COMMENTS

APPLYING THE REORGANIZATION TEST TO PENSION PLANS IN THE AGGREGRATE: WAS THE THIRD CIRCUIT CORRECT?

ABSTRACT

Defined benefit pension plans are losing their place of prominence in this country as a means for workers to secure a level of income upon retirement. Not only is the 401(k) defined contribution plan gaining steam, but the defined benefit plans that are in place are becoming vastly underfunded. Corporations are increasingly dumping their plans onto the Pension Benefit Guaranty Corporation (PBGC), as the government entity charged with administering the nation's pension insurance program has been saddled with a debt approaching $23 billion.

Not only has the PBGC racked up a massive debt, but it is also becoming easier for corporations to dump their underfunded plans onto the PBGC in the course of a bankruptcy proceeding. As long as the corporation meets the standards of the reorganization test, it can dump its plans onto the PBGC. Add to this the decision in Kaiser, *that courts are to review the plans in the aggregate, not on a plan-by-plan basis, and you have the perfect storm spelling trouble for the PBGC.*

This comment takes the position that the Third Circuit correctly decided the issue in Kaiser, *but at a cost that could spell disaster for the future of the PBGC. The court correctly bases its decision on principles of equity, but in the process makes it easier for corporations to terminate their pension plans, thus increasing the strain on an already debt-riddled agency with little ability to self-correct its situation. If a solution is to come, it must come from Congress, which, up to this point, has done little to show that it will address the problem.*

I. INTRODUCTION

Corporate bankruptcy and the termination of underfunded pension plans is an increasingly worrisome problem in the United States.[1] Since

[1]For example, "Bethlehem Steel, Polaroid, US Airways, Delta Air Lines, and United Airlines are only some of the well known but financially troubled firms that have either terminated . . . [their pension plans] or are likely to do so in the near future." Mark M. Glickman & Charles A. Jeszeck, U.S. Gov't Accountability Office, *PBGC and the Current Challenges Facing the U.S. Defined Benefit Pension System*, Remarks at the Institute for Industrial Relations, UC Berkley, Spring Colloquia (Apr. 4, 2005), *available at* http://www.irle.berkeley.edu/events/spring05/seminars

2000, and particularly since the terrorist attacks of September 11, 2001, the number of corporations seeking to terminate their pension plans has increased dramatically.[2] In fact, seven of the ten largest corporate bankruptcies in United States history have occurred in this time period.[3]

It is within this context that *In re Kaiser Aluminum Corp.* (*Kaiser II*)[4] becomes so important. The Third Circuit Court of Appeals' decision makes it easier for companies to terminate their pension plans, and also places increasingly substantial burdens on the Pension Benefit Guarantee Corporation (PBGC). This comment discusses the decision reached by the Third Circuit and its far-reaching effects.

Part II of this comment provides a basic introduction to the parties and their effect on the issue. Part III examines the state of the law before *Kaiser* and the trends that affect the PBGC's financial status. Part IV examines the court's decision in *Kaiser*. Next, Part V discusses the effects of the decision, specifically the increasing burden that the *Kaiser* decision will place on the PBGC and the lack of power that the PBGC has to defend its financial position. Finally, Part VI, the conclusion, argues that despite the negative effects associated with its holding, *Kaiser* was properly decided.

II. THE PARTIES

A. *What is Kaiser?*

The Kaiser Aluminum Corporation (Kaiser) is involved in all aspects of the aluminum industry. Its strategic objective is to become the preferred supplier of aluminum products for aerospace and high strength uses, as well as other product lines, including automotive.[5] Kaiser employs approximately 3,000 workers in the United States and is responsible for the pension benefits of more than 11,000 retirees and beneficiaries.[6] Because of liquidity and cash flow constraints, Kaiser and its affiliated corporate entities filed for

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/glickman/glickman.pdf.

[2]Nicholas J. Brannick, *At the Crossroads of Three Codes: How Employers Are Using ERISA, the Tax Code, and Bankruptcy to Evade Their Pension Obligations*, 65 OHIO ST. L.J. 1577, 1577 (2004).

[3]*Id.* Brannick points out that several industries were particularly affected by this economic downturn, including commercial airlines and steel producers. *Id.* at 1578. *See also* Christopher Mumma, *Bethlehem Judge Allows Elimination of Benefits*, PITTSBURGH POST-GAZETTE, Mar. 25, 2003, at C9 (pointing out the assumption by the PBGC of the $3.7 billion employee pension fund of the Bethlehem Steel Corporation in 2003 was, at the time, the largest liability assumed by the PBGC in its twenty-eight year history).

[4]456 F.3d 328 (3d Cir. 2006).

[5]KAISER ALUMINUM CORPORATE PROFILE 1 (2004), *available at* http://www.kaiseral.com /pdf/kaiser.pdf (last visited July 12, 2007).

[6]*Kaiser II*, 456 F.3d at 331.

chapter 11 bankruptcy protection in early 2002.[7]

B. *The PBGC*

The PBGC was established by Congress in 1974 as part of Title IV of the Employee Retirement Income Security Act (ERISA).[8] ERISA sets minimum standards for companies that establish pension plans.[9] The PBGC is a wholly owned United States government corporation[10] that administers the nation's pension plan termination insurance program.[11] "Its purpose is to encourage the continuation and maintenance of . . . defined benefit pension plans."[12] The PBGC is not funded by general tax revenues and is not backed by the full faith and credit of the United States.[13] Rather, the PBGC receives revenues from claims,[14] insurance premiums, trusted plan assets,[15] and investment income.

The PBGC guarantees a "minimum level of pension benefits to participants in qualified pension plans in the event that the plans cannot pay benefits."[16] However, the benefits guaranteed by the PBGC are substantially lower than the fully vested pensions due to plan participants.[17]

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[7]Brief of Appellees Kaiser Aluminum Corp. and its Affiliated Debtors and Debtors in Possession at 7, *Kaiser II*, 456 F.3d 328 (3d Cir. 2006) (No. 05-2695). Kaiser's brief states that "weak industry and economic conditions as well as asbestos liabilities and growing retiree obligations" also contributed to the need for chapter 11 protection. *Id.*

[8]*Kaiser II*, 456 F.3d at 331. *See* 29 U.S.C. § 1302(a) (2006). By enacting ERISA, "Congress sought to ensure that employees and their beneficiaries would not be completely 'deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans.'" Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 637 (1990) (quoting Pension Benefit Guaranty Corp. v. R.A. Gray & Co., 467 U.S. 717, 720 (1984)).

[9]6A HON. WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE, 2D, § 156:22 (2006).

[10]*Id.* § 156:23.

[11]60A AM. JUR. 2D *Pensions* § 586 (2003). The PBGC ensures that workers would receive their vested pension plan benefits on termination of the plans, even if the funding levels of the plan were insufficient and the firm could not afford to pay the difference. RICHARD A. IPPOLITO, THE ECONOMICS OF PENSION INSURANCE 3 (Irwin 1989).

[12]*Kaiser II*, 456 F.3d at 331. A "defined benefit plan" is one where an employer promises employees a definitely determinable benefit at retirement. NORTON, *supra* note 9, § 156:59. This is contrasted against "defined contribution plans," such as 401(k) accounts, where a separate account is maintained by each participant. *Id.* § 156:58.

[13]William G. Beyer, *Pensions, Bankruptcy, and the Pension Benefit Guaranty Corp.*, *in* 2005 ANNUAL SURVEY OF BANKRUPTCY LAW 119, 120 (William L. Norton, Jr. ed., 2005).

[14]PBGC files claims against an employer for liability arising from the termination of an underfunded plan. *Id.*

[15]When a plan terminates, PBGC becomes the plan's statutory trustee and takes over the plan's assets. *Id.* at 121.

[16]*Kaiser II*, 456 F.3d at 331.

[17]*Id.* The Supreme Court emphasized this point in *LTV Corp.* by stating ERISA puts limits on the amount PBGC may guarantee upon termination. Therefore, employees are only guaranteed

III. STATE OF THE LAW AND TRENDS PRE-*KAISER*

A. *How Employers Can Terminate Their Pension Plans*

When a plan covered by ERISA terminates with insufficient funds to satisfy its obligations, the PBGC takes over the plan's assets and liabilities and uses these assets to pay pension subscribers certain guaranteed benefits.[18] Plans can be terminated by the employer in either a standard or distress termination. In a standard termination, the plan must have enough money to pay all its benefits before the plan can be released.[19] In a distress termination, the plan does not have enough assets to pay all of its obligations.[20] In order to terminate the plans, the employer must show severe financial distress.[21] When this is the case, the PBGC steps in and pays guaranteed benefits.[22]

Under a distress termination, the reviewing court applies a four part statutory test, commonly known as the "reorganization test," to determine if the company has met the criteria to terminate its plans.[23]

> The Reorganization Test has four requirements: (1) the company must have filed a chapter 11 petition; (2) its bankruptcy case must not have been dismissed, [sic] (3) the company must submit to PBGC a request for bankruptcy court approval of the plan termination, [sic] and (4) the bankruptcy court must determine that "unless the plan is terminated, such person [or in this case corporation] will be unable to pay all its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process and approv[e] the termination."[24]

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what ERISA provides, even if they were entitled to greater benefits under the original plan. Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 638 (1990).

[18] *LTV Corp.*, 496 U.S. at 637.

[19] PENSION BENEFIT GUARANTY CORP. FACT SHEET: THE PENSION BENEFIT GUARANTY CORP., *available at* http://www.pbgc.gov/media/key-resources-for-the-press/content/page13540.html. Thus, a standard termination does not implicate PBGC responsibilities. *LTV Corp.*, 496 U.S. at 639.

[20] PENSION BENEFIT GUARANTY CORP., *supra* note 19.

[21] *Id.* For example, the company can show that continuing the plan would force the company to shut down (i.e., not be able to exist outside of chapter 11).

[22] *Id.*

[23] *See* 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) (2006).

[24] Kaiser Aluminum Corp. v. Pension Benefit Guar. Corp. (*In re* Kaiser Aluminum Corp.) (*Kaiser I*), No. 04-145-JJF, 2005 U.S. Dist. LEXIS 5106, at *6 (D. Del. Mar. 30, 2005), *aff'd*, 456 F.3d 328 (3d Cir. 2006) (quoting 29 U.S.C. § 1341(c)(2)(B)(ii)(IV)). One court has simplified this issue into a basic threshold question: "Can the Debtor obtain confirmation of *any* plan of

The PBGC may also involuntarily terminate certain pension plans.[25] The PBGC may do so if the plan has not met minimum funding requirements, if the plan cannot pay current benefits when due, or to protect PBGC's insurance fund.[26] The PBGC must terminate a plan if assets cannot pay benefits currently due.[27]

B. *PBGC's Financial Status*

According to PBGC's 2005 Annual Report,[28] at year end, the PBGC was responsible for the pensions of approximately 1.3 million people and paid nearly $3.7 billion in benefits.[29] Due to the number of claimants and the amount the PBGC is obligated to pay out, the PBGC itself, as well as the single-employer program (SEP), is in severe financial trouble. By the end of 2005, the program's deficit was $22.8 billion.[30]

This deficit was in large part fueled by United Airlines' (United) decision to turn its pension plans over to the PBGC, making it the largest corporate pension default in United States history.[31] The total underfunding in United's plan was $10 billion and the PBGC was forced to take a loss of nearly $7 billion.[32]

IV. ANALYSIS OF THE *KAISER* HOLDING

A. *The Holding*

Kaiser filed for relief under chapter 11 in early 2002.[33] As part of its reorganization, Kaiser sought, under a distress termination, to eliminate

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reorganization without the termination of the Retirement Plans?" *In re* Wire Rope Corp. of Am., 287 B.R. 771, 777 (Bankr. W.D. Mo. Dec. 30, 2002).

[25]*Kaiser I*, 2005 U.S. Dist. LEXIS 5106, at *6.

[26]PENSION BENEFIT GUARANTY CORP. TERMINATION FACT SHEET, *available at* http://www. pbgc.gov/media/key-resources-for-the-press/content/page13543.html.

[27]*Id.*

[28]Annual Report, *available at* http://www.pbgc.gov/docs/2005_annual_report.pdf [hereinafter Annual Report].

[29]*Id.* at 2.

[30]*Id.* This amount reflects a swing in PBGC's net financial position of nearly $33 billion since 2000. Congressional Budget Office, *A Guide to Understanding the Pension Benefit Guaranty Corporation* 1 (Sept. 2005), *available at* http://www.cbo.gov/ftpdocs/66xx/doc6657/09-23-GuideTo PBGC.pdf.

[31]Annual Report, *supra* note 28, at 4. United's decision followed US Airways' decision to turn its funds over to the PBGC in 2004 to the amount of $2 billion. Len Boselovic, *Benefit Guaranty Corp. Already Loaded Down with Debt: US Airways Tries to Shift Pension Bill of $2 Billion/Pension*, PITTSBURGH POST-GAZETTE, Sept. 15, 2004, at A-1.

[32]Annual Report, *supra* note 28, at 4.

[33]*In re* Kaiser Aluminum Corp. (*Kaiser II*), 456 F.3d 328, 331 (3d Cir. 2006).

several pension plans covering more than 13,500 employees.[34] In a February 5, 2004 order, the United States Bankruptcy Court for the District of Delaware approved Kaiser's motion to terminate the plans, over the PBGC's objections.[35] Despite the court's acknowledgement that Kaiser could afford to maintain its smaller plans, the court held that in order to be fair to all employees, it would apply the reorganization test to the plans in the aggregate and approved termination of all the plans.[36] The district court subsequently upheld the bankruptcy court's decision.[37]

The issue faced by the Third Circuit on appeal was whether the bankruptcy court should have applied the reorganization test to the plans on an individual basis or in the aggregate.[38] The PBGC argued that the plain language of ERISA required an evaluation of the termination on a plan-by-plan basis.[39]

The court began with a statutory analysis and found that ERISA did not explicitly govern the issue at hand.[40] Next, the court turned to congressional intent, but was unable to find any court that had performed this type of analysis.[41] The court, however, did find several cases where the debtor sought to terminate multiple pension plans under the reorganization test.[42] In each of these cases, bankruptcy courts had applied an aggregate analysis.[43]

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[34] *Id.* at 331-32. Kaiser asserted it owed nearly $48 million in unfunded contributions for the 2003 plan year and that it would be responsible for making $230 million more in contributions to plans between 2004 and 2009. *Id.*

[35] *Id.* at 332-33. The PBGC argued the bankruptcy court should evaluate the termination on a plan-by-plan basis, rather than considering the termination of the plans in the aggregate. *Id.*

[36] *Id.* at 333.

[37] Kaiser Aluminum Corp. v. Pension Benefit Guar. Corp. (*In re* Kaiser Aluminum Corp.) (*Kaiser I*), No. 04-145-JJF, 2005 U.S. Dist. LEXIS 5106, at *7 (D. Del. Mar. 30, 2005), *aff'd*, 456 F.3d 328 (3d Cir. 2006).

[38] *Kaiser II*, 456 F.3d at 334.

[39] Brief of Appellant Pension Benefit Guaranty Corp. at 12, *Kaiser II*, 456 F.3d 328 (No. 05-2695). Further, the PBGC argued that by applying a plan-by-plan analysis, Kaiser could continue funding some of their pension plans and still emerge from chapter 11. Daniel Morse, *Code to Code: The "Reorganization Test" of ERISA § 4041 Applies to Pension Plans in the "Aggregate,"* 25-7 AM. BANKR. INST. J. 26, 65 (2006). Furthermore, "the PBGC had argued that faced with a choice of burdening some or all of Kaiser's plan participants, equity weighed in favor of the former." Corinne Ball, *Distressed Mergers and Acquisitions: Ruling in* Kaiser *Clarifies Pension Plan Termination*, 236 N.Y. L.J. 5 (2006).

[40] *Kaiser II*, 456 F.3d at 335. The court stated that "ERISA does not explicitly state how the reorganization test applies when an employer seeks to terminate several pension plans at once." *Id.*

[41] *Id.* at 336.

[42] *Id.*

[43] *Id. See also In re* Aloha Airgroup, Inc., No. 04-3063, 2005 Bankr. LEXIS 882 (Bankr. D. Haw. Dec. 13, 2005), *vacated*, Nos. 05-00777 JMS/BMK, 05-00778 JMS/KSC, 05-00779 JMS/BMK, 2006 U.S. Dist. LEXIS 14,713 (D. Haw. Mar. 9, 2006) (holding the debtors proved that unless each of the plans were terminated, the debtors would be unable to pay all their debts pursuant to a plan of reorganization and would be unable to continue in business outside of chapter 11); *In re*

The court ultimately disagreed with PBGC's textual argument and held that ERISA did not require a plan-by-plan analysis.[44] This decision was based on the fact that a plan-by-plan analysis would force a court to make "basic assumptions about the order in which the plans should be considered" and that ERISA fails to provide any rules for this type of determination.[45] The court further pointed out that a plan-by-plan analysis would "disrupt the bankruptcy courts in their traditional role as agents of equity."[46] The court argued that with the unique circumstances of this case, "the Bankruptcy Court could not have applied the plan-by-plan approach without . . . producing an unfair result that would have violated principles of equity."[47]

The court also dismissed the PBGC's argument that it should be accorded *Chevron*[48] deference for its interpretation of the reorganization test.[49] While it noted that the Supreme Court had given the PBGC *Chevron* deference on ERISA matters on previous occasions,[50] the Third Circuit concluded that this type of deference was improper here because the "PBGC has neither the expertise nor the authority to determine when a plan should be terminated under the reorganization test."[51] Instead, the court stated, the expertise lies with the bankruptcy courts.[52] Since Congress delegated power to the courts, rather than the PBGC, to "make determinations under a statute,

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Wire Rope Corp. of Am., 287 B.R. 771, 781 (Bankr. W.D. Mo. Dec. 30, 2002) (holding the corporation could not pay all of its debts under a plan of reorganization and continue in business, therefore the court approved the termination of all of the corporation's retirement plans).

[44]*Kaiser II*, 456 F.3d at 337.

[45]*Id.* The court provides a hypothetical which helps illustrate the problems of a plan-by-plan approach: Assume a debtor has three pension plans each costing $20 million annually. Debtor has proven it can only afford to pay $40 million to the plans. Under a plan-by-plan approach, a bankruptcy court would be forced to decide which plans remain active on a seemingly arbitrary basis. The outcome of a plan-by-plan analysis would thus be dependent simply on the "ground rules" that a court uses, i.e., the order in which the court reviews the plans. *Id.* at 337-38.

[46]*Id.* at 339. Bankruptcy courts have authority to act to prevent injustice or unfairness. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934) (stating that courts of bankruptcy are courts of equity).

[47]*Kaiser II*, 456 F.3d at 341. The court points out that had the bankruptcy court used the plan-by-plan approach, it would have had to pick and choose which plans to terminate. This result, the court argues, "smacks of arbitrariness." *Id.*

[48]Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984). *Chevron* stands for the proposition that when Congress is silent on the meaning of certain terms contained in a statute, courts should defer to the interpretation given to the terms by the agency in charge of implementing the statute, so long as the interpretation is reasonable.

[49]*Kaiser II*, 456 F.3d at 344. The PBGC argued that since the court concluded that ERISA did not directly address whether the reorganization test applied to plans in the aggregate or on a plan-by-plan basis, the court should have deferred to the PBGC's statutory analysis. Brief of Appellant Pension Benefit Guaranty Corp., *supra* note 39, at 41.

[50]*Kaiser II*, 456 F.3d at 344.

[51]*Id.*

[52]*Id.* ERISA granted the bankruptcy courts the power to determine when an employer cannot pay all its debts and continue in business outside of chapter 11. *See* 29 U.S.C. § 1341(c)(2)(B)(ii)-(IV).

Chevron deference does not apply."[53]

Ultimately, the court concluded that when an employer seeks to voluntarily terminate multiple pension plans in a chapter 11 bankruptcy proceeding, the reorganization test applies to the plans in the aggregate.[54]

B. *The Court's Reasoning*

As was previously mentioned, the *Kaiser* court based its decision on principles of equity. The bankruptcy court determined that Kaiser did not need to terminate all of its plans, yet it approved termination of all of them regardless.[55] The Third Circuit Court of Appeals upheld this determination based primarily on the fact that it would be improper and arbitrary for the bankruptcy court to apply a plan-by-plan approach.[56]

The court also argued that a plan-by-plan approach would lead to more liquidations.[57] This was due to the fact that employers who could restructure their pension liabilities and reorganize successfully would have a harder time doing so under a plan-by-plan approach.[58] This approach would result in unnecessary liquidations and is "neither fair nor consistent [with] the Bankruptcy Code's preference for reorganization."[59]

The court recognized that its decision "implicates significant policy concerns" affecting millions of workers, hundreds of businesses, and the PBGC itself.[60] Moreover, the court pointed out, the aggregate approach may "lead to results that are less than ideal for workers and for the PBGC."[61] Despite these concerns, the court ruled that equity required that the plans be considered in the aggregate.[62] The court held that ERISA is not explicit on whether to evaluate the plans in the aggregate and that a plan-by-plan approach is unworkable.[63]

Furthermore, the court did not accord the PBGC with *Chevron* deference because, it argued, Congress delegated power to the courts to determine whether an employer can meet the reorganization test.[64] Also, *Chevron* deference was improper because the PBGC never advanced the position that

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[53] *Kaiser II*, 456 F.3d at 344.
[54] *Id.* at 347.
[55] *Id.* at 343.
[56] *Id.* at 337-42.
[57] *Kaiser II*, 456 F.3d at 343.
[58] *Id.*
[59] *Id.*
[60] *Id.* at 346.
[61] *Kaiser II*, 456 F.3d at 346.
[62] *Id.* at 347.
[63] *Id.* at 337, 339.
[64] *Id.* at 344.

the reorganization test requires a plan-by-plan analysis before this case.[65]

While the court's reasoning is sound and consistent with the policies of bankruptcy courts,[66] the court was short on precedent for its decision, since this case was a case of first impression. The court references two other opinions having similar holdings,[67] and acknowledges that these opinions are short on analysis and thus provide "little guidance."[68]

C. *Precedential Value*

The Third Circuit's holding has been followed by one court in *In re Falcon Products, Inc.*[69] There, the court acknowledged that the Third Circuit's decision is "well reasoned and correct" and that the *Falcon* court will follow it.[70] Several industry journals, including *The American Bankruptcy Institute Journal* and the *New York Law Journal*, have cited *Kaiser* as having established new precedent.[71] Thus, it is clear that *Kaiser* has already made an impact in the bankruptcy industry and on the courts.[72]

V. EVALUATION

A. *How Big is the Pension Problem?*

The PBGC currently insures the pensions of 44.1 million American workers and retirees in 30,330 private defined-benefit pension plans.[73] At

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[65]*Kaiser II*, 456 F.3d at 345 (citing Southco, Inc. v. Kanebridge Corp., 390 F.3d 276, 300 (3d Cir. 2004)). Moreover, the court ruled since the PBGC could not reference any "regulations, rulings, or administrative practices" that support its position, it cannot be accorded deference. *Id.* at 346.

[66]*Id.* at 337. Bankruptcy courts are courts of equity and forcing them to adopt a plan-by-plan approach would lead to outcomes "dramatically based on the ground rules that a court employs." *Id.* at 338. This type of analysis is contradictory to principles of equity. *Id.*

[67]*In re* Aloha Airgroup, Inc., No. 04-3063, 1524, & 1629, 2005 Bankr. LEXIS 882 (Bankr. D. Haw. Dec. 13, 2005), *vacated*, 2006 U.S. Dist. LEXIS 14713 (D. Haw. Mar. 9, 2006); *In re* Wire Rope Corp. of Am., 287 B.R. 771 (Bankr. W.D. Mo. Dec. 30, 2002).

[68]*Kaiser II*, 456 F.3d at 336.

[69]354 B.R. 889 (E.D. Mo. 2006).

[70]*Id.* at 897. The court follows *Kaiser*'s reasoning that while the result may be less than ideal for some of the parties involved, the court does not sit as "a policy-making or legislative body." *Id.* at 896.

[71]Ball, *supra* note 39; Morse, *supra* note 39, at 66.

[72]In fact, the PBGC, in *Falcon*, advanced a similar argument as that in *Kaiser*. It argued the reorganization test should be applied on a plan-by-plan basis and that one of the pension plans could not be terminated. *Falcon*, 354 B.R. at 892. The PBGC further argued that *Kaiser* was incorrectly decided. *Id.* at 896. Despite these arguments, the *Falcon* court decided to follow *Kaiser*. *Id.* at 897.

[73]Morse, *supra* note 39, at 26. This figure includes the 1.3 million people to which the

the end of fiscal year 2000, the PBGC had a surplus of $9.7 billion.[74] By the end of fiscal year 2005, that surplus had turned into a deficit of nearly $23 billion.[75] Though this amount may seem overwhelming, it represents "just a fraction of the $450 billion in pension commitments companies have made but not funded."[76]

While the above figures may seem to be a big problem in and of themselves, the real problem is the ability, or lack thereof, of the PBGC to generate funds to recover any, or all, of this deficit. The inherent problem in the system, as stated by the PBGC's former Executive Director Kathleen P. Utgoff, is that the PBGC is "required to charge the same premium [insurance] rates to all employers regardless of risk."[77] This, in turn, encourages troubled companies to underfund, because the PBGC will take over the underfunded plans.[78]

B. *Practical Consequences*

The aggregate analysis of the reorganization test approved by *Kaiser* may have the effect of increasing the number of plan terminations. It will be easier for a debtor to terminate *affordable* pension plans that they would otherwise maintain along with unaffordable pension plans.[79] With this as a distinct possibility,[80] the result may be that more pensioners will lose their promised benefits and will only receive those benefits guaranteed by the PBGC, which are significantly lower.[81]

Kaiser will also have a significant impact on the PBGC itself. First, it will likely further increase the PBGC's financial burden by making plan termination easier.[82] Also, the PBGC will not be able to collect the insur-

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PBGC is currently paying benefits. Annual Report, *supra* note 28, at 2.

[74]Richard Ippolito, *Is Pension Insurance the Next S&L Crisis?, available at* http://www.cato.org/pub_display.php?pub_id=2834&print=Y.

[75]Annual Report, *supra* note 28, at 2.

[76]Bert Caldwell, *Pension System Needs Help, but Not the Wrong Kind*, SPOKANE SPOKESMAN REV., July 25, 2006, at A6. This amount represents three times the amount of the $124 billion bailout of the savings and loan industry in the 1980s. Caldwell further argues that, by comparison, "the Social Security system is a rock of financial stability." *Id.*

[77]Sally Hanlon, *Underfunded Pension Plans: Who's to Blame?*, 31 TAX NOTES 1290, 1291 (1986).

[78]*Id.* Utgoff further compares the PBGC to an "industrial welfare program." *Id.*

[79]Morse, *supra* note 39, at 66. *See also* Kaiser Aluminum Corp. v. Pension Benefit Guar. Corp. (*In* re Kaiser Aluminum Corp.) (Kaiser *I*), No. 04-145, 2005 U.S. Dist. LEXIS 5106, at *2 (D. Del. Mar. 30, 2005), *aff'd*, 456 F.3d 328 (3d. Cir. 2006) (approving the termination of the plans in the aggregate, despite the fact Kaiser could have afforded to keep some of its plans).

[80]*See supra* text accompanying notes 35 and 67.

[81]Morse, *supra* note 39, at 66.

[82]*Id.* Furthermore, the fact that PBGC's insured plans disproportionately lie in industries facing intense competition and economic stress (such as the airline and steel industries), the PBGC's position is only likely to worsen, especially given *Kaiser*'s decision, making it easier to terminate

ance premiums from the potentially affordable pension plans (which, as previously noted, are terminated with the unaffordable plans under *Kaiser*), thus eliminating a revenue source for the PBGC.[83]

Since the termination of pension plans clearly burdens the pensioners and the PBGC, the question is raised as to who benefits from plan termination.[84] Clearly, the corporation itself is the primary beneficiary. It is relieved of the pension obligations at no expense to itself, thus allowing it an easier path to reorganization and emergence from chapter 11.[85] Executives rarely lose from plan termination, as they receive separate plans from the regular employees in the firms they head.[86] Brannick argues that the greatest beneficiaries of plan termination, however, are "pre-bankruptcy unsecured and priority creditors," because they realize greater recovery without mandatory payments into pension plans during the bankruptcy stage.[87]

C. *The Moral Hazard Problem*

As Brannick suggests, the problem inherent in the pension system is the inability of the PBGC to recover against employers who terminate their plans in chapter 11.[88] Depriving the PBGC of the ability to recover unfunded pension plans gives employers the incentive to divert resources away from their pension plans.[89]

Professor Daniel Keating defines this diversion of resources away

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underfunded plans. Glickman & Jeszeck, *supra* note 1, at 3.

[83]*See id. See also* Ippolito, *supra* note 74 (stating the PBGC's annual revenue is only approximately $1 billion, weighed against the $3.7 billion the PBGC paid out in 2005).

[84]Perhaps more relevant to this note, the question should be rephrased as to who benefits when a plan can be terminated in the aggregate, thus relieving the company of financial responsibility for even affordable plans.

[85]This is due simply to the fact that there is one less creditor, the PBGC, going after the funds of the corporation. *See also* Brannick, *supra* note 2, at 1585 ("Any consideration of the equities involved in pension plan termination cannot overlook the possibility that failure to terminate may lead to liquidation of the company."); Len Boselovic, *No. 4 Local Business Story of the Year: Steel Sees Big Changes*, PITTSBURGH POST-GAZETTE, Dec. 24, 2003, at B9 (pointing out the changes in the steel industry in 2003, including International Steel Group's buyouts of bankrupt steelmakers and the reemergence from bankruptcy of Wheeling-Pittsburgh Steel, would not have been possible without the PBGC assuming more than $7 billion of the bankrupt companies' unfunded pension obligations); Mumma, *supra* note 3, at C9 (pointing out that had the judge in the bankruptcy proceedings for Bethlehem Steel not allowed the termination of pension benefits, Bethlehem would have been forced to liquidate and its deal with ISG (where ISG offered to purchase Bethlehem's assets for $1.5 billion) would have fallen through).

[86]Brannick, *supra* note 2, at 1584.

[87]*Id.* Brannick fails to note however that the PBGC is often the largest unsecured creditor, and will generally be a member of the unsecured creditors committee, and still has a claim for the balance of the pension fund. Despite being one of the largest creditors, the PBGC is usually a loser in this process, as it will realize just cents on the dollar for its claim.

[88]*Id.* at 1611.

[89]*Id.*

from insured pension plans as a "moral hazard" problem.[90] Put in its simplest terms, the problem is that "those who are insured against certain risks have an incentive to use less than optimal care to avoid those risks."[91]

In the case of underfunded pension plans, both employers and employees are beneficiaries of the PBGC's insurance coverage. In the case of employees, when an underfunded pension plan terminates, they are guaranteed most of their pension rights that they earned up to termination.[92] Therefore, there is no strong incentive for employees to keep close tabs on the state of their employer's pension system because they are guaranteed certain payments from the PBGC.

Employers, while not the direct recipients of payments made by the PBGC, are perhaps the biggest winner from the PBGC insurance system. They can devote fewer resources to current wages by promising pension benefits upon retirement.[93] Employers could offer pension plans not guaranteed by the PBGC, but both the employer and the employees would likely rather have the guarantee assured by the PBGC.[94]

So what does this all mean? Simply put, the presence of the PBGC weakens the incentive for the employer to adequately fund their pension plans. Because the PBGC's insurance can subsidize the employer's "pension promises for an expected cost to the company of less than one hundred cents on the dollar," employers have an incentive to spend capital in other ways.[95] As Keating points out, by underfunding its pension plan, an employer can use the diverted funds to engage in risky speculative enterprises.[96] And, the incentive not to engage in these enterprises is absent. In fact, there is a greater incentive for companies to engage in this sort of risk-taking than there is for the company to continue to fund its pension plans.[97]

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

[91]*Id.* at 68. Keating gives the following example to explain the problem: An owner of a cargo ship has insurance against losses for a particular voyage. As a result, the owner may choose to take a shorter but more dangerous route because if she loses any cargo, the cost of damages are borne by the insurer. On the other hand, had the ship owner been liable for losses, she may have chosen a safer route that took longer. *Id.*

[92]*Id.* at 72.

[93]*Id.* *See* IPPOLITO, *supra* note 11, at 19. Ippolito, a former chief economist at the PBGC, conducted a survey which indicated firms in financial difficulty often increased the level of pension benefits available to the employees, presumably as a way to retain workers when the firm lacked cash flow to increase current salaries. *Id.*

[94]From the employees' perspective, uninsured pension plans are not as attractive as those plans guaranteed by the PBGC, for obvious reasons. Keating, *supra* note 90, at 73.

[95]*Id.* at 67.

[96]*Id.* at 76.

[97]If the risk-taking pays off, there is a tremendous upside for stockholders and directors of the corporation. If however, the risk-taking does not pay off, the worst that can happen is the

While this pension insurance system is beneficial to employers and employees alike, it is quite the opposite to the PBGC, according to Keating, who points out that when a company underfunds its plans, it is effectively "borrowing" an unsecured line of credit from the PBGC.[98] Much like a bank issuing a similar unsecured loan, the PBGC must contend with the risk that the "borrowing company" will dissipate the funds and fail to "repay" by either liquidating or reorganizing under Chapter 11.[99]

D. *How Does the Moral Hazard Problem Tie in to* Kaiser*?*

The answer to this question is simple. *Kaiser*'s application of the reorganization test to pension plans in the aggregate makes it easier for companies to terminate multiple pension plans, even if some of the plans are affordable.[100] Since it is now arguably easier for a company to terminate its pension plans, the moral hazard problem is increased. The company does not have to worry about funding *any* of its pension plans, provided a bankruptcy court approves its termination request. Thus even more resources can be diverted away from the plans.

Furthermore, the PBGC insurance program will be placed in serious jeopardy.[101] If the PBGC is not allowed to increase insurance premiums on the basis of risk,[102] the PBGC will face even more serious danger. As Bert Caldwell points out, the scary number is not the $23 billion deficit that the PBGC faces, but rather it is the $450 billion in underfunded pension plans

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corporation liquidates under chapter 11 and the underfunded pension plans are terminated and benefits are paid out by the PBGC. *Id.* at 77. However, it is important to note that the level of risk will not be unsafe, as the committee responsible for making the investments owes fiduciary duties to the corporation. Despite these restrictions, a corporation may stray away from low-risk low-return investments such as government bonds and trend towards higher-risk higher-return investments, as long as they comport with investment committee guidelines.

[98]Keating, *supra* note 90, at 77.

[99]*Id.* However, Keating argues, banks are far better able to handle this risk than the PBGC. This is because banks can manage the incentive problems of their borrowers through careful monitoring of their behavior. However, the PBGC is not able to do the same because, as a government organization, it has inherent limitations on its ability to monitor, namely a lack of available resources. *Id.* at 77-78.

[100]*See supra* note 79.

[101]*See generally* IPPOLITO, *supra* note 11, at 5 (pointing out Congress misjudged the effect of creating a simple insurance policy and in the process left the PBGC open to future problems without adequate protection).

[102]*See supra* notes 77-78. It may be helpful to think of this risk problem in terms of a bank loan. If a bank were to give a loan to a high-risk customer, it would invariably charge a higher interest rate. The PBGC on the other hand, as Utgoff argues, lacks power to charge these higher rates to riskier companies. Hanlon, *supra* note 77, at 1291. Therefore, no matter the risk that plans may be underfunded based on industry conditions, the PBGC can only charge the statutorily allowed insurance rate. This seriously curtails the PBGC's ability to carry out its function.

that currently exist.[103] With the PBGC's exposure to losses from financially troubled plan sponsors reaching a record $108 billion in 2005,[104] this $450 billion underfunded figure becomes particularly looming. Add to this the *Kaiser* court's holding making it easier to terminate pension plans, and the PBGC could be headed toward a future reminiscent of the savings and loan crisis of the 1980s.[105]

VI. CONCLUSION

The Third Circuit Court of Appeals in *Kaiser* was correct in applying the reorganization test to pension plans in the aggregate. Considering the fact that bankruptcy courts are courts of equity, it would not be a proper function of their role to apply the test on a plan-by-plan basis. This would lead to arbitrary results, something that bankruptcy courts are designed to avoid.

Furthermore, the court was correct in not giving *Chevron* deference to the PBGC. The PBGC had not advanced their plan-by-plan argument before this case, thus *Chevron* deference would be inappropriate. Furthermore, the court correctly pointed out that Congress left it to the bankruptcy courts to determine whether an employer has met the burdens of the reorganization test not to the PBGC.

Even though there was no direct precedent on which the court could base its decision, *Kaiser* has already been followed by one court, in another jurisdiction.[106] In fact, the *Falcon* court discussed at length the *Kaiser* holding and determined that "the Third Circuit's decision in *Kaiser* is well reasoned and correct."[107]

The main argument against *Kaiser*'s holding is the effect it will have on the PBGC. The PBGC already has a severe deficit and this deficit only looks to be increasing.[108] A plan-by-plan approach, the PBGC argues, would force corporations to retain responsibility for at least some of their plans and thus decrease the burden on the PBGC. However, when the Third Circuit

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[103] *See* Caldwell, *supra* note 76, at A6.

[104] Annual Report, *supra* note 28, at 4. This number is twenty times the amount that existed just five years earlier.

[105] As Caldwell aptly points out, the dollar figure at issue with the PBGC is three times the amount of the savings and loan bailout. Caldwell, *supra* note 76, at A6. According to models from the PBGC and the Center for Federal Financial Institutions, the potential bailout could amount to $56 to $100 billion by 2020. Glickman & Jeszeck, *supra* note 1, at 3.

[106] Falcon Products, Inc. v. Falcon Products, Inc. (*In re Falcon Products, Inc.*), 354 B.R. 889, 889 (E.D. Mo. 2006).

[107] *Id.* at 897.

[108] *See supra* notes 28 & 75-76.

weighed this approach against principles of equity, it decided that the aggregate approach was more equitable.

The answer to this problem most likely lies in the political process. Congress must make a public policy decision to determine the fate of the PBGC. It may allow the PBGC to increase its insurance rates, which would in effect be a tax on society in that the companies will increase prices on goods in order to afford these higher premiums. Or, Congress could choose to do nothing and let market forces play out, which may spell doom for the PBGC. Either way, it is for Congress to determine how to solve the problem, not the courts, as *Kaiser* strongly indicates.

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