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Chapter 11's New Ten-Ton Monster: The PBGC and Bankruptcy

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Probably the main reason that the existence of the Pension Benefit Guaranty Corporation (PBGC) raises so many distinct issues when pension plan sponsors go bankrupt is that the PBGC wears so many different hats. The PBGC is at once a representative of the federal government as well as a regulator and insurer. At least two of its roles involve contradictory impulses. Thus, as regulator, the PBGC plays a role in ensuring that pension plans are properly funded.[1] In helping to influence how strictly funding standards are to be enforced, however, the PBGC must consider what effect more aggressive enforcement efforts will have on the number of companies that remain a part of the PBGC pension system.[2]

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1. Technically, the Department of Labor enforces the funding provisions, fiduciary standards and other requirements of title I of the Employee Retirement Income Security Act of 1974 (ERISA), the statute which generally governs the creation and maintenance of pension plans by employers. The PBGC exercises its influence in enforcing funding obligations through its statutory power to terminate plans. *See* Frank Cummings, *Labor Relations and ERISA: Considerations in Corporate Change (Mergers, Acquisitions, Bankruptcy), in* ALI-ABA RESOURCE MATERIALS: LABOR AND EMPLOYMENT LAW 1787, 1812 (6th ed. 1992).

2. For example, Congress has shown in its amendments to the termination standards of ERISA a desire to "balance the need to limit access to the insurance system to cases of genuine need against the danger of making the tests so stringent that nothing short of total liquidation would qualify for PBGC assistance." H.R. REP. NO. 241, 99th Cong., 2d Sess., pt. 2, at 49 (1985), *reprinted in* 1986 U.S.C.C.A.N. 685, 707; *see also* Ellin Rosenthal, *PBGC Premium Hikes Assailed,* 49 TAX NOTES 263, 264 (1990) (noting decline in the number of defined benefit plans and quoting experts who claim that an attempt to save the PBGC through premium increases could do the agency more harm than good because of those who might drop out as a result); Ellin Rosenthal, *OMB Proposal to Shield Government from Future Bailouts Has Benefits*

Similarly, as pension insurer, the PBGC must take seriously its role as the final safety net for workers' pensions, a role that counsels in favor of the most comprehensive coverage of pension benefits. The PBGC, however, must also be cognizant of the "moral hazard" that its insurance function creates for employers within the system.[3] Put simply, the PBGC must make certain that its insurance program does not become a corporate welfare program for companies that make grandiose but empty pension promises to their employees.[4]

In its third role, as a federal government instrumentality, the PBGC has political clout that even retirees as a group lack. Particularly since the savings and loan bailout, Congress has taken the PBGC's bankruptcy reform proposals seriously.[5]

The statute that created the PBGC, the Employee Retirement Income Security Act of 1974 (ERISA),[6] creates further complexities in relation to the PBGC and bankruptcy.[7] ERISA

Community on Edge, 48 TAX NOTES 1080, 1081 (1990) [hereinafter Rosenthal, *OMB Proposal*] (citing warnings from the director of a private pension plan association that attempts to improve the PBGC's position in bankruptcy would cause many employers to terminate their plans).

3. For a detailed discussion of the moral hazard problem in the context of the PBGC insurance system, see Daniel Keating, *Pension Insurance, Bankruptcy and Moral Hazard*, 1991 WIS. L. REV. 65, which argues that the PBGC is ill-equipped to monitor pension funding. Portions of the ensuing text and notes are adapted from this article and reprinted with permission. *See also* James B. Lockhart, *Securing the Pension Promise*, 43 LAB. L.J. 195, 198 (1992) (noting that the PBGC faces the same moral hazard that the Federal Savings and Loan Insurance Corporation did: "Since PBGC is providing the pension safety net, companies can spend their resources on things other than pension plans, without receiving pressure from workers.").

4. *See* CONGRESSIONAL BUDGET OFFICE, FEDERAL INSURANCE OF PRIVATE PENSION BENEFITS 47-48 (1987) (asserting that the current premium structure results in sponsors of well-funded plans subsidizing pensions of financially weak sponsors with underfunded plans). *But see* Michael S. Gordon, *Dissenting Comments* to RICHARD IPPOLITO, THE ECONOMICS OF PENSION INSURANCE 264 (1989) (arguing that the only "authentic explanation" for the enactment of the ERISA and PBGC insurance program was Congress's desire to create a cross-subsidy system).

5. *See Agency's Losses Growing Rapidly, Reforms Needed, Bipartisan Panelists Say*, 19 Pens. Rep. (BNA) No. 33, at 1479, 1479 (Aug. 17, 1992).

6. Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5, 18, 26 and 29 U.S.C.).

7. *See* Stuart N. Alperin et al., Note, *The Employee Retirement Income Security Act of 1974: Policies and Problems*, 26 SYRACUSE L. REV. 539 (1975). *See generally* SUBCOMMITTEE ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2D SESS., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 142-43, 538, 762, 3525-26 (Comm. Print 1976) (revealing how Congress struggled with the problem of the PBGC and bankruptcy in enacting ERISA).

is an intricate statutory maze in its own right, and its intersection with the Bankruptcy Code has raised a number of issues that are still far from settled.

The most important of these unresolved issues, and the source of the most hotly contested litigation concerning the PBGC and bankruptcy, has been the size and priority of the PBGC's claims against debtors who have underfunded their pension plans. Accordingly, this Article focuses primarily on the legitimacy of the PBGC's various arguments for either secured status or an unsecured priority position in bankruptcy. The first part of this Article gives a brief overview of pensions, ERISA and the PBGC, and explores why the PBGC currently suffers from a huge financial deficit. Part II looks at the different types of claims that the PBGC may assert in bankruptcy, as well as the complex issues surrounding valuation of the PBGC's claims. Part III then discusses the viability of the PBGC's many arguments for why it deserves preferred treatment in bankruptcy. Part IV explores how bankruptcy's automatic stay affects the PBGC. The Article concludes that none of the PBGC's arguments for preferred treatment are viable, and further notes that if the PBGC wishes to remedy its current problems in bankruptcy, it should seek a legislative solution under ERISA, not the Bankruptcy Code.

I. A PBGC PRIMER

Before getting to the complicated issues that arise with underfunded pension plans in bankruptcy, it is useful to examine first some background of the PBGC. The ERISA statute that created the PBGC is complex enough to warrant entire treatises that do not even discuss the bankruptcy aspects of the subject.[8] The material that follows is thus necessarily an overview, highlighting only those features of pension law that become most relevant when insured firms go bankrupt.

A. Pensions, ERISA, and the PBGC

Pensions are generally of two types: "defined benefit" plans and "defined contribution" plans. A defined benefit plan promises to pay a retired employee an annual pension typically based on the employee's salary and years of service.[9] Most pen-

8. *See, e.g.*, MARTIN WALD & DAVID E. KENTY, ERISA: A COMPREHENSIVE GUIDE (1991).

9. *See* 29 U.S.C. § 1002(35) (1988); *see also* Harold S. Novikoff & Beth M. Polebaum, *Pension-Related Claims in Bankruptcy Code Cases*, 40 BUS. LAW.

sion plans are defined benefit plans.[10] In a defined contribution plan, the employer contributes a percentage of an employee's income to a separate account, and the employee is entitled to the balance in the account at retirement.[11]

Title IV of ERISA covers most defined benefit plans that private employers provide, but not defined contribution plans.[12] There is little reason for the federal pension insurance program to cover defined contribution plans because employers fulfill such funding obligations when they make contributions. Under defined benefit plans, in contrast, a plan sponsor meets its obligation when the participant's benefits are paid fully or it purchases an annuity contract on behalf of the participant.[13]

Title IV of ERISA provides for a mandatory government insurance program administered and enforced by the PBGC, a wholly-owned United States government corporation modeled after the Federal Deposit Insurance Corporation.[14] One purpose of title IV is to ensure that the termination of underfunded pension plans will not deprive employees and their beneficiaries of retirement benefits.[15] The PBGC provides pen-

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373, 375 (1985) (describing types of pension plans). There are two basic types of defined benefit plans: single-employer plans and multi-employer plans. Single-employer plans are those with only a single contributing sponsor. 29 U.S.C. § 1002(41) (Supp. III 1991). Multi-employer defined benefit plans are those maintained by more than one sponsor pursuant to a collective bargaining agreement, and to which more than one employer is obligated to contribute. 29 U.S.C. § 1002(37) (1988 & Supp. III 1991).

10. James G. Durfee, *ERISA Overview*, *in* PENSION AND WELFARE BENEFITS IN BANKRUPTCY 33, 37 (PLI Commercial Law & Practice Course Handbook Series No. 444, 1988).

11. *See* 29 U.S.C. § 1002(34) (1988 & Supp. III 1991); *see also* Frank H. McCulloch et al., *ERISA Pension Claims in Bankruptcy*, *in* PENSION AND WELFARE BENEFITS IN BANKRUPTCY, *supra* note 10, at 203, 206 (describing the significant features of defined contribution plans).

12. 29 U.S.C. § 1321(b)(1) (1988 & Supp. III 1991); CONGRESSIONAL BUDGET OFFICE, *supra* note 4, at 5.

In addition to PBGC insurance, employers receive tax benefits when they create ERISA-qualified pension plans. Contributions to a qualified plan are deductible from the employer's gross income, yet employees recognize no taxable income until benefits are actually paid on retirement or other separation from service. *See* 26 U.S.C.A. §§ 402(a), 404 (West 1988 & Supp. 1992). Furthermore, income earned on contributed amounts accumulates tax-free. *See* 26 U.S.C. § 501(a) (1988).

13. CONGRESSIONAL BUDGET OFFICE, *supra* note 4, at 5.

14. *See* 120 CONG. REC. 29,950 (1974) (statement of Sen. Bentsen). The PBGC's board of directors includes the secretaries of Labor, Treasury and Commerce. 29 U.S.C. § 1302(d) (1988).

15. Congress created the PBGC "to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under [affected] plans." 29 U.S.C. § 1302(a)(2) (1988); *see also* Pension Benefit Guar.

sion insurance to some forty million Americans in 85,000 private defined benefit plans.[16]

When a plan covered by title IV of ERISA terminates with insufficient assets to pay guaranteed pension obligations, the PBGC assumes control and pays most benefits vested at termination.[17] The main limitation on the scope of the PBGC's insurance coverage is that the agency may not pay any plan benefits that amount to more than $750 per month in 1974 dollars—$2352.27 per month in 1992 dollars—even if the beneficiary would have been entitled to more under the original plan.[18] Other principal limitations are that the insurance will not cover benefit increases that resulted from plan amendments adopted within the five years prior to termination, and that employees do not continue to accrue benefits after plan termination.[19] Despite these coverage limitations, about eighty-five percent of participants in terminated plans ultimately receive all of the benefits they were promised.[20]

To fund the cost of such benefits, the PBGC first looks to any assets in the underfunded plan and then makes up the shortfall with its own funds,[21] which are accumulated primarily from premiums paid by employers that maintain ongoing plans.[22] The insurance program also receives funds through the statutory claim for unfunded benefits that the PBGC has against employers that terminate their pension plans.[23] Since

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Corp. v. R.A. Gray & Co., 467 U.S. 717, 720 (1984) (explaining that Congress intended to ensure that workers would receive defined pension benefits promised by employers). The other two purposes of title IV of ERISA are to "encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants" and to "maintain premiums . . . at the lowest level consistent with carrying out [the PBGC's statutory] obligations." § 1302(a)(1), (3).

16. Lockhart, *supra* note 3, at 195.

17. *See* 29 U.S.C. §§ 1341, 1342 (1988 & Supp. III 1991).

18. *See* 29 U.S.C. § 1322(b)(3)(B) (1988); Kenn B. Tacchino, *Concerns with Pension Security*, J. AM. SOC. CLU & CHFC, May 1992, at 86, 86.

19. *See* 29 U.S.C. § 1322(b)(6) (1988); PENSION BENEFIT GUARANTY CORP., PROMISES AT RISK 17 (1987), *reprinted in PBGC Proposal to Initiate a Variable Rate Premium System; and Public Comments on Administration's Pension Plan Funding and Premium Rate Proposals: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 100th Cong., 1st Sess. 25 (1987).

20. *See* Lockhart, *supra* note 3, at 195.

21. *See* 29 U.S.C. § 1344 (1988 & Supp. III 1991).

22. *See* 29 U.S.C. §§ 1306, 1307 (1988 & Supp. III 1991).

23. *See* 29 U.S.C. § 1362(b) (1988 & Supp. III 1991). ERISA provides that the PBGC may recover its claim not only against the terminating employer, but also against members of that employer's "controlled group." 29 U.S.C.

1987, such terminating businesses have been responsible for the PBGC's full costs in assuming their pension plans.[24]

Pension plans covered by title IV may terminate either voluntarily or involuntarily. A voluntary termination takes one of two forms, standard or distress. A standard termination is a voluntary termination in which the employer's plan has sufficient assets to cover all obligations to plan participants.[25] A standard termination does not implicate the PBGC's insurance function.

A distress termination, in contrast, is a voluntary termination in which an employer with an *underfunded* pension plan can demonstrate to the PBGC that it is in financial distress.[26] The PBGC will allow a distress termination if: the terminating company is in liquidation proceedings; the company is in a reorganization proceeding and the bankruptcy court determines that absent a termination, the company will be unable to survive outside of bankruptcy; or the PBGC determines either that the company will go out of business unless its plan is terminated or that providing pension coverage has become unduly burdensome solely by reason of a declining work force.[27]

The PBGC also has the ability to terminate a plan involuntarily if it can make a showing of proper cause. Proper cause for an involuntary termination includes the plan's failure to meet minimum funding standards, the plan's inability to pay benefits when due, or a situation presenting possible long-term loss to the PBGC.[28] If the PBGC's decision to terminate is contested, district court approval is required.[29]

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§§ 1301(a)(14)(A), 1362(a) (1988 & Supp. III 1991). The "controlled group" includes all entities under "common control" as determined under regulations issued pursuant to the Internal Revenue Code. *See* 26 U.S.C. §§ 414(b)-(c), 1563(a) (1988) (providing that corporations under "common control" generally consist of those corporations affiliated through overlapping 80% ownership).

24. *See* Pension Protection Act, Pub. L. No. 100-203, § 9312(b)(2)(A), 101 Stat. 1330-333, 1330-361 (1987) (codified as amended at 29 U.S.C. § 1362(b)(2)(A) (1988)).

25. *See* 29 U.S.C. § 1341(b) (1988 & Supp. III 1991).

26. 29 U.S.C. § 1341(c) (1988 & Supp. III 1991).

27. 29 U.S.C. § 1341(c)(2)(B) (1988 & Supp. III 1991).

28. 29 U.S.C. § 1342(a) (1988 & Supp. III 1991).

29. 29 U.S.C. § 1342(c) (1988 & Supp. III 1991). One issue regarding plan termination that has arisen in bankruptcy is whether ERISA provides the exclusive means by which a plan may be terminated once the sponsor has filed for bankruptcy. At least one court, in *In re* Bastian Co., 45 B.R. 717 (Bankr. W.D.N.Y. 1985), held that the debtor may reject pension plans as executory

B. Why the PBGC is in the Hole

The PBGC is currently in financial trouble. Although the magnitude of the PBGC's crisis does not approach that of the savings and loan debacle, the PBGC's deficit is nevertheless in the billions of dollars. Recent estimates have put the PBGC's negative net worth in the range of $2.5 billion, with predictions that absent remedial legislation it will reach $18 billion before the turn of the century.[30]

At least three factors contribute to the PBGC's existing financial problems. The first is the PBGC's own "shoddy enforcement" practices in its role as pension funding regulator.[31]

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contracts under the Bankruptcy Code, 11 U.S.C. § 365 (1988), even in cases where the beneficiaries have provided post-petition services to the debtor.

The viability of this holding, however, can be questioned for at least two reasons. First, *Bastian* was decided prior to the enactment of § 1113 of the Bankruptcy Code, Act of July 10, 1984, Pub. L. No. 98-353, title III, § 541(a), 98 Stat. 390, 390 (codified at 11 U.S.C. § 1113 (1988)). This is significant because the pension plan at issue was part of a collective bargaining contract and § 1113 governs the rejection of collective bargaining agreements in bankruptcy. *See* Raymond T. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 EMORY L.J. 1009, 1033 (1987). Second, an amendment to ERISA after the case was decided states that ERISA provides the "exclusive means" for termination of covered employee benefit plans. 29 U.S.C. § 1341(a)(1) (1988). The legislative history of this amendment indicates that Congress wished not to change existing law on whether an employer could reject a pension plan as an executory contract. *See* Mark Daniels, *Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies*, 9 HOFSTRA LAB. L.J. 25, 46 (1991). The termination rules of ERISA do, of course, provide for circumstances for plan termination in bankruptcy, indicating at a minimum that Congress "envisioned ERISA-regulated terminations of pension plans in bankruptcy." *Id.* Simply because Congress envisioned ERISA-regulated terminations in bankruptcy, however, does not necessarily mean that Congress thereby intended to preclude employers from using § 365 of the Bankruptcy Code to reject pension plans as executory contracts. *See id.* at 47.

30. Lockhart, *supra* note 3, at 195-96. James B. Lockhart, executive director of the PBGC, estimates 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." *Tighter Pension Insurance Rules Urged to Protect Benefits in Reorganizations*, 2 Bankr. L. Rep. (BNA) 328, 330 (Apr. 5, 1990). ERISA provides that the federal government is not liable for any of the PBGC's obligations. 29 U.S.C. § 1302(g)(2) (1988). The PBGC may, however, borrow up to $100 million from the U.S. Treasury. *See* 29 U.S.C. § 1305(c) (1988). Moreover, some of the PBGC's transactions are reflected in the federal budget. *See* § 1302(g)(2); *see also* CONGRESSIONAL BUDGET OFFICE, *supra* note 4, at 18 n.3 (discussing the financial relationship between the PBGC and the federal government).

31. *See* Ellin Rosenthal, *PBGC's Lockhart: We're No FSLIC*, 46 TAX NOTES 502, 502 (1990) (discussing the charge that the PBGC has been guilty of "shoddy enforcement" of its own rules).

Such practices have taken the form of poor monitoring, failure to perfect potential liens, too-liberal granting of minimum funding waivers, and tardiness in terminating underfunded plans. It is probably fair to say that in recent years, as its deficit problems have become more prominent, the PBGC has been much more aggressive in its monitoring role.

A second reason for the PBGC's current financial plight is a statutory scheme that gives too much discretion to employers to determine precisely what their minimum funding obligations will be in a given year. To determine whether employers are complying with minimum funding standards, a number of actuarial assumptions are necessary. Among the actuarial assumptions that affect the minimum funding figure are mortality, interest earned on plan assets, employee turnover, and salary projections.[32] Although these assumptions must be "reasonable,"[33] there is nevertheless a significant range within which employers can accommodate their own funding preferences.

A dramatic illustration of the significance of actuarial assumptions occurred when the pension plan of Allis-Chalmers's United Auto Workers terminated in July, 1985. That plan had a funding ratio that was less than two percent of vested benefits, yet the plan was never in violation of ERISA's minimum funding rules.[34] Further indicating the broad discretion left with plan sponsors, at least one study has indicated that firms tend to change their interest-rate assumptions for their pension plans in the year prior to termination as a way to avoid additional contributions.[35]

In addition to the flexibility of actuarial assumptions, firms may secure a minimum funding waiver for a given year. The IRS may grant such waivers if the plan sponsor can demonstrate that it is unable to meet the minimum funding standards because of a "temporary substantial business hardship."[36] The use of waivers has on occasion significantly increased the liability of the PBGC. For example, when Rath Packing terminated its pension plans in 1982, accumulated unpaid waivers totalled $29.5 million, about half of the plans' total unfunded liability at termination.[37] Rath had received waivers for the then-maxi-

32. *See* Durfee, *supra* note 10, at 45.
33. 26 U.S.C. § 412(c)(3)(A) (1988).
34. *See* IPPOLITO, *supra* note 4, at 39.
35. *See id.* at 120.
36. 26 U.S.C. § 412(d)(1) (1988).
37. *See* IPPOLITO, *supra* note 4, at 54.

mum five consecutive years.[38]

The third and easily most significant reason for the PBGC's current massive deficit has nothing to do with poor monitoring or with employer discretion regarding the size of annual minimum funding requirements. Rather, this crucial factor stems from the nature of the PBGC guarantee itself, as it was originally crafted in ERISA. Briefly stated, the biggest single cause of the PBGC's present financial crisis is the decision of Congress at the PBGC's inception to guarantee what is known as "past service liability."[39]

To understand the concept of past service liability, imagine a single hypothetical company that wishes to establish for its employees a qualified defined benefit pension plan covered by the PBGC insurance program. At the pension plan's creation, the employer has about a thousand employees whose service at that point ranges from one year to thirty years. To make the pension plan benefits significant for the most senior employees, the employer would like to credit those employees for past service.

The problem with such past service credit is that the employer thereby creates a huge funding liability immediately on the plan's creation. An employer forced to fund this liability at the plan's inception has a tremendous disincentive to create such a plan at all. Thus, ERISA allows the employer to treat this past service liability as if it were a thirty-year mortgage.[40] The annual payments due on this "mortgage" comprise the past service component of the pension plan.[41] The portion of the employer's minimum funding costs that relate to employee services rendered for the current year comprises the plan's normal costs.[42]

38. *Id.*

39. *See* 26 U.S.C. § 412(b)(2)(B)(ii) (1988) (providing that when a new plan is established, past service of employees may be credited and the liability amortized over 30 years); *see also* CONGRESSIONAL BUDGET OFFICE, *supra* note 4, at xv (noting proposals to reconsider whether the PBGC should insure pensions that have not been fully funded at least at some time in the past).

40. *See* 26 U.S.C. § 412(b)(2)(B)(ii) (1988).

41. *See* Derry D. Sparlin, Jr., *Minimum Funding Claims and Waivers, in* ABA FOURTH ANNUAL NATIONAL INSTITUTE ON EMPLOYEE BENEFITS IN BANKRUPTCY AND LENDING TRANSACTIONS 1, 2 (1991) (explaining the term "unfunded past service cost").

42. *See id.*; *see also* Priscilla E. Ryan, *ERISA Considerations for Commercial Lenders, in* 13 ALI-ABA RESOURCE MATERIALS: BANKING AND COMMERCIAL LENDING LAW 373, 376 (Richard T. Nassberg ed., 1992) (explaining ERISA funding requirements). The funding requirements for a plan in a given year may change based on plan experience affecting the assumptions

The crucial point for purposes of the PBGC's solvency is not simply that employers are given the right to pay past service costs over time, but rather that the PBGC insurance covers the employees' past service. The coverage for past service benefits is probably the main source of the PBGC's projected deficit.[43]

In light of this distinction between past service liability and normal cost, it is important to understand the difference between two types of pension plan underfunding: underfunding on a termination basis and underfunding on an ongoing basis. A firm may properly fund a plan on an ongoing basis but still severely underfund it on a termination basis.[44] TWA, for example, properly funded its pension plan on an ongoing basis, but nevertheless underfunded the plan on a termination basis by $900 million.[45]

For a plan to be properly funded on an ongoing basis means simply that the sponsor has made all statutorily required contributions and thus is on schedule to meet its ultimate obligations.[46] By contrast, for a plan to be properly funded on a termination basis, the sponsor must have fully paid for all of the past service liability that was amortized when the plan was originally established.[47] Because companies get thirty years from the time of plan establishment to amortize these past service costs, it will be rare for past service liability to be fully funded at the time of plan termination.

When examining the financial plight of the PBGC, a company's underfunding on a termination basis is probably more relevant than its underfunding on an ongoing basis. Clearly, it is necessary for the PBGC's continued solvency that plan sponsors make the statutorily required annual funding contributions. But such payments will almost never be sufficient, at least if the plan ends up terminating in the short term.

Thus, to determine the PBGC's potential exposure at any

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supporting past contribution levels. An example of this sort of plan experience would be how actual patterns of retirement have matched predicted patterns of retirement. Further, upward adjustments in the amount of required contributions for a given year may be based on plan amendments that include benefit increases for participants. *See* Sparlin, *supra* note 41, at 2.

43. *Cf.* CONGRESSIONAL BUDGET OFFICE, *supra* note 4, at xv (asserting that the government's own rules, rather than noncompliance by plan sponsors, are often the source of a plan's underfunding).

44. *Id.* at 15.

45. *See* Lockhart, *supra* note 3, at 197.

46. Keating, *supra* note 3, at 74 n.51.

47. *See* Lockhart, *supra* note 3, at 197.

given point requires a dual inquiry: first, valuing the aggregate underfunding of covered pension plans on a termination basis; and second, an estimate of plans currently at risk for termination. If a plan does not terminate and annual minimum funding contributions are made, the PBGC will have no exposure even though the plan is underfunded on a termination basis. In fact, most plans probably fit this description: currently underfunded on a termination basis, but nevertheless not a present threat to the PBGC's fisc.

Unfortunately for the PBGC, the minority of plans that are at risk for termination or do in fact terminate tend to have some of the largest underfunding on a termination basis. Of the fifty firms with the largest underfunded pension plans, forty percent of the companies and seventy-five percent of the underfunded amount are concentrated in the troubled steel, automobile and airline industries.[48] Furthermore, the PBGC estimates that over fifty percent of its top fifty underfunded plans are either probable or possible losses.[49]

II. PBGC-RELATED CLAIMS IN BANKRUPTCY

The issues of identifying and quantifying its claims in bankruptcy are matters of more than just passing fancy to the PBGC. First, a large number of PBGC-insured pension plan terminations occur during the bankruptcy of the plan sponsor.[50] Second, the valuation issue will often pit non-bankruptcy ERISA policies against the equality of distribution norm of bankruptcy in a battle that greatly affects the ultimate size of the PBGC claim.[51] In a number of large bankruptcies today, the PBGC's various claims make it the single largest creditor in the case, and its total exposure in some bankruptcies extends into the hundreds of millions of dollars.[52]

48. Ellin Rosenthal, *PBGC Releases 'Top 50' List*, 50 TAX NOTES 922, 923 (1991).

49. *Id.*

50. *See* Daniels, *supra* note 29, at 80; *see also* Robin E. Phelan & J. Mitchell Miller, *Will ERISA Erase Ya?*, *in* BANKRUPTCY DEVELOPMENTS FOR WORKOUT OFFICERS AND LENDERS COUNSEL 371, 408 (PLI Commercial Law & Practice Course Handbook Series No. 507, 1989) (discussing plan sponsor and control group liability to the PBGC).

51. *See* Daniels, *supra* note 29, at 31-32.

52. *See, e.g.*, *id.* at 81-82.

A. MINIMUM FUNDING AND PLAN ASSET INSUFFICIENCY CLAIMS

Ultimately, the PBGC has just two major claims against bankrupt sponsors of pension plans, and even these two claims overlap to some extent. The PBGC's most significant claim in bankruptcy will invariably be its so-called "plan asset insufficiency" claim. This claim arises on the termination of a covered pension plan, and it amounts to the difference between the value of the plan assets at the time of termination and the value of the plan's vested obligations to its participants.[53] This claim will typically be quite large because it will consist not simply of required contributions that the plan sponsor failed to make in the past, but also of all past service liability that ERISA allowed the plan sponsor to amortize at the plan's inception. Put another way, all of the past service liability payments that were to be due from the plan's sponsor in the future are automatically accelerated on plan termination.[54]

The PBGC's second major claim in bankruptcy is for unpaid funding contributions. This claim is typically just a subset of the first claim. On termination of an ERISA-qualified pension plan, the PBGC is usually appointed statutory trustee of the terminated plan.[55] As trustee, the PBGC may assert a claim for any accrued but unpaid minimum funding contributions.[56] This second claim, therefore, relates to the sponsor's failure to fund the plan on an ongoing basis, whereas the first claim represents underfunding on a termination basis.

Note that the amount of the plan asset insufficiency claim should include the amount of missed funding contributions. If a plan sponsor has been delinquent in its required annual funding contributions, the amount of the plan asset insufficiency claim will already reflect that delinquency. A failure to fund on an ongoing basis causes a corresponding reduction in the amount of plan assets available at the time of termination, making the plan asset insufficiency claim that much greater. Although the PBGC will file claims for both amounts, courts have held that to the extent the PBGC's claims for unpaid

53. 29 U.S.C. § 1362(b) (1988).

54. *See id.*

55. *See* Michael A. Lawson, *Employee Benefits and Reorganization Under Chapter 11: Is Shareholder Value Being Eroded? (PBGC Claims, Retiree Benefits)*, *in* 18TH ANNUAL EMPLOYEE BENEFITS INSTITUTE 165, 170 (PLI Tax Law & Practice Course Handbook Series No. 280, 1988).

56. *See* 29 U.S.C. § 1362(c) (1988).

funding contributions are allowed, its claims for plan asset insufficiency must be appropriately reduced as duplicative.[57]

B. Liability of Controlled Group Members

The PBGC's two major claims—for unpaid minimum funding contributions and plan asset insufficiency—are not merely the responsibility of the plan's sponsor. Rather, the plan sponsor and the plan sponsor's "controlled group" are jointly and severally liable for these claims.[58] The term "controlled group" in this context generally includes all entities with at least an eighty-percent ownership interest in the employer and all entities in which the employer owns at least an eighty-percent interest.[59] In some cases, such as *Pension Benefit Guaranty Corp. v. LTV*,[60] the existence of these additional debtors is not especially helpful to the PBGC, because the entire controlled group is in bankruptcy.

There may also be situations in which the liability of other controlled group members who are not in bankruptcy will give the PBGC leverage with respect to its position in the plan sponsor's bankruptcy. The Eastern Airlines bankruptcy is a case in point. In that situation, Eastern's controlled group consisted of its parent, Continental Airlines Holdings, Inc. and other affiliates, some of which were solvent at the time Eastern filed.[61] Due in large part to the PBGC's rights against non-bankrupt controlled group members, the PBGC effected a bankruptcy court-approved settlement with Eastern that proved quite attractive to the federal corporation.[62]

The Eastern settlement provided for the termination of its pension plans and the establishment of a trust to be funded by the assets of Eastern's terminated plans.[63] In addition, the trust was to be funded by $30 million from Eastern and payment by the Continental controlled group for underfunding liability over a period not to exceed twelve years.[64] Two months

57. *See, e.g.*, LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 130 B.R. 690, 698 (S.D.N.Y. 1991).

58. *See* 29 U.S.C. § 1362(b), (c) (1988).

59. Ryan, *supra* note 42, at 377.

60. 875 F.2d 1008, 1011-12 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990).

61. *See* Karen E. Wagner, *Employee Benefit Claims in Bankruptcy*, *in* ALI-ABA Course of Study: Employee Benefits Litigation 381, 415-16 (1991).

62. *See id.*

63. *Id.* at 416.

64. *Id.*

following bankruptcy court approval of the Eastern settlement, however, Continental filed its own Chapter 11 bankruptcy, putting in doubt the settlement agreement.[65]

C. LESS COMMON PBGC CLAIMS

There are two other, less common types of claims that the PBGC may be able to assert in bankruptcy, depending on the facts of the case. First, the PBGC, either in its own right or in its capacity as trustee of a terminated plan, may be able to exercise common law contract rights.[66] Such contract claims could give the PBGC rights that go beyond its major statutory claims. For example, the plan might include promissory notes on which the plan sponsor is maker. Or a predecessor company may have sold a division of the firm with a specific promise to continue funding the pension plan of the unit that was sold.

The second of these less typical sorts of claims is a claim for predecessor liability. Not uncommonly, a financially troubled company will sell a subsidiary or division and transfer that subsidiary's pension liabilities to its new owner. In the Single-Employer Pension Plan Amendments Act (SEPPAA),[67] Congress provided that if a principal goal of a transaction is to evade pension liability, then any person involved in that transaction who also shares that purpose can be held liable as if that person were the contributing employer.[68] Thus, the PBGC might be able to assert a claim in the bankruptcy of a company that sold a division in an attempt to rid itself of liability for the sold unit's pension plan. This evasion liability applies as well to any members of the evading person's controlled group.[69] For an evasion of liability claim to arise, an underfunded plan must terminate within five years of the evasive transaction.[70]

SEPPAA by its terms applies evasion liability exclusively to transactions occurring after January 1, 1986.[71] At least one court has recognized, however, a common-law evasion liability

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65. *Id.*

66. *See generally* Carol C. Flowe & William Beyer, *PBGC Bankruptcy Claims, in* ABA FOURTH ANNUAL NATIONAL INSTITUTE ON EMPLOYEE BENEFITS IN BANKRUPTCY AND LENDING TRANSACTIONS, *supra* note 41, at 11 (describing various circumstances in which the PBGC would have contract rights giving rise to additional bankruptcy claims).

67. Pub. L. No. 99-272, 100 Stat. 237 (1986) (codified in scattered sections of 26 and 29 U.S.C.).

68. 29 U.S.C. § 1369(a) (1988).

69. *Id.*

70. *Id.*

71. *See* § 11,013(b), 100 Stat. at 261.

similar to that in SEPPAA for transactions prior to 1986. In *In re International Harvester's Disposition of Wisconsin Steel*,[72] the District Court for the Northern District of Illinois held that an employer that sold a business prior to 1986 and delegated its pension obligations as part of that transaction may nevertheless be liable for the plan's underfunding. The court found that a pension plan's former contributing sponsor remains liable if two conditions exist: first, if a principal purpose of the sale is to evade pension liability, and second, if the division's buyer lacks an objectively reasonable chance of meeting those pension obligations at the time of sale.[73]

Of course, the mere fact that predecessor liability now exists does not mean that courts will readily apply it. In *In re Doskocil Cos.*,[74] for example, the bankruptcy court refused to allow the PBGC's claim for predecessor liability. The debtor's predecessor sold the assets of two meat processing operations that eventually went bankrupt.[75] Each of the two operations had pension plans that ultimately terminated with significant underfunding.[76] The sales of the two meat processing operations took effect prior to SEPPAA's enactment.[77]

The PBGC claimed evasion liability against the debtor based on two theories. First, the PBGC asserted a common-law theory of evasion, pointing to the *International Harvester* case.[78] Second, the PBGC contended that certain continued dealings between the debtor and the purchasers occurring after 1986 could constitute the necessary "transactions to evade" that are required for SEPPAA evasion liability.[79]

Rejecting the PBGC's first argument, the court questioned the viability of the *International Harvester* doctrine of common-law evasion liability as applied to pre-1986 sales.[80] It determined that the legislative history of the SEPPAA suggested that it was unlikely that Congress intended the statute to impose evasion liability prior to its effective date.[81] Furthermore, the court found, even if *Harvester* were correct, the PBGC in

72. 681 F. Supp. 512 (N.D. Ill. 1988).
73. *Id.* at 525-26.
74. 130 B.R. 858 (Bankr. D. Kan. 1991).
75. *See id.* at 860.
76. The plans were underfunded by $38 million and $25 million, respectively. *Id.* at 861.
77. *See id.* at 860.
78. *Id.* at 864-65.
79. *Id.* at 868.
80. *See id.* at 866.
81. *Id.*

this case failed to produce facts showing either a subjective intent on the debtor's part to evade pension liability or an objective inability of the buyer to meet its pension obligations.[82]

Regarding the PBGC's claim for SEPPAA evasion liability, the court held that the statute only applies to certain types of post-1985 transactions. Specifically, the court held that the "transactions to evade liability" the SEPPAA contemplates must amount to actual transfers of responsibility for meeting the funding requirements of ERISA.[83] Such transfers in this case occurred prior to 1986.[84] Furthermore, the court noted, to adopt the broad definition of transaction the PBGC sought would render the five-year limitation on evasion liability contained in SEPPAA virtually meaningless.[85] The court explained that many business sales of the type at issue in this case involve extensions or renewals of credit from the seller to the buyer, just as occurred here.[86]

D. Valuation and Interest Rate Assumptions

A most difficult issue for courts when the PBGC is involved in a bankruptcy is determining the precise amount of the PBGC's claim. Valuing the PBGC's claim is most problematic when the PBGC seeks recovery for plan asset insufficiency. That amount, as discussed above, is the difference between the value of the assets in the terminated plan and the total present value of vested plan benefits at the termination date.[87]

Determining the value of the assets in the terminated plan is typically not a problem. The amount in the plan account at the time of termination is readily determinable. Quantifying the present value of vested plan benefits, however, is a different matter. As one court facing this issue candidly observed, " '[T]he truth is that the amount of the ultimate pension liability is unknown and unknowable. How can you know how long your employees will live, or whether they will quit before retirement time, or how much medical costs will go up over the next 50 years?' "[88]

The truth is, you cannot. But a bankruptcy court still must

82. *Id.* at 867-68.
83. *Id.* at 868.
84. *Id.*
85. *Id.* at 868-69.
86. *Id.* at 869.
87. *See supra* note 53 and accompanying text.
88. LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 126 B.R. 165, 167 n.4 (Bankr. S.D.N.Y. 1991) (quoting Richard C. Breeden,

try. Regarding questions such as employee life span, early retirement patterns, and future medical costs, courts must rely on actuarial assumptions. On this score, the PBGC clearly has expertise, and courts have shown a willingness to defer somewhat to the PBGC experience in this realm.[89]

Plugging in assumptions for all of these unknowable questions is, however, only half the battle. The issue of determining a discount rate remains. A discount rate is necessary in bankruptcy in any case in which a party's claim is to a future payment or stream of payments. Suppose, for example, that a debtor purchased a machine from a seller on unsecured credit and promised to pay the seller $2000 in cash two years from the date of sale. If the debtor filed bankruptcy the very next day, the seller clearly has a claim in bankruptcy. That claim, however, would not be for $2000. Rather, the amount of the seller's claim in bankruptcy would be the present value of a $2000 promise that came due two years in the future.[90]

How should the exact amount of the seller's claim be determined? Certainly the claim will be for less than $2000, because receiving $2000 today is clearly worth more than even a 100% reliable promise to receive $2000 in two years' time. To calculate how much less that $2000 payable in two years is worth today, a discount rate is necessary. The discount rate is a surrogate for the time value of money. It represents the return that could be received on money between now and the time a debtor's payment is due.[91]

The actuarial assumptions that were mentioned above in the PBGC context do not speak to the issue of discount rate. Rather, those assumptions simply enable a court to calculate the amount and length of the stream of payments that represents the promise of the terminated pension plan. Once that

Chairman, Securities & Exchange Commission, *quoted in* Dana W. Linden, *If Life Is Volatile, Account for It*, FORBES, Nov. 12, 1990, at 120, 121).

89. *See, e.g.*, LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 769-70 (Bankr. S.D.N.Y. 1990) (noting that the PBGC's expertise is valuable where issues such as actuarial considerations in determining the face amount of aggregate future liabilities of a terminated plan arise).

90. The Bankruptcy Code makes it clear that claims are to be valued as of the date of the bankruptcy filing. Section 502(b) of the Bankruptcy Code provides that the bankruptcy court shall determine the amount of each claim "as of the date of the filing of the petition." 11 U.S.C. § 502(b) (1988).

91. *See generally* ROBERT W. HAMILTON, FUNDAMENTALS OF MODERN BUSINESS 29-44 (1989) (explaining the concept of the present value of a stream of future payments).

stream of payments is quantified, a court still must discount it to its present value to determine the PBGC's claim.

In a large case, the choice of a discount rate for the PBGC's claims has major implications. In the *LTV* case, for example, each single percentage point difference in the chosen discount rate would affect the PBGC's claim by $250 million.[92] The lower the discount rate, the higher would be the present value of any claim for a future payment from the debtor. To no one's surprise, the PBGC argued for a low discount rate in the *LTV* case, whereas the debtor argued for a higher rate.[93]

The PBGC's chief argument for the lower rate was that ERISA charges the PBGC with determining the present value of all future plan benefits when a plan is terminated.[94] The court in *LTV*, however, concluded that when it comes to the valuation of claims in bankruptcy, it must subordinate ERISA policies to bankruptcy policies.[95] Such bankruptcy policies, according to the court, require interest rate assumptions that are likely to yield the claim's full economic value.[96] Further, the court observed that a party asserting a claim against the estate should not have such broad discretion to affect the return on its claim.[97]

The guiding principle for choosing a discount rate in this context, the *LTV* court held, is the rate of return available to a reasonable, prudent private pension fund investor.[98] Such a hypothetical investor is assumed to invest in a prudent portfolio with the guiding objective of earning the highest return on the invested capital consistent with the preservation of the capital and minimization of risk.[99] Applying this model in the *LTV*

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92. *See Chateaugay*, 115 B.R. at 771.

93. *See* LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 126 B.R. 165, 171 (Bankr. S.D.N.Y. 1991).

94. *See id.* at 172.

95. *See id.* at 170, 172.

96. *See id.* at 176. This second *Chateaugay* bankruptcy court opinion dealing with valuation was issued pursuant to a referral by the district court to the bankruptcy court for findings of fact and conclusions of law on the valuation issue. The district court made this referral pursuant to 28 U.S.C. § 157(c)(1) (1988) after it had agreed to the PBGC's request for a withdrawal of reference of this matter from the bankruptcy court. *See* Pension Benefit Guar. Corp. v. Official Parent Creditors' Comm. of LTV Corp. (*In re* Chateaugay Corp.), 108 B.R. 27, 29 (S.D.N.Y. 1989).

97. *See Chateaugay*, 126 B.R. at 172 (explaining that "it is the Bankruptcy Court, not the claiming creditor, which makes the determination as to the appropriate discount rate").

98. *Id.* at 177.

99. *See id.*

case, the court chose a discount rate of 11.5%, four percentage points higher than the risk-free rate the PBGC proposed.[100]

E. Allowability of Direct Claims by Plan Participants

When an employer sets up a defined benefit pension plan, its obligation in most instances is simply to fund the pension plan rather than to pay the benefits owed under the plan.[101] An employer nevertheless may, either in the pension plan or outside of the plan, guarantee the payment of pension benefits if the plan assets on termination are insufficient to cover such benefits.[102] In cases involving such a separate promise, courts have historically upheld the right of plan beneficiaries to recover from their plan sponsor the difference between the benefits promised in the plan and those the PBGC guaranteed.[103]

The cases that have upheld such a contract right on the part of plan beneficiaries were decided, however, prior to the

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100. *See id.* at 172. The second *Chateaugay* bankruptcy court was actually faced with choosing among five different discount rates: a PBGC-calculated rate that used the agency's interpretation of statutory law and regulations; a second PBGC-suggested rate based on the rate a private insurer would charge the terminating company for guaranteed annuity contracts that covered the company's vested pension liabilities; a third PBGC rate which purported to be a pure present-value approach that used a risk-free discount rate; a rate proposed by LTV that was risk-adjusted and employed a company-specific risk of default (thus increasing the rate significantly from a risk-free rate); and the rate that the committee of unsecured creditors of LTV Steel proposed and the court ultimately chose, a pension fund portfolio theory that used a risk-adjusted discount rate. *See id.*

101. *See* Cummings, *supra* note 1, at 1808.

102. *See* David G. Heiman, *Executory Contracts, Employee Relations and Pension Claims, Interim Distributions and Acquisitions of Interests in Chapter 11 Cases, in* CHAPTER 11 BUSINESS REORGANIZATIONS 247, 414 (PLI Commercial Law & Practice Course Handbook Series No. 598, 1992).

103. *See, e.g.,* Murphy v. Heppenstall Co., 635 F.2d 233, 234 (3d Cir. 1980) (upholding the right of employees under a collectively bargained pension plan to recover from the employer the difference between benefits the plan promised and those that the PBGC guaranteed), *cert. denied,* 454 U.S. 1142 (1982); *see also In re* M & M Transp. Co., 3 B.R. 722, 724-25 (S.D.N.Y. 1980) (holding that an employer may be liable to former employees for benefits due under a terminated plan even though the employer met its obligations to the PBGC under ERISA). *But see In re* Johnson Steel & Wire Co., 61 B.R. 203, 206-07 (Bankr. D. Mass. 1986) (refusing to allow claim of employees for the difference between what was originally promised under a pension plan and the amount that the PBGC actually paid on termination because the company had carefully limited its direct liability to employees in case of plan termination and because employees' failure to familiarize themselves with pension plan and trust documents did not render the plan provisions non-binding).

enactment of the Pension Protection Act (PPA) in 1987.[104] The PPA contains a key amendment to ERISA that gives the PBGC a claim against the contributing sponsor for 100% of all vested benefits at the time of termination.[105] By contrast, when these earlier cases were decided, the PBGC's claim against the terminating employer was merely for a percentage of the benefits the PBGC guaranteed.[106] Furthermore, ERISA now provides that the PBGC must distribute to plan beneficiaries any amounts that it recovers from the terminating sponsor that are in excess of the guaranteed benefits that the PBGC must ultimately pay.[107]

In light of these significant changes in the statutory recovery scheme, it is not surprising that the bankruptcy court in *In re Adams Hard Facing Co.*,[108] a 1991 case, reached a result different from the earlier cases treating this issue. In *Adams Hard Facing*, the court refused to allow the direct claims of plan participants against the debtor for pension plan entitlements not guaranteed by the PBGC.[109] In reaching its decision, the court cited specifically the PPA amendment creating the PBGC's increased recovery claim against terminating employers.[110] The court also held that allowing these direct participant claims would defeat the purpose of the ERISA section that allocates non-guaranteed benefit amounts among plan participants according to the priorities set out in ERISA.[111]

F. Contributions During Bankruptcy to Ongoing Plans

Not every pension plan terminates when a company files Chapter 11 bankruptcy. In those cases where the debtor's pension plan continues, courts must decide whether the debtor may continue to make its regular annual funding contributions

104. Pub. L. No. 100-203, 101 Stat. 1330-333 (1987) (codified as amended in scattered sections of 26 and 29 U.S.C.).

105. *See id.* § 9312(b)(2)(A), 101 Stat. at 1330-361 (codified as amended at 29 U.S.C. § 1362(b)(1)(A) (1988)).

106. *See* 29 U.S.C. § 1362(b) (1982), *amended by* 29 U.S.C. § 1362(b) (1988).

107. *See* Wagner, *supra* note 61, at 412-13. Section 9312(a) of the Pension Protection Act repealed the former ERISA § 4049 trust and § 9312(b)(3) added 29 U.S.C. § 1322(c)(1) (1988), which provides that if on collection of its claim for the full amount of unfunded benefits the PBGC collects more than its own reimbursement claim, the PBGC must distribute the excess to the beneficiaries of the terminated plan. *See* § 9312(a), (b)(3), 101 Stat. at 1330-361.

108. 129 B.R. 662 (W.D. Okla. 1991).

109. *See id.* at 663.

110. *See id.*

111. *Id.*

to the plan. Although this question is not wholly settled, the argument seems stronger that courts should allow continued funding contributions by the debtor.

Such payments are probably proper for a number of reasons. First, plan participants can contend that contributions to pension plans are analogous to post-petition wages and thus should be paid currently as a cost of administration.[112] Second, SEPPAA establishes new standards for termination that suggest that Congress intended that payments to ongoing plans continue in Chapter 11 bankruptcy cases. These new standards forbid a company in Chapter 11 from voluntarily terminating a pension plan unless the bankruptcy court decides that the company could not survive outside of bankruptcy absent a termination of the plan.[113] Congress apparently intended that pension plans continue in effect during and "ride through" the bankruptcy reorganization whenever possible.

The argument against continued funding of an ongoing pension plan in Chapter 11 is that such contributions in fact represent payment for previously performed work.[114] As such, the contributions constitute impermissible payments to pre-petition creditors.[115] Unfortunately, assessing the validity of this assertion is complicated by the typical allocation of any plan year's funding contributions between normal cost and past service cost.

As noted earlier, normal cost represents the present value

112. *See* Columbia Packing Co. v. Pension Benefit Guar. Corp., 81 B.R. 205, 208 (D. Mass. 1988); *see also In re* Pacific Far E. Line, Inc., 713 F.2d 476, 480 (9th Cir. 1983) (holding that pre-petition settlement by debtor with maritime association's pension plan was properly permitted in full as an administrative expense). Section 363(c)(1) of the Bankruptcy Code arguably gives a statutory justification for such payments by allowing the debtor in Chapter 11 to use property of the estate "in the ordinary course of business" without notice or a hearing. 11 U.S.C. § 363(c)(1) (1988 & Supp. III 1991). Further, § 363(b)(1) allows the Chapter 11 debtor to use property outside of the ordinary course of business following notice and a hearing.

113. *See* 29 U.S.C. § 1341(c)(2)(B) (1988).

114. *Cf.* Pension Benefit Guar. Corp. v. LTV Corp., 875 F.2d 1008, 1019 (2d Cir. 1989) (noting that employees of LTV gave their pre-petition labor partly in consideration for the company's pension promises, thus causing "any obligation to pay into the pension fund plans [to be] pre-petition debts"), *rev'd on other grounds*, 496 U.S. 633 (1990).

115. Section 549 of the Bankruptcy Code allows the trustee to avoid any transfer of property of the estate that occurs post-petition and is not otherwise authorized by the Bankruptcy Code or by the court. *See* 11 U.S.C. § 549(a) (1988 & Supp. III 1991). Thus, contributions to pension plans that the debtor made post-petition would be potentially avoidable under § 549 absent a proper Bankruptcy Code justification or specific authorization by the court.

of plan benefits that workers accrue for work performed during that year.[116] Past service cost, however, technically stems from services plan participants rendered prior to the effective date of the plan's establishment.[117] Thus, one could argue that the portion of the sponsor's annual contribution attributable to the plan's normal cost should be an allowable expense of the debtor's administration, whereas the typically larger portion for past service cost may not serve as the basis of a permissible post-petition payment by the debtor.

The notion of bifurcating the expenses of a pension plan between normal cost and past service cost is relevant in other contexts as well. For example, in considering the priority of the PBGC's claims in bankruptcy, some courts have chosen to grant a special status only to the portion of a plan's unfunded liability that represents normal cost.[118]

The realities of the situation, however, make such a differential treatment of normal cost as compared with past service cost seem artificial. Pension promises are, after all, nothing more than a form of deferred compensation. The "quid pro quo" between employee and employer in this regard is essentially that the employee agrees to work in a given year and the employer agrees in return to make the proper minimum funding contribution for that year. Simply because the amount of any year's pension funding requirement includes a component known as "past service cost" does not change the fact that the entire payment is compensation for the work of employees in that calendar year.

Although past service cost is calculated with reference to the number of years of past service, such an expense is in no sense compensation for those past years' labor. Remember that during those previous years, the employer had no defined pension plan in place. The compensation for work done during that earlier period was whatever salary and non-pension fringe benefits the employer was offering at the time. In short, as one court astutely observed, the past service cost component of a pension plan's funding requirements should be considered merely an actuarial unit of measure rather than true compensa-

116. *See supra* text accompanying notes 40-42.

117. *See* Sparlin, *supra* note 41, at 2.

118. *See, e.g.*, LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 776-78 (Bankr. S.D.N.Y. 1990) (denying administrative priority status to PBGC claims except for a small portion attributable to post-petition service of the debtor's employees).

tion for work performed at an earlier time.[119]

III. PBGC LIENS AND NON-LIEN BANKRUPTCY PRIORITIES

The reality of most corporate bankruptcies is that those at the back of the creditor line are not likely to recover on their claims. Thus, a creditor's ability to assert successfully some special status for a claim becomes crucial. Such status may take the form of a valid and unavoidable lien or it may involve qualifying for one of the Bankruptcy Code's priority classes. The priority or lien position that the PBGC seeks for its claims in bankruptcy will often make the difference between significant recoveries for the federal pension insurer or bare minimal return. It is hardly surprising, then, that the PBGC has invested much of its political effort in the last couple of years to improving through legislation what it sees as its less-than-adequate status as a claimant in bankruptcy cases.[120]

A. Types of Liens

The PBGC has some chance of asserting three major types of liens in the bankruptcy of a plan sponsor. Two of these three liens correspond to the two major claims that the PBGC will normally have against a terminating employer, those for plan asset insufficiency and delinquent minimum funding contributions.[121] The PBGC lien with the greatest potential significance is that which corresponds to the PBGC's claim for plan asset insufficiency.

The plan asset insufficiency lien arises only after demand by the PBGC.[122] Further, this lien must be perfected in the same manner as a tax lien in order for it to be effective against later judgment or secured creditors as well as against the

119. *See* Columbia Packing Co. v. Pension Benefit Guar. Corp., 81 B.R. 205, 209 (D. Mass. 1988).

120. *See* Rosenthal, *OMB Proposal*, *supra* note 2, at 1081 (noting legislative proposals for the PBGC that include improving its position in bankruptcy); *see also Chandler Introduces Administration-Supported Pension Protection Legislation*, 20 TAX MGMT. COMPENSATION PLAN. J. 48, 48 (1992) [hereinafter *Pension Protection Legislation*] (describing proposed legislation that would give the "PBGC higher priority in bankruptcy proceedings, as well as a greater role in managing these proceedings").

121. *See* 29 U.S.C. § 1362(b) (plan asset insufficiency), (c) (delinquent funding contributions) (1988).

122. *See* 29 U.S.C. § 1368(a) (1988).

trustee in bankruptcy.[123] The amount of the lien is the lesser of either the PBGC's total plan asset insufficiency claim or thirty percent of the aggregate net worth of the contributing sponsor's controlled group.[124]

The second major type of lien that the PBGC might assert in bankruptcy cases actually takes two forms. This lien stems from the plan sponsor's failure to make required funding contributions. The first form that this lien takes is identical to the lien described above for plan asset insufficiency, and, indeed finds its source in the same ERISA section.[125] This lien arises only after demand by the PBGC, must ultimately be perfected by the PBGC, and has the above-described thirty-percent net worth limitation.[126]

The PPA created the second form of the delinquent funding contribution lien. This form, unlike the first, arises automatically against a plan sponsor on the sixtieth day after a missed contribution installment was due.[127] Its limitation is that it applies only to the extent that missed contributions exceed $1 million in the aggregate.[128] Although this second lien form arises without the need for a formal demand, it must also be perfected like a tax lien for it to be effective against certain other parties.[129]

The third major type of PBGC lien relates to the IRS's granting of a minimum funding waiver. Congress gave the IRS the specific authority to require collateral from a plan sponsor as a condition to granting a minimum funding waiver for a particular year.[130] The lien that arises as a result is not subject to the usual tax perfection requirements and only the PBGC may enforce it.[131]

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123. *See* 29 U.S.C. § 1368(c)(4) (1988). The tax lien procedure is set forth at 26 U.S.C. § 6323(f) (1988). The trustee is given the power through Bankruptcy Code § 544(a) to avoid any liens that are unperfected at the point of the bankruptcy filing. *See* 11 U.S.C. § 544(a) (1988).

124. 29 U.S.C. § 1368(a) (1988); *see also* Flowe & Beyer, *supra* note 66, at 7 (explaining ERISA employer liability provisions).

125. *See* 29 U.S.C. § 1368(a) (1988).

126. *See id.*; *see also* Sparlin, *supra* note 41, at 13 (describing the effect of § 1368(a) on the PBGC's claims for plan asset insufficiency).

127. *See* 29 U.S.C. § 1082(f) (1988).

128. *See id.*

129. *See* 29 U.S.C. § 1082(f)(4)(C) (1988).

130. *See* 29 U.S.C. § 1085a(a)(2) (1988).

131. *See id.* There are two other less common sources of collateral from which the PBGC might benefit. First, the IRS may levy an excise tax and, eventually, create a lien against the assets of an underfunded plan's sponsor. A 10% excise tax is imposed automatically if a funding deficiency has accumu-

B. WHY PBGC LIENS OFTEN FAIL TO WORK IN BANKRUPTCY

A number of Bankruptcy Code provisions hinder the effective use of the PBGC's liens in the bankruptcy of a plan sponsor. The first and most prominent of these Code provisions is section 362, the automatic stay, which is discussed in Part IV below. Essentially, the automatic stay prevents the PBGC from taking the actions necessary to perfect its liens post-petition, even where the liens arise or attach prior to bankruptcy. The problem is particularly severe in practice because by the time the PBGC recognizes the need for collateral, the terminating company is typically already in bankruptcy.[132] Moreover, even if the automatic stay did not prevent the lien's formation post-petition, section 545 of the Bankruptcy Code would by itself avoid the fixing of a statutory lien such as the PBGC's on property of the debtor if the lien were unperfected at the point of the bankruptcy filing.[133]

A further obstacle to the effective use of PBGC liens in bankruptcy cases is found in Bankruptcy Code section 724. Section 724 provides that in a Chapter 7 bankruptcy, tax liens and certain tax lien equivalents such as the PBGC's liens are denied secured status in a bankruptcy liquidation even if they were perfected pre-petition.[134] Instead, the claims underlying these perfected pre-petition liens must settle for seventh-priority status as tax claims.[135]

The Bankruptcy Code does include one provision found within section 547's preference rules that actually aids the

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lated. *See* 26 U.S.C. § 4971(a) (1988). An additional tax of 100% of the accumulated funding deficiency is imposed if the shortfall is not eliminated after notice from the IRS. *See* § 4971(a), (b), (d). The IRS can create a lien on the employer's property if the employer fails to pay the excise tax after a demand by the IRS. *See* 26 U.S.C. §§ 6321, 6323, 6325 (1988). Second, the PPA created a new rule in which the PBGC can demand security if a benefit increase will bring the ratio of a plan's assets to current liabilities under 60%. *See* 26 U.S.C. § 401(a)(29) (1988). The plan loses its qualification if the security is not provided. *See id.*

132. *See* Edward R. Mackiewicz & Paul A. Green, *Pension-Related Claims in Bankruptcy*, PENSION BRIEFINGS, July 1987, *reprinted in* PENSION AND WELFARE BENEFITS IN BANKRUPTCY, *supra* note 10, at 421, 435; *see also* McCulloch et al., *supra* note 11, at 225 (discussing priorities and liens creditors assert against firms in bankruptcy).

133. Bankruptcy Code § 545(2) provides that a trustee may avoid the fixing of a statutory lien on the debtor's property if the lien "is not perfected or enforceable at the time of the commencement of the case" against a hypothetical bona fide purchaser for value. 11 U.S.C. § 545(2) (1988 & Supp. III 1991).

134. *See* 11 U.S.C. § 724(b), (d) (1988 & Supp. III 1991).

135. *See* 11 U.S.C. § 724(b)(2), (b)(3) (1988 & Supp. III 1991).

PBGC's lien status. Normally, if perfected less than simultaneously with its attachment and within ninety days of a bankruptcy filing, the lien is avoidable as a preference.[136] Section 547(c)(6) of the Bankruptcy Code creates an exception to preference liability for any statutory liens not avoidable under section 545.[137] If a statutory lien such as the PBGC's is perfected pre-petition, even if only within ninety days of bankruptcy, it nevertheless survives scrutiny under section 545 and thus qualifies for section 547(c)(6) protection.[138]

C. THE SECTION 507(a)(7) PRIORITY

The PBGC must perfect its two major liens, for plan asset insufficiency and for missed funding requirements, in the same manner as tax liens.[139] The PBGC has seized on this language in ERISA to argue that the claims underlying these liens are entitled to priority status even in cases where it did not perfect the liens themselves in time to be effective in bankruptcy.[140]

Section 507 of the Bankruptcy Code creates various categories of priority claims. Section 507(a)(7) gives a seventh priority to certain tax claims.[141] The PBGC contended in the *LTV* case that although it failed to perfect its lien, it should be treated in bankruptcy at least no worse than a federal taxing authority, and thus should benefit from the seventh-priority position that the IRS enjoys.[142] The district court disagreed with this contention, however, and held that the PBGC should be treated like any other unsecured creditor.[143]

The court reasoned that just because the PBGC is entitled to create a lien that is tantamount to a federal tax lien, the underlying claim itself should not necessarily be given tax priority

136. *See* 11 U.S.C. § 547(b) (1988 & Supp. III 1991). If perfection takes place within 10 days of attachment, however, the lien will not be avoidable as a preference even if perfection took place within the 90 days before filing. *See* § 547(e)(2) (creating a 10-day grace period between attachment and perfection for purposes of preference law).

137. *See* 11 U.S.C. § 547(c)(6) (1988).

138. *See id.*

139. *See* 29 U.S.C. §§ 1082(f)(4)(C) (1988), 1368(c)(2) (Supp. II 1990).

140. *See, e.g.*, LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 779-80 (Bankr. S.D.N.Y. 1990).

141. *See* 11 U.S.C. § 507(a)(7) (1988).

142. *See* LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 130 B.R. 690, 697 (S.D.N.Y. 1991).

143. *See id.*; *see also In re* Divco Philadelphia Sales Corp., 64 B.R. 232, 234 (Bankr. E.D. Pa. 1986) (finding that although "an ERISA lien for employer liability is to be treated as a tax lien for purposes of priority, § 1368 does not state that the underlying ERISA liability is tax liability").

status.[144] The court noted also that the legislative history to section 724 of the Bankruptcy Code specifically mentions ERISA claims, but that the list of taxes in section 507(a)(7) fails to do so.[145] Thus, the court concluded, any potential tax-related priority owned by the PBGC may occur only in a Chapter 7 case, pursuant to the terms of section 724.[146]

D. THE SECTION 503(b)(1)/SECTION 507(a)(1) PRIORITY

Section 507(a)(1) of the Bankruptcy Code gives a first unsecured priority to any administrative expenses allowed under section 503(b).[147] Section 503(b)(1)(a) includes within the list of allowable administrative expenses "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case."[148]

Seizing on this language, the PBGC has argued for an administrative expense priority status for its claims.[149] The PBGC contends that both the debtor's unpaid funding obligations and its termination liability are actual and necessary costs of preserving the debtor's bankruptcy estate.[150] In particular, the PBGC has strenuously contended that as long as the termination of a pension plan takes place post-petition, then all of the termination liability arising at that point must be considered a priority expense of administration.[151]

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144. *See Chateaugay*, 130 B.R. at 697.

145. *Id.*

146. *See id.* In Pension Benefit Guar. Corp. v. Washington Group, 8 Employee Benefits Cas. (BNA) 1351, 1358 (M.D.N.C. 1987), the court held that the PBGC's failure to perfect a lien pre-bankruptcy did not prevent its enforcement post-bankruptcy. The court reasoned that ERISA's mandated priority for that lien, if the PBGC's claim were to lack any priority, would defeat the congressional purpose of protecting vested employee benefits. *Id.* In LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 782 (Bankr. S.D.N.Y. 1990), the bankruptcy court rejected the *Washington Group* case as failing to distinguish a claim and a lien. The *Chateaugay* court further criticized *Washington Group* by noting that although the claim arose under Chapter X of the Bankruptcy Act, the court failed to notice that the debtor raised arguments under the Bankruptcy Code. *Id.*; *cf.* Pension Benefit Guar. Corp. v. Ouimet Corp., 470 F. Supp. 945, 953 n.19 (D. Mass. 1979) (dictum) (suggesting in Bankruptcy Act case that an unperfected PBGC lien would at least get tax priority under the Bankruptcy Code), *aff'd*, 630 F.2d 4 (1st Cir. 1980), *cert. denied*, 450 U.S. 914 (1981).

147. *See* 11 U.S.C. § 507(a)(1) (1988).

148. 11 U.S.C. § 503(b)(1)(A) (1988).

149. *See, e.g., Chateaugay*, 115 B.R. at 765.

150. *Id.* at 775.

151. *Id.* at 772-73.

The PBGC put forth this argument in *LTV*, but went little further than its similar contention for section 507(a)(7) status. On appeal, the district court agreed with the bankruptcy court's denial of the PBGC's claim for section 507(a)(1) status.[152] The bankruptcy court analyzed the PBGC claim for administrative expense status in light of a two-part test for allowance under the rubric of section 503(b)(1). First, the obligation in question must arise from a transaction with the post-petition, rather than the pre-petition, debtor, and second, the obligation for which administrative expense status is sought must have directly benefited the estate.[153]

Applying this test, the bankruptcy court determined that the obligation of LTV to the PBGC on plan termination was really of a pre-petition rather than a post-petition nature. Even though the technical "breach" in this case occurred post-petition on plan termination, the true triggering event for the debtor's liability was the pre-petition labor of its employees in exchange for the promise of future pensions.[154] As for benefit to the estate, the bankruptcy court pointed out that the pension plan termination in no way induced any employees to continue working for the estate, since most of the pension obligations were owed to retirees.[155]

The district court affirmed the bankruptcy court's conclusion that only a small portion of the PBGC's claim should be classified as an administrative expense.[156] That portion of the claim would be for any unfunded contributions due during the bankruptcy case itself that were directly attributable to the post-petition labor of LTV employees.[157]

Even as to these unfunded post-petition contributions, the *LTV* court was more restrictive than some other courts have been when faced with a similar issue. The court in *LTV* did not allow an administrative expense priority even for the full amount of unpaid contributions to the plan that could be allocated to the period between bankruptcy filing and plan termination. Instead, the court allowed the priority for only that portion of unpaid post-petition contributions representing the

152. *See* LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 130 B.R. 690, 697 (S.D.N.Y. 1991).

153. *Chateaugay*, 115 B.R. at 772.

154. *Id.* at 773-75.

155. *Id.* at 775-76.

156. *See Chateaugay*, 130 B.R. at 697.

157. *Id.*

plan's normal cost rather than its past service cost.[158]

As suggested earlier, this part of the *LTV* opinion probably goes too far in restricting the priority of the PBGC.[159] Although the annual funding requirements for a pension plan can be divided into a normal cost and past service component, the reality is that the promise of any year's annual contribution represents consideration to employees for work that they will perform during that year. On this score, the *LTV* holding is in conflict with the district court holding in *Columbia Packing Co. v. Pension Benefit Guaranty Corp.*[160]

In *Columbia Packing*, the court reasoned that the entire unpaid funding requirements allocable to the period between bankruptcy filing and plan termination ought to be given the section 507(a)(1) priority.[161] The court rejected the debtor's argument, accepted in *LTV*, that the portion of the funding requirement attributable to past service cost is pre-petition in nature and therefore not eligible for the priority.[162] The court held that past service cost "is more properly viewed as simply an actuarial unit of measure for determining the employer's current periodic contribution."[163] As such, it is not really compensation for work performed before the inception of the plan and thus need not be viewed as pre-petition in nature.[164]

E. The Section 507(a)(4) Priority

One other section of the Bankruptcy Code gives the PBGC a source of potential priority for at least one of its bankruptcy claims, its claim for unpaid minimum funding contributions. That section, 507(a)(4), gives a fourth priority to unsecured claims for contributions to an employee benefit plan that arise from services rendered within 180 days before the date of the bankruptcy filing or the cessation of the debtor's business, whichever occurred first.[165]

In addition to the time period within which the appropriate services must have been provided, several other limitations at-

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158. *See id.* Although the district court did not explicitly distinguish normal cost and past service cost, the bankruptcy court opinion that the district court affirmed did address the issue. *See Chateaugay*, 115 B.R. at 777.

159. *See supra* p. 824.

160. 81 B.R. 205 (D. Mass. 1988).

161. *Id.* at 207-09.

162. *See id.* at 208-09.

163. *Id.* at 209.

164. *See id.*

165. *See* 11 U.S.C. § 507(a)(4)(A) (1988).

tach to a section 507(a)(4) priority claim. Section 507(a)(4)(B) states that the total priority claimed thereunder cannot exceed $2000 per employee covered by the employee benefit plan.[166] Furthermore, any priority under section 507(a)(4) must be reduced by the aggregate amount paid to employees under the section 507(a)(3) wage priority.[167] The section 507(a)(4) priority must also be reduced by any amounts the estate paid on behalf of employees to any other employee benefit plan.[168]

Just as in the context of section 507(a)(1), the distinction between the normal cost component of required pension contributions and the past service cost component creates a point of controversy among courts. Calculating the section 507(a)(4) priority according to *LTV*'s logic in the section 507(a)(1) context includes only the normal cost component of pension plan contributions.[169] Other courts, however, such as that in *Columbia Packing*, hold that the section 507(a)(4) priority may include both the normal cost and past service portions of any unpaid minimum funding contributions.[170]

In *Columbia Packing*, the bankruptcy court also confronted the issue of how to calculate the amount of the section 507(a)(4) priority in a case where the number of employees had been fluctuating during the 180 days immediately prior to the bankruptcy filing.[171] The court offered a detailed formula that the district court upheld on appeal with one slight modification.

According to the bankruptcy court, three steps are involved in arriving at the proper section 507(a)(4) figure in a case involving an unstable work force. First, the company's minimum annual required contribution must be multiplied by 180/365 to reflect the time limit within which the section 507(a)(4) priority may accrue.[172] Second, the resulting figure must be multiplied by X/Y, where X is the average number of employees working for the company during the final 180 days

166. 11 U.S.C. § 507(a)(4)(B) (1988).

167. *Id.*

168. *Id.*

169. *See* LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 777 (Bankr. S.D.N.Y. 1990).

170. *See* Columbia Packing Co. v. Pension Benefit Guar. Corp., 81 B.R. 205, 209-10 (D. Mass. 1988); *see also In re* United Dep't Stores, 49 B.R. 462, 465 (Bankr. S.D.N.Y. 1985) (finding that "claims for contributions to employee benefit plans keyed to discrete employee services are granted a fourth priority under section 507(a)(4)").

171. *See In re* Columbia Packing Co., 47 B.R. 126, 131 (Bankr. D. Mass. 1985).

172. *Id.* at 131-32.

and Y is the number of employees on which the actuarially determined minimum annual contribution was calculated.[173] This second step adjusts for the fact that fewer employees than the annual minimum funding figure had originally assumed performed the necessary "services rendered" during the 180 days before bankruptcy. Third, according to the bankruptcy court, the result of this calculation must be no greater than $2000 times X, where X again is the average number of employees working for the company during the 180 days before bankruptcy.[174]

The district court in *Columbia Packing* made one modification to the bankruptcy court's formula, to account for the effect of the normal cost/past service cost dichotomy on the bankruptcy court's second step. The district court held that when decreasing the PBGC's priority to reflect a reduction in the average number of employees during the priority period, the reducing fraction should be multiplied only by the normal cost portion of the minimum funding contribution.[175] The past service portion should not be similarly reduced, the court said, because that past service liability "is more accurately viewed as a current cost of continuing the plan rather than as a form of compensation for past service."[176] Put another way, the district court rightly recognized that even when an employee quits, the company will continue to owe the past service portion of that employee's vested pension rights for many years. This will be true even though any further normal costs attributed to that employee can cease in the future.

F. PBGC Setoff Rights

Other than lien status or statutory priority status, a creditor can make itself preferred in bankruptcy through one other method: a right of setoff. A right of setoff exists when a debtor and creditor are mutually indebted and the debts are due and owing on each side. Section 553 of the Bankruptcy Code preserves the creditor's right of setoff, provided that that right exists at the point of the bankruptcy filing.[177]

173. *Id.*

174. *Id.* at 132.

175. Columbia Packing Co. v. Pension Benefit Guar. Corp., 81 B.R. 205, 210 (D. Mass. 1988).

176. *Id.*

177. *See* 11 U.S.C. § 553 (1988). Section 553(a) of the Bankruptcy Code also provides that the creditor's right to setoff is subject to the constraints of § 362's automatic stay. *See* § 553(a). Section 362(a)(7) stays the setoff of any pre-peti-

It is conceivable, though not likely, that the PBGC will owe a debt to a plan sponsor at the time the sponsor files for bankruptcy. More common would be an instance in which some other branch of the federal government owed the debtor money, while at the same time, the debtor owed liability to the PBGC. This latter situation existed, for example, in the case of *In re Art Metal U.S.A.*[178]

In *Art Metal*, the debtor filed bankruptcy at a time when the U.S. Postal Service and General Services Administration owed it certain debts,[179] and the debtor owed money to the PBGC.[180] The PBGC hoped to benefit from this arrangement to setoff funds that the two government agencies owed to the debtor.[181] The court in *Art Metal*, however, construed the elements of setoff strictly and refused the PBGC's request. The court denied the PBGC's setoff rights because the PBGC lacked the crucial element of mutuality of obligation with the debtor.[182] The court explained that Congress "establish[ed] the PBGC as a separate, self-sustaining entity whose profits do not go to the U.S. government."[183] In addition, Congress provided that the government would not be liable for the obligations of the PBGC.[184] Therefore, the court concluded, "Congress effectively denied the PBGC the right to setoff its claims against the debts" of otherwise unrelated agencies of the U.S. government.[185]

IV. THE PGBC AND THE AUTOMATIC STAY

Clearly the automatic stay has been a major obstacle in bankruptcy for the PBGC. Scarcely any of the PBGC's most significant enforcement powers—termination, restoration, and lien creation—are completely safe from the stay's broad reach. Fortunately for the PBGC, there is an important exception to the stay for certain regulatory actions by government agencies. This exception at least provides the PBGC an opportunity in

tion debt owed to the debtor, *see* 11 U.S.C. § 362(a)(7) (1988), but a creditor should ultimately be able to effect such a setoff by obtaining a lift of the stay for cause under § 362(d)(1).

178. 109 B.R. 74 (Bankr. D.N.J. 1989).

179. *Id.* at 75.

180. *Id.* at 76-77.

181. *See id.* at 75.

182. *Id.* at 80.

183. *Id.*

184. *Id.*

185. *Id.*

some situations to continue pursuing its enforcement goals despite the intervention of bankruptcy.

A. Restoration Actions

The question of restoration has arisen so far only in the *LTV* case, but the various opinions extensively discuss whether the automatic stay prohibits the PBGC's restoration of a pension plan during bankruptcy.[186] Although these opinions have covered the issue in some depth, virtually all of the judicial pronouncements thus far have technically been dicta. The opinions concluded that the PBGC's restoration of LTV's pension plans was improper for reasons other than the stay. Thus, the statements in these cases concerning the effect of the stay on restoration are in fact superfluous. Nevertheless, litigants and courts alike tend to attach weight even to those legal pronouncements that are not necessary to reach the result in a given case. That is especially true in *LTV*, since the district court and court of appeals in that case have had tremendous experience in deciding many of the country's most significant commercial and bankruptcy issues.

LTV contended that the PBGC's restoration action violated three provisions of bankruptcy's automatic stay. First, according to LTV, the restoration initiated an administrative proceeding that could have been commenced pre-petition and thus violated section 362(a)(1) of the Bankruptcy Code.[187] Second, the restoration involved exercise of control over property of the estate and thereby ran afoul of section 362(a)(3).[188] Finally, LTV argued that restoring the plans constituted an impermissible attempt to collect a pre-petition debt not allowable under section 362(a)(6).[189]

Besides violating the letter of the stay, LTV said that the PBGC's restoration was contrary to the policy behind the stay. LTV claimed that through restoration the PBGC hoped to

186. The PBGC's ability to restore a pension plan is essentially the antithesis of its power to terminate a plan. On restoration, the original plan sponsor resumes responsibility for funding the plan. The Supreme Court's 1990 decision in Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633 (1990), recognized the PBGC's broad discretion in restoring terminated pension plans of companies in Chapter 11. For a complete analysis of that case and its impact, see Keating, *supra* note 3, at 79-86.

187. Pension Benefit Guar. Corp. v. LTV Corp. (*In re* Chateaugay Corp.), 87 B.R. 779, 793 (S.D.N.Y. 1988), *aff'd*, 875 F.2d 1008 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990).

188. *Id.* at 793-94.

189. *Id.*

claim for itself a greater share of the debtor's limited assets.[190] According to LTV, such an attempt by the PBGC frustrated the two major purposes of the Bankruptcy Code, the equal treatment of creditors and the fresh-start principle for debtors.[191]

The PBGC denied that its restoration constituted an automatic stay violation and contended, in any event, that its action was protected by the regulatory enforcement exception to the stay found in section 362(b)(4) of the Bankruptcy Code.[192] The PBGC argued that its restoration did not violate section 362(a)(1)'s prohibition against pre-petition administrative proceedings because this restoration could not have begun prior to LTV's bankruptcy.[193] Further, the PBGC asserted that the liability of LTV triggered by restoration did not arise until post-petition and thus was not an impermissible act to collect a pre-petition debt under section 362(a)(6).[194] Finally, the PBGC contended that its restoration was exempt from the stay under section 362(b)(4) as a proceeding by a governmental unit to enforce its police or regulatory power.[195]

The district court in *LTV*, while ultimately denying PBGC's restoration of the pension plan on administrative law grounds, more or less agreed with all of the PBGC's arguments concerning the automatic stay. The court said it did not believe that restoration would violate the stay, because section 362 prohibited only those actions taken directly against property of the bankruptcy estate.[196] In this case, the court noted, a restoration by LTV would not result in immediate involuntary payments by LTV to the PBGC, nor would it cause a direct change in the possession or control of any of LTV's assets.[197]

On the applicability of the government regulatory exception of section 362(b)(4), the district court disagreed with LTV's contentions that the primary purpose of this action was pecuni-

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190. *Id.* at 794.

191. *Id.* (citing *In re* B.D. Int'l Discount Corp., 701 F.2d 1071, 1075 n.8 (2d Cir.), *cert. denied*, 464 U.S. 830 (1983)).

192. *Id.*

193. *Id.*

194. *See id.*

195. *Id.*

196. *Id.* at 802-03.

197. *Id.* at 800-01. Specifically, the district court pointed out that restoration in a bankruptcy proceeding does not by itself require the debtor's compliance with minimum funding payments. *Id.* at 802. The reason, the court said, is that the provisions of ERISA "which set forth the minimum funding obligations . . . are expressly subordinated to other non-ERISA federal laws, like the [Bankruptcy] Code." *Id.* at 800 n.16 (citation omitted).

ary and that the action was thereby removed from the ambit of the exception.[198] This argument, the court said, proved too much.[199] Any action that the PBGC takes will in a sense be pecuniary, the court observed, but the PBGC's inherent financial interests are simply surrogates for the pensioners whose rights it insures.[200] Thus, the court concluded, the PBGC's pecuniary interest will almost necessarily be a proper public interest for purposes of the section 362(b)(4) exception to the stay.[201]

When the Second Circuit heard the restoration case on appeal, it commented only briefly on the question of the automatic stay. Without much elaboration, the appeals court said that it was "less convinced than the district court" that the restoration did not implicate a violation of the stay in the first instance.[202] But even if restoration did violate section 362(a), the appellate court said, it was clear that restoration qualified for an exemption from the stay under section 362(b)(4).[203] After all, Congress's stated purpose in enacting ERISA was to protect the public welfare and the " 'continued well-being and security of millions of employees' " who participate in defined benefit pensions plans.[204] According to the court, there was no question that restoration directly furthered those ends and thus fit within the stay exception.[205]

Despite the above statements of the district and appellate courts, the PBGC has lost one stay battle in the restoration arena. Following the PBGC's restoration victory at the Supreme Court, the PBGC and the IRS published regulations that governed the minimum funding requirements for restored plans.[206] Pursuant to these regulations, the PBGC proposed a repayment schedule to amortize the LTV plans' unfunded liability.[207] LTV responded by requesting the district court to issue a declaratory judgment that the "proposed repayment schedule not be used . . . to compel [the] payment of pension

198. *Id.* at 806.

199. *Id.*

200. *Id.*

201. *See id.* at 803-06.

202. Pension Benefit Guar. Corp. v. LTV Corp., 875 F.2d 1008, 1020 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990).

203. *Id.*

204. *Id.* (quoting 29 U.S.C. § 1001(a) (1988)).

205. *Id.*

206. LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 130 B.R. 690, 699 (S.D.N.Y. 1991) (citing 55 Fed. Reg. 42,704, 42,713 (Oct. 23, 1990)).

207. *Id.*

plan obligations outside of a plan for reorganization."[208]

The Department of Labor (DOL), the entity charged with enforcing compliance with minimum funding requirements, argued along with the PBGC that the DOL's enforcement of the payment schedule against LTV would be exempted from the stay pursuant to section 362(b)(4).[209] The district court disagreed, however, holding that "not every act by the DOL is one to protect the public health and welfare."[210] According to the court, these actions by the DOL to enforce the funding obligations of the plans protected a purely pecuniary interest and thus did not fit within the regulatory exception to the stay.[211]

For stay purposes, then, courts have attempted to distinguish between the act of restoration and the actual enforcement of a restoration's financial obligations. The courts in *LTV* viewed the restoration act as the mere re-establishment of liability, which either fails to implicate the stay at all or fits within the regulatory exception. By contrast, once the restoration of a pension plan is in place, the DOL, as the enforcer of pension funding obligations, will not be allowed to compel payment during the pendency of the bankruptcy case. Undoubtedly, the DOL can, like the PBGC, point to its crucial role in implementing the laudable policies of ERISA. That fact, however, did not change the district court's view in *LTV* that insisting on the debtor's current funding obligations was nevertheless a prohibited act to recover a debt from the estate.[212]

B. Lien Creation and Enforcement

As discussed earlier, the PBGC has access to a number of liens that enable it to place its claims before those of other creditors. These liens include one for plan asset insufficiency, another for missed funding contributions, and a third through the IRS for granting a funding waiver in a given year.[213]

Historically, the PBGC's liens have not proven to be as great an advantage as they might seem. One of the greatest limitations on the utility of PBGC liens has been the automatic stay. Specifically, section 362(a)(4) stays "any act to create, per-

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208. *Id.*
209. *Id.* at 700.
210. *Id.*
211. *Id.*
212. *See id.*
213. *See supra* part III.A.

fect, or enforce any lien against property of the estate."[214] The PBGC's most significant lien, the one that attaches to its plan asset insufficiency claim, does not even arise until plan termination. Pension plan terminations, however, typically occur only when the plan sponsor is already in bankruptcy.[215]

Another of the PBGC's liens, the lien for delinquent funding contributions, is created automatically. That lien arises once sixty days have passed following the plan sponsor's failure to make a scheduled payment, as long as the missed payment puts the employer's total delinquent funding contributions over the $1 million mark.[216] Even this lien, however, must be perfected like a tax lien prior to bankruptcy for it to be effective against the trustee in bankruptcy.[217] As the bankruptcy court in the *LTV* case pointed out, just as tax liens are prevented by the automatic stay from arising post-petition by operation of law, so too are the PBGC liens that Congress chose to treat like tax liens.[218]

Conceivably the PBGC could argue that its post-petition lien creation or lien perfection is exempted from the bankruptcy stay by the section 362(b)(4) regulatory exception. That exception, however, does not apply to cases in which the governmental unit's exercise of its regulatory power is meant to serve primarily a pecuniary interest. As noted above, the district court in *LTV* drew a distinction between the PBGC's restoration action and the DOL's attempt to enforce the minimum funding requirements arising from restoration.

The court allowed the restoration act itself under the regulatory exception because it merely established the existence and amount of LTV's funding obligations.[219] The court deemed the effort by the DOL in Chapter 11 to enforce those obligations outside of a confirmed plan, however, to be an impermissible act to collect a debt.[220] Similarly, an attempt by the PBGC to create or perfect a lien in bankruptcy would go beyond the mere establishment of a plan sponsor's liability. Rather, such

214. 11 U.S.C. § 362(a)(4) (1988).

215. *See* Daniels, *supra* note 29, at 80.

216. *See* 29 U.S.C. § 1082(f) (1988).

217. *See id.*

218. LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 115 B.R. 760, 780-81 (Bankr. S.D.N.Y. 1990).

219. *See* Pension Benefit Guar. Corp. v. LTV Corp. (*In re* Chateaugay Corp.), 87 B.R. 779, 800-02 (S.D.N.Y. 1988), *aff'd*, 875 F.2d 1008 (2d Cir. 1989), *rev'd on other grounds*, 496 U.S. 633 (1990).

220. *See* LTV Corp. v. Pension Benefit Guar. Corp. (*In re* Chateaugay Corp.), 130 B.R. 690, 700 (S.D.N.Y. 1991).

an action by the PBGC would involve increasing the priority of an already-established claim against the employer. That brand of leap-frogging by one creditor over another is precisely what the automatic stay was designed to prevent.

C. Plan Termination

Another weapon in the PBGC's enforcement arsenal that implicates the automatic stay is the PBGC's ability to terminate a pension plan involuntarily. Termination gives rise to the PBGC's claim for plan asset insufficiency by essentially accelerating all of the past service liabilities that the plan sponsor was able to amortize at the plan's inception.[221]

In considering whether plan termination by the PBGC violates the stay, the distinction between liability establishment and liability collection must be revisited. Post-petition plan termination seems quite similar to plan restoration in that it simply establishes a liability to the PBGC that was contingent at the point of the employer's bankruptcy filing. Thus, like plan restoration, the PBGC's involuntarily plan termination should either not violate the stay in the first instance or clearly qualify for the section 362(b)(4) exception. Just in case anyone had any doubts on this question, ERISA specifically excepts from the coverage of the automatic stay any involuntary terminations of pension plans by the PBGC.[222]

D. Actions by Parties Other Than the PBGC

When a plan sponsor files for bankruptcy, there may be parties other than the PBGC who will have pension-related claims against the debtor. As noted earlier, because of recent statutory changes, plan beneficiaries probably no longer have an independent right to sue their employer for the difference between the amount of their originally promised pension benefits and those benefits covered by the PBGC guarantee. Nevertheless, plan beneficiaries may have separate breach of fiduciary duty actions against pension plan fiduciaries, who are often upper-level managers of the sponsoring employer.

Such was the case in *LTV*, where pension plan participants sought to pursue actions against certain LTV executives outside of the context of bankruptcy.[223] Because these managers were

221. *See supra* text accompanying notes 53-54.

222. *See* 29 U.S.C. § 1342(e) (1988).

223. *See* Pension Benefit Guar. Corp. v. LTV Corp. (*In re* Chateaugay Corp.), 76 B.R. 945 (S.D.N.Y. 1987).

not "the debtor," the automatic stay of section 362 did not by its own terms prevent the continuation of the non-bankruptcy lawsuits. Despite the lack of protection from section 362, however, LTV convinced the bankruptcy court to invoke section 105(a) of the Bankruptcy Code as a means to enjoin these pension actions that were pending in various state courts.[224] Section 105(a) is a catch-all provision that grants to the bankruptcy court the power to issue "any order, process or judgment that is necessary or appropriate to carry out the provisions of this title."[225] Some courts have used section 105(a) to extend the reach of the automatic stay to protect co-defendants of the debtor where those co-defendants are somehow thought to be essential to the reorganization of the debtor.[226] This must have been the logic of the bankruptcy court in *LTV* when it agreed at LTV's behest to issue a blanket injunction prohibiting these related pension actions against parties other than LTV itself.[227]

The district court in *LTV* disagreed with the bankruptcy court's broad interpretation of section 105(a) in this context. It held that LTV should not be entitled to this blanket injunction simply by asserting, as it had, that lawsuits against management would divert its time away from a successful reorganization.[228] The court conceded that LTV was certainly entitled to a stay of these related actions to the extent that it was liable as a co-fiduciary of these pension plans.[229] The source of that stay, however, would be section 362 rather than section 105(a).[230]

The district court did not foreclose the possibility that section 105(a) could come to the aid of the besieged LTV plan fiduciaries. But, the court said, such an application of section 105(a) would require a more particularized showing of potential harm than had been made thus far by LTV. Specifically, the court found, LTV would need to show that its efforts to address the pension plan problems through its reorganization outweighed the interests of plan participants in pursuing their actions in

224. *See id.* at 946-47.

225. 11 U.S.C. § 105(a) (1988).

226. *See* Barry L. Zaretsky, *Co-Debtor Stays in Chapter 11 Bankruptcy*, 73 CORNELL L. REV. 213, 215 (1988) (discussing bankruptcy courts' use of equitable powers under § 105 to stay actions against co-debtors).

227. *See Chateaugay*, 76 B.R. at 946.

228. *Id.* at 948-49.

229. *Id.* at 951.

230. *See id.* at 949-52.

non-bankruptcy forums.[231]

CONCLUSION

This Article has demonstrated that each of the PBGC's recent efforts to secure for itself a higher position in bankruptcy has met with very limited success at the judicial level. Despite the PBGC's aggressive arguments at both the bankruptcy court and district court levels, the federal pension insurer has been unable to convince courts that current laws give the agency the liens and priorities that it believes its claims deserve. It is not surprising, then, that the PBGC now seeks a legislative change to achieve what it could not achieve through litigation. Specifically, the PBGC has been fighting for the enactment of a law that would give the federal pension agency a priority position in bankruptcy.[232] This approach, however, ignores a number of realities. First, bankruptcy is not the place to solve the problems of underfunding, since it was outside of bankruptcy that the PBGC allowed the underfunding to occur. Second, creating a bankruptcy priority for retirees will likely accelerate the financial demise of companies most guilty of underfunding by restricting their access to credit both before and after a bankruptcy filing. Finally, giving a special priority to retiree benefits necessarily reduces the bankruptcy recovery of other claimants, many of whom are arguably in groups as worthy of sympathy as are the retirees.

A more sensible solution to the PBGC's current problems in bankruptcy would be to adjust the non-bankruptcy law behind the PBGC's massive deficit. Specifically, Congress ought to re-examine the wisdom of having the PBGC guarantee past service benefits that an employer is currently allowed to amortize over thirty years. It is the insurance of these past service benefits, and not the Bankruptcy Code, that is the true cause of the current pension crisis. Accordingly, if there is to be legislative tinkering to benefit the financial position of the PBGC, it ought to be with ERISA and not with the Bankruptcy Code.

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231. *Id.* at 952.

232. *See Pension Protection Legislation*, *supra* note 120, at 48 (describing legislation introduced by Rep. Rod Chandler (R-Wash.) that would give the PBGC a higher priority in bankruptcy cases); *see also* Rosenthal, *OMB Proposal*, *supra* note 2, at 1081 (noting that the Office of Management and Budget proposed remedying the PBGC's financial problems by giving it an enhanced position in bankruptcy).