New York Law Journal
Corporate Update
Thursday, August 24, 2006
ALM

Ruling in 'Kaiser' Clarifies Pension Plan Termination

BY CORINNE BALL

Distressed Mergers And Acquisitions

Although debate continues over the extent to which funding obligations to a qualified defined benefit pension plan may be treated as prepetition claims in chapter 11, whether a chapter 11 debtor can effect a "distress termination" is the dominant issue. When a debtor's pension plan assets are not sufficient to satisfy all benefit liabilities, it may seek a distress termination if it meets the "reorganization test" by demonstrating that it will be unable to pay its debts and continue its business outside of chapter 11 unless its pension plan is terminated.[1] Although Title IV of the Employee Retirement Income Security Act of 1974[2] establishes the exclusive means of terminating single-employer pension plans, including a "distress termination" under the reorganization test, the recent decision in *Kaiser Aluminum Corporation v. Pension Benefit Guaranty Corporation*[3] arguably eases and certainly clarifies the showing required for distress termination of multiple pension plans and establishes the bankruptcy court as the "expert" and "equitable" forum for such determinations. In *Kaiser*, the Third Circuit Court of Appeals held that when a chapter 11 debtor seeks to terminate multiple pension plans simultaneously under the reorganization test,[4] the bankruptcy court should apply the test to all of the plans in the aggregate, rather than to each plan independently. *Kaiser* suggests that all unions ought to come to the bargaining table to reach a resolution, thus saving jobs and the debtor's business.

Corinne Ball *is a partner at Jones Day.* **John R. Cornell**, *a partner, and* **Ross S. Barr,** *an associate, assisted in the preparation of this article.*

Equally important, however, is recent legislation which, following a distress termination, imposes an "exit surcharge" or termination premium of $1,250 per terminated plan participant annually for three years after emergence from bankruptcy.[5] The exit surcharge has no relation to the level of underfunding of any terminated plan. It applies to a voluntary or distress termination by a debtor as well as an involuntary termination by the Pension Benefit Guaranty Corporation (the "PBGC"). The surcharge may conceivably exceed the level of underfunding of a terminated pension plan.

A purchaser of the debtor's assets in a going concern sale under section 363 of the Bankruptcy Code, however, is not subject to the surcharge. Hence, the collective impact of *Kaiser* and the surcharge, rather than enhancing the prospects for stand-alone reorganization or providing premium income to the PBGC, may instead suggest that troubled companies and their unions explore a sale process earlier.

Plan Termination

The PBGC is a corporation chartered under federal law that administers the pension plan termination insurance program created by ERISA and funded by premiums charged to employers who sponsor insured plans. The PBGC, as the insurer of retiree benefits, subject to certain monthly limits,[6] under qualified terminated pension plans is the creditor representative of the debtor's pension plans in a chapter 11 case. It challenges distress terminations and pursues pension-related claims against debtors to recover assets for the benefit of the terminated underfunded plans. Pension claims, and, in particular, termination claims can make the PBGC a dominant force in a chapter 11 case, as in the United Airlines and Delta Air Lines cases. Interestingly, to the extent that debtors succeed in effecting distress terminations for underfunded plans, the PBGC, as opposed to the underfunded plan, will be the beneficiary of the "exit surcharge" or "termination premium."

Defined benefit pension plans remain a common factor for many employers with union pension plans. Collective bargaining agreements often require the employer to maintain defined benefit pension plans and make all contributions required by ERISA. Modifications to pension plans established under a collective bargaining agreement usually require consent of the union. ERISA recognizes this nexus and provides that a plan sponsor may not

voluntarily terminate a plan "if the termination would violate the terms and conditions of an existing collective bargaining agreement."[7] However, a debtor in bankruptcy seeking a distress termination may remove a contractual bar to a plan's termination by receiving the bankruptcy court's approval to unilaterally reject or modify the collective bargaining agreement pursuant to section 1113 of the Bankruptcy Code. Among other things, section 1113 requires that the proposed modification be "necessary to permit the reorganization of the debtor" and "assure[ ] that all creditors, the debtor and all affected parties are treated fairly and equitably."[8]

ERISA does not explicitly provide how the reorganization test is to be applied when the employer seeks to terminate several union pension plans at once. That test is satisfied when a bankruptcy court determines that a plan sponsor will be unable to continue business outside of chapter 11 "unless the plan is terminated."[9] Notably absent is instruction for the courts when multiple plans are at issue.

Kaiser Plan Termination

While in chapter 11, Kaiser moved the bankruptcy court to terminate six of its pension plans under the reorganization test. In its motion, Kaiser asserted that it owed nearly $48 million in unfunded minimum contributions for 2003 and would be required to make $230 million in minimum contributions to the plans between 2004 and 2009. Kaiser also sought authority under section 1113 of the Bankruptcy Code to terminate its collective bargaining agreements with certain of its unions and modify its retiree benefits under section 1114 of the Bankruptcy Code.

The bankruptcy court applied the test, in the aggregate, to all six plans and concluded that the terminations were required for Kaiser to emerge from chapter 11. It rejected the PBGC's argument that it should apply the reorganization test on a plan-by-plan basis to each of Kaiser's pension plans because it believed that considering the plans piecemeal would give creditors "the kind of leverage that would force the debtor to bargain[ ] . . . with one union and not with another." Further, the court held that a plan-by-plan approach would give the debtors leverage against its creditors that Congress did not intend. Finally, although the bankruptcy court acknowledged that Kaiser could maintain three of its smaller plans under the PBGC's plan-by-plan approach while terminating the larger ones, it held that fairness to Kaiser's employees required the reorganization test to be applied to all of Kaiser's pension plans in the aggregate.

'Kaiser' should promote resolution by forcing all of the company's unions to the bargaining table to try to work out an arrangement which will save jobs, preserve the going concern entity and save their pensions from the same fair and equitable, yet unfortunate, fate. In combination with recent legislation, 'Kaiser' will more likely compel the company and all of its unions into those discussions with a potential acquiror, who will likely be interested only in the future, not the legacy of the past.

The PBGC appealed the decision to the district court, which upheld the bankruptcy court's aggregate analysis and added that the reorganization test must be read in light of section 1113 of the Bankruptcy Code, holding that section 1113's fairness and equity mandate required the bankruptcy court to consider the plans in the aggregate. The PBGC appealed the district court's decision to the Third Circuit.

The PBGC Appeal

On appeal, the Third Circuit first recognized that Congress did not provide guidance on how to apply the reorganization test when the sponsor seeks to terminate several pension plans. Further, it noted that although in every case that it had identified in which a debtor sought to terminate multiple pension plans the courts applied an aggregate analysis, those courts did not provide a rationale as to why they employed that approach as opposed to the plan-by-plan approach.[10]

The PBGC argued that ERISA defines the reorganization test in terms of the singular "plan" because Congress intended that bankruptcy courts would consider each plan that an employer seeks to terminate independently. It reasoned that had Congress intended bankruptcy courts to apply the reorganization test to multiple plans in the aggregate, section1341(c)(2)(B)(ii)(IV) would instruct bankruptcy courts to determine whether an employee can continue its business outside chapter 11 "unless the plans are terminated." To support this argument, the PBGC noted that Congress chose to use the singular terms "single-employer plan" or "plan" throughout Title IV in a manner that it contended created a specific statutory scheme to govern the single employer plan termination insurance program.[11]

The court rejected the PBGC's textual argument, first observing that the simple use of the singular "plan" in section 1341 did not, by itself, constitute a Congressional mandate to the bankruptcy courts to apply a plan-by-plan approach to the reorganization test. Thereafter, it highlighted the defects in the plan-by-plan approach identified by the bankruptcy court, noting the potentially arbitrary or contradictory results. It appeared that if two of Kaiser's larger pension plans were terminated, it could maintain three or four of its smaller plans. It also appeared that the court could eliminate the smaller plans first and, thus, save the larger plans. In addition, if the bankruptcy court applied the reorganization test to each plan and assumed that all the other plans

remained active, it would be forced to authorize the termination of each of the plans, in turn. Ultimately, the court concluded that it would be difficult to imagine that Congress would mandate the use of the plan-by-plan approach but provide no guidance on the mechanics of the approach, making it essentially unworkable.

The court found that sections 1113 and 1114 of the Bankruptcy Code support its holding that a plan-specific approach to the reorganization test would contravene bankruptcy courts' function to serve as courts of equity. Sections 1113 and 1114 allow debtors to terminate or modify collective bargaining agreements or retiree benefits, respectively, only if affected parties are treated "fairly and equitably" and the bankruptcy court determines that the "balance of the equities clearly favors" granting the relief requested.[12] However, if a bankruptcy court had to apply the reorganization test on a plan-by-plan basis and choose which pension plans to terminate and which to save, the debtor's employees would hardly be treated fairly and equitably, as some would receive their full pension benefits, while others would receive only the amount insured by ERISA. In fact, the court noted that it would be likely that employees within the same union would be treated differently, as they frequently participate in different pension plans.

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. The court stated that although it was not unsympathetic to this view, the aggregate approach was more in line with the objectives of the Bankruptcy Code because "[w]hen an employer seeks to terminate multiple plans, participants in one plan will be less likely to agree to termination if doing so would open the door to a decision by a bankruptcy court to single out their plan for termination under the plan-by-plan approach, while leaving the employer's other plans intact.".

Finally, the court rejected the PBGC's arguments that (1) the legislative trend to tighten the restrictions on pension plan terminations supports a plan-by-plan approach, and (2) because it is an agency to which Congress delegated the power to adopt rules and regulations to carry out Title IV of ERISA, the court should defer to its interpretation of ERISA. First, the court rejected the legislative intent argument, stating that all that the legislative history evidences is an intent to make it more difficult for employers to terminate pensions. Finally, it noted that the PBGC has neither the expertise nor the authority to determine when a plan should be terminated under the reorganization test. Rather, "[i]ssues relating to an employer's bankruptcy and reorganization are within the expertise of the bankruptcy courts . . . ."In closing, the court observed that any other result would require Congressional action and clearer legislation.

Conclusion

Kaiser could lead to more plan terminations, even where the termination of less than all of an employer's plans would suffice to save the employer from liquidation. At first, it may seem that recent legislation might serve to counteract *Kaiser*. Consider that, under section 4006(a)(7) of ERISA, if a debtor effects a distress termination of all of its plans, including one or more plans that are only slightly underfunded, with 10,000 participants, an annual termination premium of $12,500,000 would be due for three years after emergence. Yet, it is hard to see how imposing such a liability solves the underlying issue for the debtor. Undoubtedly this exit surcharge will render post-emergence financing impossible, or at least more scarce. This expense is avoided in a sale. Hence, troubled companies and their unions should turn to the sale process earlier. Indeed, the Congressional Budget Office has just reduced its estimated PBGC receipts arising from the surcharge legislation dramatically, from its earlier prediction of $1.8 billion to $411 million, anticipating that "many more participants are likely to be in terminated plans whose sponsors cannot reorganize successfully after filing for bankruptcy."[13]

Kaiser should promote resolution by forcing all of the company's unions to the bargaining table to try to work out an arrangement which will save jobs, preserve the going concern entity and save their pensions from the same fair and equitable, yet unfortunate, fate. In combination with recent legislation, *Kaiser* will more likely compel the company and all of its unions into those discussions with a potential acquiror, who will likely be interested only in the future, not the legacy of the past.

1 An employer may also seek to terminate its pension plans under the following tests: (a) the liquidation test; (b) the inability to continue in business test; or (c) the unreasonably burdensome pension cost test. 29 U.S.C. §§ 1341(c)(2)(B)(i), (iii).

2 29 U.S.C. § 1001, et seq.

3 No. 05-2695, 2006 WL 2061337 (3d Cir. July 26, 2006).

4 29 U.S.C. § 1341(c)(2)(B)(ii).

5 Pension Protection Act, H.R. 4, 109th Cong. § 8101(a)(7)(A) (2006) (enacted).

6 For plans with a 2006 termination date, the maximum guarantee is $47,659.08 yearly ($3,971.59 monthly) for a single life annuity beginning at age 65.

7 29 U.S.C. § 1341(a)(3).

8 11 U.S.C. § 1113(b)(1)(A).

9 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) (emphasis added).

10 See In re Aloha Airgroup, Inc., No. 04-3063, 2005 WL 3487724, at *1 (Bankr. D. Haw. Dec. 13, 2005), vacated as moot, No. 05-00777, 2006 WL 695054, at *3 (D. Haw. Mar. 14, 2006); In re Philip Servs. Corp., 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004); In re Wire Rope Corp. of Am., 287 B.R. 771, 777-78 (Bankr. W.D. Mo. 2002).

11 See, e.g., 29 U.S.C. § 1321 (providing when a "plan" is covered by the termination insurance program); 29 U.S.C. § 1322 (identifying the benefits guaranteed under a "single-employer plan").

12 11 U.S.C. §§ 1113, 1114.

13 See DAILY TAX REPORT, no. 159, ISSN 1522-8800 at G-8 (Aug. 17, 2006)

This article is reprinted with permission from the August 24, 2006 edition of the NEW YORK LAW JOURNAL. © 2006 ALM Properties, Inc. All rights reserved. Further duplication without permission is prohibited. For information, contact ALM Reprint Department at 800-888-8300 x6111 or visit **almreprints.com**. #070-08-06-0052