Landmark Third Circuit Ruling on Multiple Pension Plan Termination

Jones Day Obtains Unanimous Ruling from the Third Circuit Rejecting Plan-by-Plan Analysis in Favor of Aggregate Approach in Applying ERISA "Reorganization Test"

November/December 2006

Gregory M. Gordon
Mark G. Douglas

Termination of one or more defined benefit pension plans has increasingly become a significant aspect of a debtor-employer's reorganization strategy under chapter 11 of the Bankruptcy Code, providing a way to contain spiraling labor costs and facilitate the transition from defined benefit-based programs to defined contribution programs such as 401(k) plans. Recently, Jones Day obtained a victory for its client Kaiser Aluminum Corporation that will significantly impact the ability of a chapter 11 debtor to effect a "distress termination" of multiple pension plans. In the first circuit-level decision on the issue, the United States Court of Appeals for the Third Circuit unanimously held in *In re Kaiser Aluminum Corp.* that, when an employer in chapter 11 seeks to terminate more than one pension plan, the plans must be analyzed on an aggregate rather than a plan-by-plan basis.

ERISA and PBGC

The respective rights and obligations of employers and retirees vis-à-vis pension benefits are governed not by the Bankruptcy Code, but by the Employee Retirement Income Security Act ("ERISA"), which provides the primary regulatory framework and protection for pension benefits. Enacted in 1974, ERISA is a comprehensive regulatory scheme intended to protect the interests of pension plan and welfare benefit participants and beneficiaries and to preserve the integrity of trust assets. On a basic level, it establishes minimum participation, vesting and funding standards and contains detailed reporting and disclosure requirements. ERISA also created the Pension Benefit Guaranty Corporation ("PBGC") to act as both the regulatory watchdog and the guarantor, at least to a certain extent, for the pension and related rights of the U.S. workforce.

Companies pay insurance premiums to PBGC, and if an employer can no longer support its pension plan, PBGC takes over the assets and liabilities and pays promised benefits to retirees up to certain limits. The maximum annual benefit for plans assumed by the agency in 2005 was $45,614 for workers who wait until 65 to retire. For plans assumed in 2006, the maximum yearly benefit amount is $47,659. PBGC self-finances payments to employees under terminated plans through four sources of income: (i) insurance premiums paid by current sponsors of active plans (in 2006, thirty dollars per year per participant, although companies posing high risks of underfunding must pay an additional nine dollars per participant); (ii) assets from terminated plans taken over by PBGC; (iii) recoveries from former sponsors of terminated plans; and (iv) PBGC's own investments.

PBGC insures only "defined benefit" plans. These are plans under which an employer determines the benefits it will pay its employees and contributes the necessary amounts to a pension fund. The amount of retirement income an employee will receive generally depends on the employee's length of service. ERISA and the Internal Revenue Code determine the amount of the required minimum periodic funding contributions the employer must make. Not all plans are defined benefit plans. Many employers have "defined contribution" plans instead. In these plans, the employer contributes a certain amount for each participant, but makes no promise regarding the ultimate benefit or amount that each participant will receive. Defined contribution plans, such as 401(k) plans, are not guaranteed by PBGC.

There are several ways for a pension to terminate under ERISA. In a “standard termination,” an employer can voluntarily terminate its plan so long as the plan has sufficient assets to pay all future benefits. The employer remains liable to PBGC for all plan benefit liabilities. An employer can also voluntarily act to terminate its plan in a “distress termination” under the following circumstances: (i) liquidation in bankruptcy; (ii) a reorganization in bankruptcy in which the court “determines that, unless the plan is terminated, [the employer] 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 approves the termination; and (iii) a non-bankruptcy situation where termination is necessary because, unless a distress termination occurs, the employer will be unable to pay its debts when they mature and will be unable to continue in business, or the costs of providing pension coverage have become unreasonably burdensome solely as a result of a decline in the employer’s workforce. The standard set forth in option (ii) is commonly referred to as the “reorganization test.”

Upon termination of a plan, PBGC assumes responsibility for guaranteed benefits while attempting to collect funds from the employer. An employer cannot effectuate either a standard or distress termination if terminating the plan would violate the terms and conditions of an existing collective bargaining agreement. However, a plan sponsor seeking a distress termination while in bankruptcy may nullify a contractual bar to plan termination by obtaining court authority to reject or modify the bargaining agreement under section 1113 of the Bankruptcy Code. Finally, PBGC itself can move to terminate a company's pension plan if the company defaults on its minimum funding requirements and PBGC determines that it will be exposed to unreasonable risk in the long run if the plan continues.

Representing Kaiser Aluminum Corporation and its affiliates in their chapter 11 cases, Jones Day successfully litigated against the PBGC in the bankruptcy court, the district court and, ultimately, the Third Circuit Court of Appeals regarding the application of the "reorganization test" to a chapter 11 debtor's distress termination of multiple pension plans.

Kaiser Aluminum

Aluminum mining, refining, and manufacturing giant Kaiser Aluminum Corp. and 25 of its affiliates (collectively, "Kaiser"), with Jones Day's assistance as reorganization counsel, filed for chapter 11 protection between February 2002 and January 2003. As part of Kaiser's attempt to reorganize, the company moved to voluntarily terminate six of its seven pension plans, all of which had been established pursuant to collective bargaining agreements with various unions. The plans covered nearly 13,500 active employees and retirees. The plans were underfunded by nearly $48 million for the 2003 plan year, and Kaiser projected that it would be required to make $230 million in minimum contributions to the plans between 2004 and 2009.

PBGC opposed Kaiser's motion to terminate the plans, arguing that the bankruptcy court should evaluate each proposed plan termination separately under the ERISA "reorganization test." PBGC acknowledged that Kaiser's two largest pension plans would satisfy the reorganization test, but claimed that, when considered on a plan-by-plan basis, Kaiser's four smaller plans did not satisfy the test. The combined minimum funding contributions for these four plans were projected to be roughly $12.8 million between 2004 and 2009 — less than six percent of the estimated $230 million required to fund all of Kaiser's pension plans during that time frame. When these smaller plans were considered on a plan-by-plan basis, PBGC contended, Kaiser could continue funding some or all of them and still successfully reorganize under chapter 11.

The bankruptcy court rejected PBGC's position, agreeing with Kaiser that the plan-by-plan approach endorsed by PBGC would violate the requirement under section 1113(b) of the Bankruptcy Code that debtors bargain fairly and equitably with unions. The court reasoned that considering the plans piecemeal would give creditors the kind of leverage that would force a debtor to initiate bargaining with one union and not with another. Likewise, the court observed, "debtors could use a plan-by-plan approach to gain leverage against creditors that Congress did not intend."

PBGC appealed the decision to the U.S. District Court for the District of Delaware, which affirmed, concluding that ERISA does not mandate a plan-by-plan approach in applying the reorganization test. PBGC then appealed to the Third Circuit Court of Appeals.

The Third Circuit's Ruling

Explaining that ERISA does not explicitly state how the reorganization test is to be applied when an employer seeks to terminate several plans at once, the Court of Appeals remarked that "[i]n every case that we have identified in which a debtor sought to terminate multiple pension plans under the reorganization test, bankruptcy courts have applied an aggregate analysis, apparently without protest from the PBGC." The Court rejected PBGC's contention that a plan-by-plan analysis is mandated by ERISA because lawmakers used the singular terms “single-employer plan” and “plan” in the relevant portion of the statute. The use of the singular form of “plan” in ERISA, the Third Circuit emphasized, “does not constitute a congressional mandate to the bankruptcy courts to apply a plan-by-plan approach to the reorganization test.”

The Court of Appeals agreed with Kaiser that a plan-by-plan approach would be “unworkable” because it would compel bankruptcy courts to make basic assumptions about the order in which plans should be considered and the status of other plans that a debtor-employer proposes to terminate. As currently drafted, the Third Circuit observed, ERISA “leaves open too many questions about how to engage in a plan-by-plan analysis for us to conclude that Congress envisioned such an approach in the multiplan context.”

Moreover, the Court of Appeals explained, the adoption of a plan-by-plan approach to the reorganization test would disrupt the bankruptcy courts in their traditional role as courts of equity:

> The PBGC would have the Bankruptcy Court terminate some of Kaiser’s plans while leaving the others in place, seemingly without a principled basis on which it could make the determination of which workers to prefer over others. We will not impose this result, which we believe would treat Kaiser’s workers unfairly and inequitably, without a clear congressional mandate.

The Third Circuit rejected PBGC’s assertion that a legislative trend tightening restrictions on pension plan terminations indicates that Congress would endorse a plan-by-plan approach. According to the Court of Appeals, “[a]t most, the legislative history demonstrates that Congress had a general intent to make it more difficult for employers to terminate pensions; however, that is hardly determinative of whether, or how, the reorganization test should be applied in the multiplan context.”

Finally, the Third Circuit rejected PBGC's argument that the federal courts should defer to PBGC's interpretation of the reorganization test, stating that "deference to the PBGC here is improper because PBGC has neither the expertise nor the authority to determine when a plan should be terminated under the reorganization test." Issues relating to an employer's bankruptcy and reorganization, the Court of Appeals emphasized, "are within the expertise of the bankruptcy courts, not the PBGC."

Outlook

While *Kaiser Aluminum* is not the first case in which a court has applied the aggregate analysis approach in determining whether multiple plan terminations satisfy the reorganization test, it is the first case in which PBGC has challenged the application of an aggregate analysis and advocated a competing alternative. Moreover, the Third Circuit is the first court at the circuit level to consider the issue, and its decision in *Kaiser Aluminum* fortifies the "bigger picture" policy underlying the chapter 11 reorganization process. Employers in many financially troubled industries, including airlines, automobile manufacturers and auto parts suppliers, have multiple pension plans that are underfunded. *Kaiser Aluminum* is a significant precedent for any employer with multiple plans considering chapter 11 as part of its overall reorganization strategy.

President George W. Bush gave his imprimatur on August 17, 2006 to the most sweeping pension reform in 30 years. Among other things, the Pension Protection Act of 2006 includes provisions that:

- require employers to make sufficient contributions to their single-employer defined-benefit pension plans over the next seven years to achieve 100 percent funding;
- prohibit employers and unions from increasing pension benefits from single-employer plans that are less than 80 percent funded, unless the additional benefits are paid for immediately;

- require employers that terminate a pension plan in bankruptcy to pay $2,500 per participant upon exiting from bankruptcy; and

- allow airlines that freeze all benefit accruals in their pension plans an additional ten years to meet their funding obligations, while allowing airlines that freeze new plan participants but allow current participants to accrue new benefits three additional years to meet their funding obligations.

According to some commentators, the reforms are unlikely to restore PBGC to solvency, but they may improve the embattled insurer's financial outlook, at least in the short term. As more and more employers make the transition away from defined benefit plans because of stricter funding requirements, PBGC's premium base may actually diminish in the long run. Moreover, the rules governing pension plan funding are not the only factors influencing PBGC's troubled financial condition — legislation can do little to stave off major business failures that are inevitable in a volatile economy.

In re Kaiser Aluminum Corp., 456 F.3d 328 (3d Cir. 2006).

In re Aloha Airgroup, Inc., 2005 WL 3487724 (Bankr. D. Haw. Dec. 13, 2005), *vacated as moot,* 2006 WL 695054 (D. Haw. Mar. 14, 2006).

In re Philip Servs. Corp., 310 B.R. 802 (Bankr. S.D. Tex. 2004).

In re Wire Rope Corp. of Am., 287 B.R. 771 (Bankr. W.D. Mo. 2002).

Pension Plans Assumed by PBGC in 2005-2006
(b) = in bankruptcy

Company	Date	Shortfall Assumed
Republic Storage Systems Co., Inc. (b)	October 23, 2006	$29 million
Levitz Home Furnishings, Inc. (b)	October 3, 2006	$23.5 million
Plymouth Rubber Co. (b)	July 19, 2006	$11.9 million
Victory Memorial Hospital	July 5, 2006	$29 million

Pittsburgh Brewing Co. (b)	May 23, 2006	$11 million
Jernberg Industries Inc.	May 5, 2006	$10.2 million
Aloha Airlines Inc. (b)	April 28, 2006	$117 million
Falcon Products Inc. and sub. Shelby Williams Industries Inc.(b)	November 25, 2005	$31.6 million
Huffy Corp. (b)	October 5, 2005	$80 million
Westpoint Stevens Corp. (b)	August 19, 2005	$286 million
Amcast Industrial Corporation (b)	July 28, 2005	$83 million
Techneglas Inc. (b)	June 30, 2005	$70 million
United Airlines (b)	April 22, 2005	$6.6 billion
Liam Ventures Inc.	March 31, 2005	$133 million
Lobdell Emery Corp. and Howell Industries, subsidiaries of Oxford Automotive Inc. (b)	February 25, 2005	$35 million
Penn Traffic Co. (b)	February 24, 2005	$125 million
US Airways (b)	February 2, 2005	$2.3 billion
Murray Inc. (b)	January 19, 2005	$103 million