the airlines make up a large portion of the liabilities the PBGC expects to incur.[72] At Delta Airlines and Northwest Airlines alone, employees are expected to lose $5.1 billion in expected pension benefits, while the PBGC is expecting to incur over $11.2 billion in losses from these two plan providers alone.[73]

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65 *Id.*

66 *PBGC and United Airlines, supra* note 57.

67 *Id.*

68 *Id.*

69 Press Release, PBGC, PBGC Releases Fiscal Year 2005 Financial Results (Nov. 15, 2005) (on file with author), *available at* http://www.pbgc.gov/media/news-archive/2005/pr06-06.html.

70 *Id.*

71 *Id.*

72 Bradley Bett, Executive Dir., PBGC, Statement on Airline Bankruptcy Filings (Sept. 15, 2005), *available at* http://www.pbgc.gov/media/news-archive/2005/pr05-61.html.

73 *Id.*

Similarly, the PBGC agreed to assent to a distress-termination request by US Airways.[74] Under the terms of the US Airways request, employees lost $200 million in expected pension benefits, while the PBGC assumed control over the corporation's three plans, which had combined liabilities in excess of combined assets to the order of $2.3 billion.[75] Commenting on the assumption of ever-larger pension-plan shortfalls, the Executive Director for the PBGC, Bradley Belt, stated that while the agency would "protect the pension benefits of US Airways' workers and retirees," he worried that "the pension safety net is badly frayed" and was in need of serious modification.[76]

In contrast with the Delta and Northwest distress termination, bankruptcy-driven plan assumptions, the PBGC attempted to proactively negotiate a settlement with United Airlines for the termination of their four defined benefit plans.[77] Under the terms of the settlement, the PBGC would accept a twenty percent equity position in the reorganized United Airlines in exchange for agreeing to "involuntarily" terminate each of the United plans.[78] The propriety of the PBGC engaging in such bartering is the subject of Part II, while an analysis of the long-term effectiveness of this strategy is the subject of Part III.

Regardless of the accounting methods used to describe, or perhaps disguise, the true nature of this country's looming pension crisis, it is apparent that massive airline pension defaults are a large contributor to the problem. Estimates of the eventual combined price tag for all the to-be-terminated airline plans are as high as $31 billion.[79]

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[74] Press Release, PBGC, PBGC Takes $2.3 Billion Pension Loss from US Airways (Feb. 2, 2005) (on file with author), *available at* http://www.pbgc.gov/media/news-archive/2005/pr05-22.html.

[75] *Id.*

[76] *Id.*

[77] Press Release, PBGC, PBGC Reaches Pension Settlement with United Airlines (Apr. 22, 2005) (on file with author), *available at* http://www.pbgc.gov/media/news-archive/2005/pr05-36.html.

[78] *See* Marilyn Adams, *United Leaves Bankruptcy Behind*, USA TODAY, Feb. 1, 2006, *available at* http://www.usatoday.com/money/companies/2006-02-01-united-bankruptcy_x.htm.

[79] David Field Washington, *Pension Burden Stacks Up*, AIRLINE BUS., Jan. 1, 2005, at 16, *available at* http://www.flightglobal.com/Articles/Article.aspx?liArticleID=191455&PrinterFriendly=true.

II. WHY THE RECENT CHANGES TO THE BANKRUPTCY CODE AND RECENT COURT DECISIONS EXERCISING OVERSIGHT RESPONSIBILITY FOR THE PBGC MISSED GOLDEN OPPORTUNITIES TO DEAL WITH THE LOOMING PENSION CRISIS

This section examines the changes to the Bankruptcy Code made by the recent amendments contained in the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") as they might affect airlines filing subsequent to the general effective date of October 17, 2005. Additionally, this section will show how substantive changes were made to the Bankruptcy Code to provide added protection to certain special interests, such as landlords and utilities, which if similarly applied to the PBGC might have dramatically improved its financial situation. Finally, this section details recent court rulings that, by allowing the PBGC to piece together negotiated settlements with bankrupt airlines terminating their pension plans, are prolonging the inevitable reckoning of the entire pension benefit guarantee system and thereby increasing the size of the eventual bailout that all American taxpayers must shoulder.

A. CHANGES MADE (AND NOT MADE) TO THE BANKRUPTCY CODE WHICH WILL AFFECT AIRLINES AND THE PBGC'S EFFORTS TO SURVIVE

The recent changes to the Bankruptcy Code were passed, one might naturally (and naively) assume from its title, in order to prevent widespread abuse of bankruptcy protection as well as to better protect consumers. Subsequent to its passage, however, it has been met with scathing criticism.[80] At least one sitting bankruptcy judge made the following remarks:

> [t]hose responsible for the passing of the Act did all in their power to avoid the proffered input from sitting United States Bankruptcy Judges, various professors of bankruptcy law at distinguished universities, and many professional associations filled with the best of the bankruptcy lawyers in the country as to the perceived flaws in the Act. This is because the parties pushing the passage of the Act had their own agenda. It was apparently an agenda to make more money off the backs of the consumers in this country.[81]

[80] *In re* Sosa, 336 B.R. 113, 114 (Bankr. W.D. Tex. 2005).

[81] *Id.*

Whatever the actual motivation for passage of the Act, and whether the proclivity of airlines to routinely seek bankruptcy protection was a factor, it is undeniable that substantive changes were made to the Code which affect not only consumers but also large corporations, and in some instances affect the airlines as well.

For instance, under prior provisions of the Bankruptcy Code, a debtor-in-possession or trustee had considerable latitude in its decision to either assume or reject pre-petition lease obligations.[82] Under formerly applicable provisions, the trustee had sixty days in which to decide whether to accept or reject such a lease obligation.[83]

This procedure has drastically changed under the BAPCPA amendments.[84] The debtor now has 120 days in which to make its decision to accept or reject its pre-petition leases.[85] Importantly, however, the trustee can request only a single 90-day extension.[86] Following this maximum period of 210 days, the trustee can only seek an extension with the approval of the creditor/landlord—an unlikely event to say the least.[87] After the expiration of this 210-day period, the lease is deemed rejected as a matter of law, and the trustee must vacate the premises immediately, even without further court action.[88]

The amendments go further, however, and alter the standing of an initially assumed lease.[89] If a trustee later rejects or avoids a lease that was initially assumed, the creditor/landlord gains administrative priority standing for damages for his rejected lease, effectively moving all of his claims up the priority ladder and in front of all general unsecured creditors.[90] Moreover, the creditor/landlord then becomes entitled to all remaining payments under the lease as an unsecured claimant.[91]

Even better for commercial creditors/landlords, a new provision prevents the standard automatic stay provision from affecting a continuing action to evict a tenant where the landlord has

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[82] 11 U.S.C.A. § 365(d) (West 2005).

[83] *Id.* § 365(d)(1).

[84] *Id.* § 365(d).

[85] *Id.* § 365(d)(4)(A)(i).

[86] *Id.* § 365(d)(4)(B)(i).

[87] *Id.* § 365(d)(4)(B)(ii).

[88] *Id.* § 365(d)(4)(A).

[89] *Id.* § 503(b)(7).

[90] *Id.*

[91] *Id.* § 502(b)(6).

already obtained a judgment prior to the filing of the bankruptcy petition.[92] Whereas a debtor could seek protection of its facilities via the automatic stay provision of a traditional bankruptcy filing, a company now must diligently manage its pre-bankruptcy activities to make sure that any essential facilities are not in arrears.[93]

It is unclear exactly how these changes will affect airline bankruptcy proceedings any more than the typical business/commercial debtor. The changes will obviously make it considerably easier for a landlord who deals with airline tenants to either be compensated for the use of his premises, or alternatively, to reacquire the premises so that it can be relet in a much shorter time, thereby improving the creditor's profitability. What is clear, however, is that the commercial real estate lobby, particularly commercial retail landlords, effectively lobbied Congress to have their position in a bankruptcy proceeding greatly improved.

In another, somewhat obscure, portion of the BAPCPA amendments, another ever-present participant in bankruptcy proceedings fought to have its lot improved. Utility providers are afforded increased protection under BAPCPA and are given rather unique abilities to protect their unsecured claims.[94] A new provision was added to the pre-existing section 366 that, in effect, gives a utility provider complete discretion over deciding what constitutes adequate protection for purposes of allowing a debtor in possession to continue to use the utility's services.[95] Unlike every other creditor involved in the bankruptcy proceeding, the utility provider is allowed to determine whether the debtor's offer to protect the provider constitutes adequate protection, and if not, to refuse to provide services to the debtor without any intervention from the court.[96] It is up to the debtor to request a hearing to contest the decision by the utility provider to terminate or otherwise alter its services to the debtor.[97]

One of the first cases to discuss this new power conferred upon utility providers was *In re Lucre, Inc.*[98] A local exchange carrier providing telecommunication services to the Michigan

92 *Id.* § 362(b)(22).
93 *Id.*
94 *Id.* § 366(c).
95 *Id.*
96 *Id.*
97 *Id.*
98 333 B.R. 151 (Bankr. W.D. Mich. 2005).

market filed an emergency motion with the court to extend the automatic stay and thereby prevent the local power company and its upstream and downstream communication-facility providers from terminating services to the competitive local exchange carrier.[99] The court took a firm position based on the explicit language of section 366(c) and held that the new statute expressly states that the only way in which an injunction against a utility provider can be extended is for either the utility provider to accept the adequate-assurance offer of the debtor or for the debtor to accept the adequate assurance that is requested by the utility provider.[100] This appears to greatly enhance the utility's bargaining power because the utility can effectively set the terms of service and then wait for the debtor to decide whether it can find adequate funding to guarantee payment for its utilities, which are often entirely indispensable to continued operations.[101] The court does soften its holding slightly, however, by suggesting that the utility provider "might" have an obligation to negotiate for adequate assurance in good faith.[102]

Regardless of how bankruptcy courts as a whole eventually decide how much of an upper hand to give to utilities in this unusual situation, it is clear that debtors as a whole are now in a position where they cannot seek immediate court intervention at the first hint of creditor displeasure. Whereas a recalcitrant debtor could previously count on the goodwill of the typical bankruptcy judge wanting to preserve as much of the estate as possible to allow for long term recovery for as many unsecured creditors as possible, it now appears that this judicial discretion has been severely limited by express statutory instructions to steer clear of the suddenly sacrosanct turf of utility providers.

As was the case with the increase in bargaining power for commercial lessors, there is no question that this change favors creditors over would-be airline debtors-in-possession. Airlines are generally extremely capital intensive enterprises and depend heavily on leased equipment, leased facilities, and enormous energy, telecommunications, and other utility expenditures.[103] What is important to consider, however, is not the change in the

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99 *Id.* at 152-53.

100 *Id.* at 154.

101 *See id.*

102 *Id.*

103 For example, American Airlines ended its fiscal year 2004 with over $19 billion in property, plants, and equipment. AMR Corp., 2004 Annual Report (Form 10-K), at 44 (Feb. 25, 2005). Delta Airlines ended its fiscal year 2004 with

relative positions of property lessors and utility providers, but rather the approach that Congress (no doubt with the help of associated interest group lobbyists) took with these isolated special interests.

If Congress had wanted to provide the PBGC with greater leverage in bankruptcy proceedings, it could have taken the same approach and provided either stronger priority, as it did with commercial lessors, or presumptively authoritative control over the setting of adequate-protection terms, as it did with utility providers. While neither alone would be sufficient to prevent the currently insolvent airlines from unloading the pension obligations onto the PBGC, some alteration to the PBGC's standing in a bankruptcy proceeding is vital if the agency is to have any chance of survival without a massive infusion of federal assistance. That Congress chose not to include any such provision to specifically benefit the PBGC speaks to the body's lack of concern for the growing problem, an insufficient understanding of the nature or severity of the problem, an unwillingness to confront the issue head-on where little public focus has been directed at the issue, or some combination thereof. In any event, the passing of the first significant update to the nation's bankruptcy code in more than twenty-five years, without any mention of the PBGC or pension insurance, and in the face of the swelling deficits at the federally funded agency, is without question a disappointing lost opportunity.

B. Recent Court Decisions Concerning the PBGC's Ability to Terminate Plans Through Distress and Involuntary Terminations

Congress was unwilling to give the PBGC greater distribution priority or bargaining power in the most recent amendments to the Bankruptcy Code. However, the courts have responded by giving the PBGC a very wide berth in its decision-making authority, perhaps as much in an effort to allow the agency to proactively protect itself in the face of mounting losses as in an effort to faithfully interpret the agency's statutory grant of power. This section will describe the reasoning of court decisions in the most recent PBGC airline termination cases, which have unmistakably shown a willingness to let the PBGC expand its ability to negotiate plan terminations with the airlines that are as PBGC-

over $16.5 billion in property, plant, and equipment. Delta Air Lines, Inc., Annual Report (Form 10-K), at F-3 (March 10, 2005).

favorable as could be expected under the circumstances. In doing so, however, the courts may have given the agency just enough authority to prevent current account deficits from bankrupting the PBGC itself, possibly at the expense of a viable long-term solution and public awareness of the growing underlying financial time bomb.

The United States District Court for the District of Columbia has been particularly willing to defer to the PBGC. In *Adams v. PBGC*, the court allowed the PBGC to draft a particularly novel settlement agreement in its section 1342 involuntary termination of Trans World Airlines' ("TWA") two retirement plans.[104] TWA's plans were underfunded by approximately $1.1 billion at the time of the settlement agreement.[105] In an effort to save the plans, or at least to lessen the eventual underfunded liability, the PBGC entered an agreement with TWA whereby a third-party investor would agree to fund the plans' ongoing contribution obligations in exchange for TWA notes that would vest if the airline were able to successfully reorganize its operations and become profitable.[106] The plans were eventually terminated nine years after the initial settlement agreement between TWA and the PBGC.[107] Airline employees whose pensions were reduced from the levels stated in their collective bargaining agreement with TWA sued TWA and PBGC, claiming that such an involuntary settlement exceeded the statutory authority of the PBGC and amounted to nothing more than an attempt on the part of both the third-party guarantor and the PBGC to evade their responsibilities at the expense of the plan members.[108]

The court found, however, that the PBGC was expressly authorized to engage in "liability settlements" under section 1367.[109] The court went on to say that "'federal law authorizes the PBGC to enter into settlement agreements like the one challenged in this case,'" citing section 1362(b)(3) as an express grant of authority.[110] In so holding, the D.C. court was merely following clear and incontrovertible precedent laid down by the Supreme Court itself which allows the PBGC almost unfettered discretion in brokering settlements and providing what must be

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104 Adams v. PBGC, 332 F. Supp. 2d 231, 235-39 (D.D.C. 2004).

105 *Id.* at 233.

106 *Id.*

107 *Id.* at 233-34.

108 *Id.*

109 *Id.* at 236.

110 *Id.* (quoting Allied Pilots Ass'n v. PBGC, 334 F.3d 93, 95 (D.C. Cir. 2003)).

considered immunity from subsequent liability to settlement participants if the agency believes it is in its best interest to do so.[111]

That the Supreme Court would hold that a federal agency should be given discretion is not troubling. That the Court is basing such an extremely broad grant of power to the agency on the language used in the statute might well be. Section 1367 merely states that the PBGC "is authorized to make arrangements with contributing sponsors . . . including arrangements for deferred payment of amounts . . . and for such periods as the [PBGC] deems equitable and appropriate."[112] Section 1362(b)(3) grants the agency the ability to "agree to alternative arrangements for the satisfaction of liability to the [PBGC]."[113] Admittedly, nothing in either of these grants of discretionary authority limits the ability of the PBGC to enter settlement agreements.[114] One wonders, therefore, whether the Supreme Court is implicitly authorizing the PBGC to go to the limits of due process, and if not, what limitations would apply, assuming the agency was acting within the pension insurance and guaranty context.

A very recent United States District Court for the District of Columbia decision further expounded on this expansive grant of discretion in a case involving similar circumstances at another troubled airline.[115] As mentioned previously, United Airlines entered bankruptcy protection in 2002. During the initial bankruptcy proceedings, the PBGC seemed to be attempting to prevent United from terminating its pension obligations through a traditional debtor-led distress termination.[116] The agency apparently resisted efforts by the airline to seek court approval for cessation of even its then-current monthly contribution obligations throughout 2004 and 2005.[117] The PBGC appeared to be unsuccessful in its efforts, however, as United's request to sus-

[111] *See* Nachman Corp. v. PBGC, 446 U.S. 359, 367 (1980) ("[Congress] grant[ed] the PBGC discretion to arrange reasonable terms for the payment of [ERISA] liability"); *see also* Lockheed Corp. v. Spink, 517 U.S. 882, 890 (1996) ("[p]lan sponsors who alter the terms of a plan do not fall into the category of fiduciaries").

[112] 29 U.S.C.A. § 1367 (West 2005).

[113] *Id.* § 1362(b)(3).

[114] *See id.*

[115] Ass'n of Flight Attendants-CWA, AFL-CIO v. PBGC, No. Civ.A. 05-1036ESH, 2006 WL 89829 (D.D.C. Jan. 13, 2006).

[116] *Id.* at *2.

[117] *Id.*

pend all contributions to its plans was granted by the presiding bankruptcy court judge.[118]

The reality of the situation, however, is somewhat more complicated. Throughout the early part of 2005, the PGBC appeared to continue its opposition to any efforts by United to terminate its current or future obligations.[119] Such efforts included opposition to United's June 30, 2005, motion to terminate its plan through court-sanctioned distress termination, which included a brief filed with the court that argued that any attempt by United to terminate its plan was "premature" without further information showing that the plans were not salvageable.[120] Even the Executive Director of the PBGC, Bradley Belt, sent a written response to a contemporaneous flight attendants' union proposal to salvage the plans, saying that the agency "'continue[d] to believe that the interests of the participants and the pension insurance program would best be served by the continuance'" of the pension plan.[121]

In behind-the-scenes negotiations, however, the PBGC had been in settlement talks with United as early as February, 2005.[122] An agreement between United and the PBGC was reached on April 22, 2005.[123] The court was called upon by the union to declare the settlement beyond the scope of the agency's authority, and by the PBGC in a subsequently filed motion to declare the plan involuntarily terminated.[124]

The court sided entirely with the PBGC.[125] In doing so, it pointed to language in ERISA authorizing the agency "to terminate a pension plan based on a '*possible* long-run loss.'"[126] The court went on importantly to state the following:

> the agency need not have perfect information regarding either the exact amount of increased liability or the probability that the agency will have to assume this liability. In this case, PBGC staff assessed the risk and costs to the agency of delaying termination. Armed with those figures, the agency chose, as it was entitled to do, to invoke its power to involuntarily terminate under [section] 1342 instead of waiting for the resolution of a [section] 1341 ter-

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118 *Id.*
119 *Id.*
120 *Id.* at *2.
121 *Id.*
122 *Id.* at *3.
123 *Id.*
124 *Id.* at *9.
125 *Id.*
126 *Id.* (quoting 29 U.S.C. § 1342(a)(4) (2005) (emphasis added)).

mination. Such determinations regarding the amount of loss the agency is willing to risk are precisely the sort of discretionary decisions [with which a court should not interfere].[127]

This case is perhaps more troubling than *Adams.*[128] In *Adams,* the court was willing to allow the agency to enter a settlement based upon facts known or estimable at the time of the decision, where the settlement terms among the airline, the third-party financier, and the agency were publicly disclosed.[129] If the plan members adversely affected by the settlement agreement between the pension sponsor and the agency objected to any terms as being inequitable, recourse (however limited it might have been, given the overwhelming deferential nature of review practiced by the district court) would have been possible either via objection to the overreaching by the agency or sponsor in contravention of the express terms of ERISA or through a sheer plea to equitable considerations.[130]

The decision in *Association of Flight Attendants* is more disconcerting, not because of the ultimate decision reached by the agency or the amount of the underfunded liability assumed, but rather because of the methods employed by the PBGC in its settlement negotiations and communications with affected parties.[131] Congress' grant of power to the agency, its breadth aptly described by the court in *Association of Flight Attendants,* cannot possibly extend indefinitely without regard to the interests of directly affected parties.[132] It must be remembered that the agency's *statutorily* defined purpose includes the obligations "to encourage the continuation and maintenance of voluntary private pension plans *for the benefit of their participants*" and "to provide for the timely and uninterrupted payment of pension benefits *to participants* . . . ."[133] Privately negotiating "involuntary" termination settlements that adversely affect plan participants while publicly decrying plan sponsor attempts to self-terminate their plans seems to be overweighting the agency's other obligation "to maintain premiums. . . at the lowest level . . . ."[134]

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[127] *Id.*

[128] Adams v. PBGC, 332 F. Supp. 2d 231 (D.D.C. 2004).

[129] *See id.* at 234.

[130] *See id.* at 235-37.

[131] *Ass'n of Flight Attendants-CWA, AFL-CIO,* 2006 WL 89829.

[132] *Id.* at *9.

[133] 29 U.S.C.A. § 1302(a)(1)-(2) (West 2005) (emphasis added).

[134] *Id.* § 1302(a)(3).

That is certainly not to say that the agency is not vigilantly pursuing the course of action it most feels will best protect the total pool of pension plan capital under its supervision. On the contrary, Part III of this comment will attempt to show that, given the constraints placed on the PBGC by its mandate from Congress, the current Bankruptcy Code, and inefficiencies endemic in any system of government-sponsored interruption of market forces, especially with respect to insurance products, the PBGC is unable to substantively improve the condition of the pension guarantee program through any means other than in direct and oftentimes surreptitious bartering with plan sponsors to negotiate a pension plan termination and bankruptcy reorganization plan that, while not explicitly permitted by the Bankruptcy Code, improves the agency's priority status enough to acquire some assets to offset the acquired plan liabilities. Had Congress taken the opportunity presented by the first re-write of the Bankruptcy Code in more than twenty-five years to give the PBGC statutorily-mandated higher priority, the agency would not be forced to achieve that goal through other means. Had courts not been willing to allow the PBGC to conduct its affairs by such covert means, then perhaps the issue would have been brought to the forefront for more deliberate discussion.

III. STRATEGIES FOR REPAIRING THE NATION'S PENSION SYSTEM

There have been nearly as many recommendations for fixing the PBGC as there have been academics who have examined the agency. Recommendations include increasing the rates charged by the PBGC for its insuring of plan premiums, modifying to the bankruptcy priority system (as discussed in Part II), and novel initiatives such as changing the entire insurance system to a more market-based program. First, this section will describe the manner in which the PBGC is currently funded to provide a backdrop for the changes that have been previously recommended. Next, it will examine each of the proposed solutions, and ultimately find that while each might be able to incrementally reduce the PBGC's funding shortfall, none is able to make the system solvent in today's operating environment. Finally, this section will end with a solution to the problem that is actually no solution at all: terminating the PBGC, and dividing the losses that would result from its termination among all parties involved, including the plan sponsor's equity holders, other creditors, and pension plan members, and ultimately the taxpay-

ers. Retirement plan insurance, if it is a viable service, must then be provided by market participants who have both an incentive to monitor the creditworthiness and behavior of their plan and to sponsor customers and capital at risk to make sure that their decisions are rational in light of their own self interest.

A. THE EXISTING PBGC FUNDING MECHANISM

The PBGC is not a federally funded insurance program.[135] ERISA requires that the PBGC be financed solely through the premiums it charges for its insurance services, the recoveries that it makes from plans that were voluntarily terminated through standard or distress termination, the funds recovered in involuntary terminations, and the interest earned from the investment of these funds.[136] The agency does have a $100 million line of credit with the Treasury Department, which gives the federal government some direct exposure, however limited.[137] ERISA explicitly limits the federal government's exposure to PBGC claims only to trust funds held by the agency for the benefit of plan members.[138]

While this would seem to relieve the federal government of potential long-term liability for PBGC deficits, the White House itself so much as admits that the responsibilities of the PBGC eventually will fall on the general revenue fund of the United States.[139] Government Accounting Office figures for total government debt included $71 billion for liabilities of the PBGC.[140] Few would argue that the government will be required to shoulder the load when, not if, the PBGC finally becomes unable to make ongoing payments on its assumed pension plan obligations.

As mentioned earlier, one of the primary sources of PBGC revenue is the premium base collected from ongoing plans. The agency actually collects two distinct types of premiums. First, plans are required to pay a flat rate fee, currently $19 per

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135 Colloquium, Wendy Kiska et. al, *Understanding & Controlling PBGC's Risk Exposure*, Nw. Univ. Colloquium Series: Law & Econ. (2004), http://www.law.northwestern.edu/colloquium/law_economics/Lucas.pdf.

136 29 U.S.C.A. § 1303.

137 *Id.* § 1305(c).

138 *Id.* § 1303.

139 *See* OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOV'T 231 (2005).

140 *Id.*

pension plan member per year.[141] Second, those plans that are underfunded as of the close of the prior year must pay an additional $9 variable rate premium to compensate for the added risk they pose to the fund.[142] This flat rate fee with an additional variable rate risk premium, however, is far too crude to allow the PBGC to adequately allocate funding responsibility based upon risk, as any viable insurance program must do. Amazingly, ERISA imposes this pricing scheme upon the PBGC, mandating that the agency will employ rates that "shall be uniform for all plans."[143]

B. Increasing Base and Variable Rates to Shore Up the PBGC

Recommendations to allow the PBGC to charge higher, and market based, rates have been made for some time.[144] The Director of the Congressional Budget Office recently passionately advocated a change to higher, risk-based premiums.[145] The PBGC's Executive Director, Bradley Belt, has made numerous requests to Congress to alter the premium structure of the PBGC.[146] Belt noted that UAL continued to pay (and oftentimes did not pay) the same flat rate premium as highly solvent corporations, "[even though its] credit rating has [only] been [good enough for] junk bonds status and its pension underfunded by more than $5 billion on a termination basis since at least 2000 . . . ."[147]

As should be obvious to anyone familiar with basic economics, it is inconceivable that any system which sets a flat rate for an insurance plan, without any regard to market risks in the system in general and firm specific risk in particular, can function prop-

141 29 U.S.C.A. § 1306(a)(3)(A)(i).

142 *Id.* § 1306(a)(3)(E)(ii).

143 *Id.* § 1306(a)(1).

144 Vineeta Anand, *New PBGC Head Set to Fix System*, PENSIONS AND INVESTMENTS ONLINE, May 17, 2004, at 2, http://www.pionline.com/article.cms?articleID=45336&issueDate=2004-05-17&ht=. (Belt believes the PBGC must "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").

145 *PBGC's Unfunded Pension Liabilities: Will Taxpayers Have to Pay the Bill?: Hearing Before the H. Comm. on Budget*, 109th Cong. (2005) (statement of Douglas Holtz-Eakin, Dir., Cong. Budget Office).

146 *The Effect of Federal Bankruptcy and Pension Policy on the Financial Situation of the Airlines: Hearing Before the S. Comm. On Commerce, Sci. and Transp.*, 108th Cong. (2004) (testimony of Bradley D. Belt, Executive Dir., PBGC).

147 *Id.*

erly. Firms would recoil at a flat rate price set high enough to actually keep the entire plan solvent. Those firms healthy enough to seek insurance for their plan in private markets would do so, leaving only weak firms which cannot find insurance from private firms to weigh upon the remainder of the plan base.[148] After healthy firms fled the system, the average flat rate price capable of sustaining the remaining plans would be so high as to push the remaining plan sponsors into insolvency. Firm management contemplating the creation of a defined benefit plan (few as they might be) might well be breaching their fiduciary duty to their shareholders by entering into such a morass.[149] Moving to a higher flat rate would therefore be the worst of both worlds: healthy firms would be forced to flee the system, thereby depriving the PBGC of much needed revenues from firms unlikely to later burden the system with underfunded liabilities and pushing weak firms further into insolvency.

Even a variable rate that takes into account the firm-specific risk of each plan sponsor would ultimately fail in this environment. It seems equitable that firms that have the higher chance of breaching their pension plan obligations should pay a higher insurance rate in accordance with the higher likelihood of the eventual PBGC assumption of liabilities, and some have suggested that this is the answer to repairing the PBGC.[150] Indeed, it makes some sense that a firm would take into account the added cost of variable rate premiums when deciding how and whether to allocate funding for pension obligations.[151] Healthy firms would appreciate lower rates, but those firms that should be charged significantly higher rates than the current $19 annual premium given their firm-specific risk, financially unstable by definition, would be unable to afford a premium commensurate with their financial status. Moving to a variable rate regime, therefore, would only force weak firms into bankruptcy.

Even if a variable rate premium increase designed to compensate the PBGC for increased firm-specific risk were a proper

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[148] Nanette Byrnes & Davis Welch, *The Benefits Trap*, BUS. WK., July 19, 2004, at 64.

[149] *Id.*

[150] Phil Davies, *Pensions in Peril*, FED. RESERVE BANK OF MINNEAPOLIS: THE REGION, June, 2005, http://woodrow.mpls.frb.fed.us/pubs/region/05-06/davies.cfm?js=0.

[151] *Retirement Protection Act of 1993: Hearing on H.R. 3396 Before the Oversight Subcomm. on Ways and Means*, 103rd Cong. (1993).

means to better allocate expense, the prevailing corporate protectionism in Congress would prevent such a change from being made. One commentator succinctly stated her position: "If Congress increases premiums to solve the PBGC's problems, they would send a message to companies that are meeting their pension obligations 'that not only do they have to pay for their own pension benefits, at some point they will pay for the benefits of their competitors.' "[152] It is unclear from this statement whether she and the senator whom she quoted understand that multi-billion-dollar government bailouts come from people who not only are paying their own expenses but also at some point will have to pay for the benefits of others.[153] Another commentator said that "if premiums are raised too much for employers with well-funded plans, the attractiveness of offering defined benefit plans will decrease."[154] Perhaps that is exactly what needs to happen.

C. A Change in the PBGC's Pre- and Post-Petition Bankruptcy Priority Status

To understand why many commentators recommend that the PBGC be given a higher priority status in bankruptcy proceedings, it is important to know the current position the agency has when a corporation seeks bankruptcy court protection. This section will thus explain the agency's current position and then comment on the recommendations that scholars have made for improving it.

When an insolvent firm seeks bankruptcy protection, there is a high likelihood that there will not be sufficient assets to satisfy the claims of all of the corporation's secured and unsecured creditors. Secured creditors are those that have claims against not only the cash and cash equivalent positions of the debtor but also against the debtor's specific assets that were encumbered with a lien in favor of the creditor in exchange for the creditor lending the debtor capital.[155] As such, secured creditor claims will be satisfied from the assets of the debtor before un-

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152 Leigh Allyson Wolfe, *Is Your Pension Safe? A Call for Reform of the Pension Benefit Guaranty Corporation and Protection of Pension Benefits*, 24 Sw. U. L. Rev. 145, 177 (1994) (quoting *Hearings on the Ret. Act of 1933 Before the S. Comm. on Fin.*, 103d Cong. 4 (1994) (statement of James M. Jeffords, U.S. Sen. from Vt.)).

153 *See id.*

154 Jerry Geisel, *Liabilities Threatening Long-Term Future of PBGC*, Bus. Ins., Aug. 30, 2004, at T12.

155 11 U.S.C.A. §§ 506-507 (West 2005).

secured creditors receive any distribution at all.[156] Unsecured creditors, however, are classified according to the type of claim they are pressing against the debtor and the priority system that Congress enacted in the Bankruptcy Code for economic as well as policy reasons.[157] As such, the priority of a creditor's claim often determines whether it is satisfied in full or left completely out in the cold.[158] To rise above all other general unsecured creditors and have a reasonable chance of recovery, the PBGC therefore must make sure that it has a lien against the debtor's assets.[159]

Achieving this status under the current system, however, is what many consider to be the root of the PBGC's problem in today's bankruptcy system.[160] The PBGC has two options. First, it can attempt to obtain a lien against the debtor's assets for unfunded benefits owed to the plan.[161] Alternatively, the PBGC can seek a lien against the debtor's assets for the continuing contributions that the plan sponsor owes to the plan but is not making.[162] The problem, however, is with the Bankruptcy Code's automatic stay provision.[163] Once a debtor files a bankruptcy petition, the automatic stay prevents "any act to create, perfect, or enforce any lien against property of the estate."[164]

This puts the PBGC in an untenable position. If the agency waits to see whether a plan sponsor is going to be able to maintain its plan and stay solvent or recover from its problems with an infusion of outside capital, then the automatic-stay provision of the Code will prevent it from seeking either a lien against the assets of the debtor or an execution of a previously acquired lien. Troubled companies have little reason to alert the PBGC to their plans to enter bankruptcy; indeed, it would be imprudent for the management of the soon-to-be debtor-in-possession to do anything that would give its creditors additional leverage and secured positions against its assets, thereby weakening the debtor's collateral position in any subsequent reorganization plan. For its part, the PBGC cannot be blamed for not wanting

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156 *Id.*

157 *See id.* § 507.

158 *See id.*

159 *See id.*

160 *See* Keating, *Pension Insurance, supra* note 27, at 90-92.

161 29 U.S.C.A. § 1362(b)(1) (West 2005).

162 *Id.*

163 11 U.S.C.A. § 362(a)(4).

164 *Id.*

to actively engage in the levying of possibly insolvent companies. The government agency would be imprudent to begin pushing companies into bankruptcy and involuntary termination proceedings given the large number of companies with hundreds of thousands of employees teetering on the verge of insolvency.

Because of these issues, many have recommended giving the PBGC elevated status in bankruptcy proceedings. As was discussed in Part II, Congress chose not to address the pension-insurance underfunding problem in the 2005 amendments to the Bankruptcy Code. Had they done so, perhaps the mounting financial crisis would have been brought to the forefront and dealt with in a more public forum.

On the other hand, it is not at all clear whether changing the priority status of the PBGC would be the panacea that some claim. The purpose of Chapter 11 bankruptcy proceedings is to allow the debtor to reorganize its operations and emerge anew, hopefully in the process sustaining some of the going concern value of the business operations and preserving jobs for the firm's employees. Administrative expenses, those creditor claims that Congress has determined to be entitled to immediate payment, however, must be completely satisfied before the company can emerge from bankruptcy protection.[165] If the PBGC is to be afforded administrative expense status for its claims, this would be an immense expense for which the reorganizing corporation must account.[166]

Even if a revision to the Code were to label the PBGC's claims as something other than an administrative expense, the fact of the matter would remain that the bankrupt corporation would need to address all of its pension plan deficiencies in some manner before being allowed to continue in business. Given the huge size of the deficiencies at today's domestic airlines, it is not clear that it would be possible to finance such sums, whether in a single lump sum payment or stretched out over many years, and it would be a risky and dubious investment on the part of would-be financiers to sink such large sums of capital into airlines that have not shown that they could be profitable, despite the skyrocketing price of fuel.

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[165] *Id.* § 1129(a)(9)(A).

[166] *See id.*

D. "SUPERPRIORITY" STATUS FOR THE PBGC

A novel idea has been proposed by Professor Keating of the University of Washington in St. Louis. Professor Keating would grant "superpriority" to the PBGC's claims, both pre- and post-petition, which would trump *all* other would-be creditors of the bankrupt estate, regardless of whether these other creditors are secured or unsecured.[167] Unlike the problem of trying to convert a pre-petition debt into a post-petition secured claim, as in the above suggestions to fashion a higher priority in bankruptcy, Keating's proposal would solve the problem without mucking up the traditional pre- and post-petition distinction by conveying upon the PBGC a unique status.[168]

Further, the positioning of the PBGC before other creditors, both secured and unsecured (it might still be possible, under a slightly modified version of his proposal, to allow post-petition creditors and lenders higher priority in order to allow the debtor-in-possession access to vital post-petition funding opportunities), would remove the PBGC's burden of monitoring the activities of the debtor, and place those burdens on the creditors who now stand in the lower-ranked position formerly held by the PBGC and other general unsecured creditors.[169] It could certainly be argued that this burden should not be borne by general creditors, but it is undeniable that creditors, landlords, and lenders in the business of judging and valuing credit and market risk as part of their normal operations are in a much better position to perform this function than the PBGC. At worst, the added costs of monitoring debtors and the additional interest premiums associated with a lower bankruptcy priority would be priced according to market mechanisms instead of arbitrarily set (or not set) by a government agency.

It suffers, however, from the same main problem as the bankruptcy modification proposals, that is, it places a larger burden on businesses already suffering from bankruptcy proceedings. Even worse, because of the proposed superpriority of the PBGC's claims, there would be businesses completely unable to reorganize due to the massive burden of underfunded pension obligations. United Airlines, fresh out of bankruptcy, is a good example. United's nearly $7 billion in unfunded obligations, if required to be repaid to the PBGC before the airline could have

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167 Keating, *Pension Insurance*, *supra* note 27, at 100.

168 *See id.*

169 *See id.*

emerged from bankruptcy protection, would have rendered the airline worthless. The new stock of the reformed corporation began trading on February 3, 2006, at $40 per share and closed the week at $34.60 per share.[170] That gave the airline an implied market valuation of $4.32 billion.[171] Being required to repay the entire pension obligation would have meant the end of the airline and little or no recovery for the PBGC. As it stands, the PBGC is in line to recover some portion of its losses, albeit in unusual fashion. The agency, as part of its settlement agreement with United (discussed in Part II, *infra*), owns twenty percent of the reorganized airline.[172] The demands of an unrelenting superpriority status creditor would have made such an arrangement unworkable.

E. A Move to a Hybrid Government-Private Model of Pension Insurance

The most promising suggestions, however, come from Richard Ippolito, the former chief economist at the PBGC.[173] Mr. Ippolito's to the point analysis stands in stark contrast to the incremental tinkering proposed by other followers of the PBGC.[174] He places the blame for the agency's woes squarely on the moral hazard created by a system that rewards companies by allowing them to book earnings from the overfunding of their plans but push underfunding onto the PBGC.[175] Worse yet, as he points out, Congress allows companies with underfunded plans to stretch out their repayments over long periods of time, often granting extreme lenience when lobbied and allowing companies to make *no* contributions during economic downturns or particularly difficult times for certain industries, including the airlines.[176]

His recommendations are straightforward: either premiums must go up, or distributions must go down, but under no cir-

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170 Kathleen Pender, *Market Disinclined to Buy Shares in a Reorganized United Airlines*, SAN FRANCISCO CHRON., Feb. 5, 2006, at J-1.

171 *Id.*

172 Associated Press, *United Airlines' New Stock Starts Trading*, ABC NEWS, Feb. 2, 2006, http://abcnews.go.com/Business/wireStory?id=1572130&CMP=OTC-RSSFeeds0312&ad=true.

173 Richard A. Ippolito, *How to Reduce the Cost of Federal Pension Insurance*, CATO INST.: POL'Y ANALYSIS, No. 523 (Aug. 24, 2004), *available at* http://www.cato.org/pubs/pas/pa523.pdf.

174 *Id.* at 1.

175 *Id.*

176 *Id.*

cumstance is the current system of government sponsorship viable.[177] Ideally, Ippolito envisions a system of private pooling of pension-plan-provider premiums, which charges a general market risk-based premium and a firm risk-specific premium to more closely mirror the true long-term cost of insuring plans with the expected net present value of distributions.[178] He stops short, however, of recommending the complete withdrawal of the federal government from the equation, and recommends that the PBGC or some other agency provide a public pool in which risky companies unable to find private insurance partners could participate.[179] While on the right track, his suggestion falls short for the same reason as those that propose increased base- and variable-rate premiums: the healthy would leave the system, leaving only the weak to contribute little but demand an eventual bailout.

IV. CONCLUSION

There is no doubt that the PBGC is a ticking time bomb. There is no doubt that the magnitude of the eventual taxpayer bailout of the system, if nothing is done, is going to make the Savings & Loan crisis of the 1980's look mild. Estimates of the current underfunding of defined benefit plans run into the hundreds of billions of dollars.

On the other hand, it appears that Congress has no intention of taking the politically difficult steps necessary to prevent such a catastrophe. The most recent amendments to the Bankruptcy Code were twenty-five years in the making, and there is no denying that cries from the PBGC and those that closely follow the pension crisis in this country rang out for changes to be made to improve the priority of the pension guarantor, if nothing else, to reduce the avalanche of unfunded plans currently being foisted upon the PBGC, especially by the airlines. While no consensus existed about how *best* to improve the PBGC's bankruptcy standing, there should not have been any question that *something* should have been done, on the model of the advantages given the utility companies, or even to commercial landlord/creditors. Nothing, however, was done.

Similarly, the courts that have recently been charged with monitoring the PBGC have chosen to allow events to take their

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[177] *Id.* at 13.

[178] Ippolito, *supra* note 173, at 15.

[179] *See id.* at 12.

course. Recent cases have held that, whatever may have been the intent of Congress when it created the system of voluntary, distress, and involuntary plan terminations, the situation now calls for allowing the PBGC to do whatever it can to preserve whatever assets for which it can negotiate, oftentimes in exchange for its help in allowing the airlines and other large employers to breach their collective bargaining agreements through the novel new "involuntary voluntary" terminations.

Doing so, however, was a half-measure much worse than no action at all. Perhaps allowing the PBGC considerable discretion—too much at times—was an act of statutory construction. Perhaps it was an act of judicial pragmatism. For certain, doing so prolonged the inevitable and increased the ultimate cost of bailing out the program.

It is time for all parties, the courts included, to admit that the nation's pension plans, the PBGC, and therefore the taxpayers, are in trouble. Tinkering with rates and moving the PBGC up one rung on the short and rickety ladder of bankruptcy priority in the scramble for too few assets are too little too late. It is time for honest assessment, and because these earlier opportunities were lost—time for difficult decisions. All parties involved will sacrifice. Former shareholders in bankrupt airlines, and those that will inevitably become bankrupt, face the complete loss of their equity investments. Creditors must accept that their claims must be (at least partially) subordinated to a higher good. Employees must accept a reduced pension, much like everyone must accept a reduced level of all other social programs, such as social security and health care benefits. Worse yet, the taxpayers must accept another multi-billion dollar bailout of a program that benefited few. There may have been a time when the program could be saved—but that time is not now.

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