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Airlines in Distress: Can the Pension Benefit Guaranty Corporation Weather This Crisis?

Introduction

Imagine yourself as a pilot who has been employed by a major U.S. airline for over thirty years. You are quickly approaching retirement and are looking forward to spending time with your family, woodworking in your garage, and traveling to exotic locations. Although your pension will make your budget a little tighter, you are confident that with careful planning you can live the life you desire. One day, you pick up the paper to find that your dreams are in jeopardy; your employer has announced that it is terminating its pension plans. You know that there is a federal agency that ensures pension plans, but you also recall that this will mean a substantial reduction in the amount of benefits you receive annually. Numbly, you wonder what will happen now.

In the days shortly before the passage of the Employee Retirement Income Security Act (ERISA),1 its proponents had high hopes that this legislation would add much needed security to the nation's ailing pension plans.2 But thirty years after the 1974 enactment of ERISA, there are many who would argue that pension plans today are almost as insecure as they were in the 1960s and 1970s when major companies, like the Studebaker-Packard Corporation (Studebaker), declared bankruptcy and ended their pension plans.3 United Airline's (United)

3. Leigh Allyson Wolfe, Is Your Pension Safe? A Call for Reform of the Pension Benefit Guaranty Corporation and Protection of Pension Benefits, 24 Sw. U. L. Rev. 145, 146 (1994). On the other hand, the successes of ERISA cannot be denied. The Department of Labor claims that there has been a general increase in funding rates since 1974. Mark Daniels, Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies, 9 Hofstra Lab. & Emp. L.J. 25, 37 (1991) (citing U.S. Department of Labor Pension & Welfare Administration, Trends in Pensions 119–20 (J. Turner & D. Beller eds., 1989)). Before the enactment of ERISA, “only about one-third of all plans held assets sufficient to pay all accrued benefits due upon termination. However, by 1985 almost three-quarters of all plans had a sufficient level of assets to pay termination liabilities.” Id. Currently, most plans are adequately funded. Id.
July 2004 announcement that it would stop paying into its pension plan underscores this argument.\(^4\)

In December 2002, United announced that it was entering Chapter 11 bankruptcy proceedings.\(^5\) In 2004, while in Chapter 11, United was to pay $500 million in pension contributions and owe another four billion dollars by 2008.\(^6\) On June 28, 2004, a federal loan board turned down United’s request for $1.6 billion in assistance.\(^7\) A month later, on July 23, 2004, United announced that it would no longer contribute to its four pension plans during bankruptcy.\(^8\) Some experts estimated that if United terminated its plans, United could save as much as three billion dollars.\(^9\) On July 26, 2004, the U.S. government challenged United’s actions by declaring that the airline was “violating federal law by suspending $568 million in payments to its pension plans.”\(^10\) A few weeks later, on August 13, 2004, the Pension Benefit Guaranty Corporation (PBGC), the federal agency that guarantees the pension plans, formally announced that it would move to prevent United’s actions.\(^11\) Currently, the PBGC has assumed responsibility for United’s pension plans.\(^12\)


\(^5\) Micheline Maynard, Notes Shed Some Light on Panel Decisions To Deny Aid to United, N.Y. TIMES, Aug. 25, 2004, at C4. A Chapter 11 bankruptcy is not necessarily the end of a company, but rather just the opposite:

By filing a chapter 11 petition . . . the managers of a company indicate their hope that the business will continue. The managers further indicate that they are no longer capable of operating the company under normal conditions, and therefore need the protection of a law tailored to permit operation of a business under distressed conditions. A financially distressed company in reorganization inevitably will make operational decisions that will directly affect the wages, benefits, and job security of its employees.

Donald R. Korobkin, Employee Interests in Bankruptcy, 4 AM. BANKR. INST. L. REV. 5, 12 (1996). In contrast, under a Chapter 7 bankruptcy, the company will be terminated. Daniels, supra note 3, at 64. The main goal of a Chapter 7 bankruptcy is to distribute a company’s assets to its creditors. Id. (citing 11 U.S.C. §§ 701–66 (1998)).


\(^7\) Maynard, supra note 5.

\(^8\) Griffin, supra note 4.

\(^9\) Caroline Daniel, UAL Steps Up Pace of Change: Airline Must Do More to Impress Creditors and the Government, FIN. TIMES, Sept. 1, 2004, at 25. If United terminates its current defined benefits plans, it may use defined contribution plans instead, which would only cost about $1 billion over four years. Id.

\(^10\) Griffin, supra note 4.


Spurred in large part by United’s actions, the collapse of steel companies in the 1990s, and the overall instability of many industries using defined benefit plans, many economists and politicians have advocated ERISA reform.\textsuperscript{13} Several of these proposed revisions are geared toward ensuring the survival of the PBGC.\textsuperscript{14} This Comment proposes that raising the PBGC’s status in bankruptcy will ensure the long-term survival of the PBGC and best protect the employees of the airline industry. Part II of this Comment provides a brief overview of ERISA, the PBGC, and several of the recent issues regarding defined benefit plans that are gaining national attention because of the current airline industry crisis.\textsuperscript{15} Part III examines two proposed reforms relating to the PBGC: modifying the variable-rate premium structure and raising the PBGC’s priority status in bankruptcy proceedings so that the PBGC is able to place liens on the company’s assets while it is in bankruptcy.\textsuperscript{16} This Comment analyzes each of these proposed reforms by examining the flaws in the current structure as well as the pros and cons of each solution. This Comment then proposes elements of an “ideal solution” and ultimately advocates that raising the PBGC’s status in bankruptcy best satisfies these elements.\textsuperscript{17} Part IV examines the current status quo of the airline industry and the effect that this Comment’s proposed reform will have on different airlines, airline employees, and the PBGC.\textsuperscript{18} Part V concludes that while raising the PBGC’s status in bankruptcy would be difficult for United, it

\textsuperscript{13} For example, when United Airlines and US Airways announced that they would terminate their pension plans, the PBGC said it would guarantee the pension benefits for these airlines’ employees but noted that “we need fundamental reforms to improve the financial health of the defined benefit pension system, to protect participants’ benefits, and to shore up the federal pension insurance system.” PBGC, \textit{PBGC Calls for Pension Protections: Actions of US Airways and UAL underscore need for fix} (Sept. 14, 2004), available at http://www.pbgc.gov/news/press_release/2004/pr04_65.htm [hereinafter \textit{Pension Protections}]. David M. Walker, Comptroller General of the United States, stated that:

\begin{quote}
[T]he problems of underfunded pension plans extend far beyond the airline industry, to steel, automotive related manufacturing and other sectors of the economy that sponsor defined benefit (DB) plans. Thus, policymakers must seek both short-term and long-term pension solutions that balance the interests of these industries’ active and retired employees, customers, and stockholders, the PBGC, and American taxpayers.
\end{quote}


\textsuperscript{14} The scope of this Comment will be limited to single-employer situations and accordingly, multi-employer plans will not be considered.

\textsuperscript{15} See infra notes 20–87 and accompanying text.

\textsuperscript{16} See infra notes 88–182 and accompanying text.

\textsuperscript{17} See infra notes 183–213 and accompanying text.

\textsuperscript{18} See infra notes 214–249 and accompanying text.
may ultimately provide the best solution to ensure the long-term survival of the PBGC.\textsuperscript{19}

II. BACKGROUND

This section first reviews the context in which ERISA was enacted, the problems this legislation was designed to alleviate, and the types of pension plans it covers.\textsuperscript{20} This section next provides an overview of the methods by which pension plans can terminate under ERISA.\textsuperscript{21} Finally, this section examines the importance of reforming ERISA to ensure the survival of pension plans and to protect workers.\textsuperscript{22}

A. Overview of ERISA and the PBGC

In the 1960s and 1970s, several major companies collapsed and terminated their pension plans.\textsuperscript{23} Because there were no laws requiring companies to fund their pension plans, many pension plans were severely underfunded.\textsuperscript{24} Therefore, when a company collapsed, there was often not enough money in the pension plans to cover the bene-

\textsuperscript{19} See infra Part V.
\textsuperscript{20} See infra notes 23–51 and accompanying text.
\textsuperscript{21} See infra notes 52–65 and accompanying text.
\textsuperscript{22} See infra notes 66–87 and accompanying text.
\textsuperscript{23} Studebaker Packard was one of the most well-known companies that terminated its pension plan during this time period. Other companies eliminating benefits included the Kaiser-Frazer Corporation (Kaiser) and the American Motors Corporation. James A. Wooton, The Most Glorious Story of Failure in the Business: The Studebaker Packard Corporation and the Origins of ERISA, 49 BUFF. L. REV. 683, 695–97 (2001). The Kaiser Corporation provides an example of how in the pre-ERISA period a company not undergoing bankruptcy could default on pension plans for its own financial benefit. Kaiser, with a few long-term employees, closed its plant, and forced its employees to forfeit whatever benefit accruals they had. Id. But, Kaiser continued the plan for a small number of employees who worked at other smaller plants. Id. As a result, Kaiser’s plan had more funding than was necessary for the amount of employees the plan supported. Id. at 696. The former employees sued to force Kaiser to terminate the plan and distribute its funds, but were ultimately unsuccessful. Id.
\textsuperscript{24} In the 1870’s, American Express was the first private company to sponsor a pension plan for its employees. Wolfe, supra note 3, at 146 (citing Michael Tackett, Pensions Began as Reward, Remain Employer’s Option, Chi. Trib., Dec. 3, 1989, at 25). However, because union leaders resisted pension plans as a “departure from traditional union goals,” the growth of these plans was slow. J. Robert Suffoletta Jr., Who Should Pay When Federally Insured Pension Funds Go Broke? A Strategy for Recovering from the Wrongdoers, 65 NOTRE DAME L. REV. 308, 311 (1990) (citing 100 CONG. REC. 10,318–19 (1954)). For example, “[b]y 1930, a mere 2.7 million active workers—only fifteen percent of all privately employed nonfarm workers—were covered by private pension plans with reserves of $800 million.” Id. at 311–12 (citing AMERICAN COUNCIL OF LIFE INSURANCE, 1981 PENSION FACTS 33 (1981)). Private pension plans became more popular in the 1950s. Id. The Revenue Act of 1942 provided deductions for contributions of these plans, and because of the high tax rates in the 1950s, these plans became more attractive to employers. Id. (citing Revenue Act of 1942, Pub. L. No. 753, § 165, 56 Stat. 798, 862–67). “[B]y 1960, private pension plans covered 20.5 million persons.” Id. However, there was little federal oversight over these programs which led to substantial underfunding in some cases. It was not
fits. A well-known example of pension underfunding was the bankruptcy of Studebaker in 1963:

When Studebaker-Packard closed the facility in December 1963 the pension plan for hourly workers did not have enough assets to meet its obligations. Retirees and retirement-eligible employees aged sixty and older received their full pension, but the plan defaulted on its obligations to younger employees. Some received a lump-sum payment worth a fraction of the pension they expected, and others got nothing at all.

Against this backdrop, Congress enacted ERISA to accomplish three distinct goals: "[T]o encourage the growth of defined benefit pension plans, to provide timely and uninterrupted payment of pension benefits, and to keep pension insurance premiums at a mini-

until 1962 that United Auto Worker Union officials began seriously advocating "public reinsurance for private pension plans." Wooton, supra note 23, at 724.


26. The Studebaker company originally began as a wagon company in the 1800s and began manufacturing automobiles in 1902. A Very Brief History of the Studebaker Family and Company, Studebaker Family, at www.studebakerfamily.org/history.html (last visited Feb. 19, 2005). Due in large part to the army vehicles and ambulances Studebaker provided to the U.S. government in World War I, Studebaker developed a reputation as a producer of reliable automobiles until the 1930s. Id. In the 1930s, however, Studebaker encountered serious financial problems, which were only temporarily resolved by World War II. Id. After the war, Studebaker never totally regained its pre-WWII position. Id. In particular, Studebaker was very negatively impacted by a poorly-received car it produced in 1953, called the Centennial. Id. In 1957, the company merged with Packard in hopes of raising its rapidly slumping sales but Studebaker's problems proved to be too severe, and in 1963, it shut its doors. Id. Because of this shutdown, approximately four thousand workers lost most of their pension benefits. Douglas J. Elliot, PBGC: A Primer, Center for Federal Financial Institutions (Apr. 7, 2004), available at http://www.coffi.org/pubs/PBGC%20A%20Primer.pdf.

27. Wooton, supra note 23, at 683–84. Ultimately, when Studebaker announced in 1968 that it would close its plant in South Bend, Indiana, "the liability of [its] pension plan exceeded its assets by $15 million." Id. at 726. The Congressional findings in ERISA state:

[T]hat the continued well-being and security of millions of employees and their dependants are directly affected by these plans; . . . that [the benefit plans] have become an important factor affecting the stability of employment and the successful development of industrial relations; . . . and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

29 U.S.C. § 1001(a) (2000). Thus, ERISA requires the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the federal courts. Id. § 1001(b). ERISA also seeks to improve the equitable character and the soundness of such plans by requiring them to: (1) vest the accrued benefits of employees with significant periods of service; (2) meet minimum standards of funding; and (3) obtain plan termination insurance. Id. § 1001(c). See also Reece, supra note 2, at 152.
These three goals aimed at adding a missing but necessary element of security to pension plans without overburdening the employer. On Labor Day in 1974, President Gerald Ford signed ERISA into law.

Title IV of ERISA created the PBGC, an agency designed to administer an insurance program protecting workers' and retirees' pension benefits should their employers terminate their pension plans. ERISA does not require that employers contribute all funds necessary to pay all future pensions up front but instead sets contribution amounts according to a complex formula. Therefore, if the plan terminates for any reason, the PBGC guarantees it will pay the owed pensions but only up to a certain amount. The maximum pension benefit guaranteed by the PBGC for plans ending in 2004 is $44,386.32 per year. According to the Center on Federal Financial Institutions (COFFI), "forty-four million employees and retirees in more than 31,000 private defined benefit pension plans rely on the PBGC to protect $1.5 trillion worth of promised pension payments."

The PBGC has three main sources of funding. First, the PBGC receives insurance premiums paid by employers who have defined benefit plans under ERISA. All employers currently must pay nineteen


29. Wooton, supra note 23, at 739.


31. Section 302 of ERISA determines minimum funding contributions for defined benefit plans. However, some experts contend that underfunding issues do not arise from the statutory funding requirements, but rather from other factors. See PBGC: A Primer, supra note 26, at 27. The author noted: "[U]nderfunding results from: inadequate investment returns; employer flexibility on timing of contributions; retroactive benefit increases; and misestimates of lifespans and retirement dates." Id. at 2.

32. Id.


34. COFFI is an independent, nonprofit institute that studies federal insurance activities See Coffi, at www.coffi.org.

35. Id.

36. Boselovic, supra note 28. See also infra notes 97–129 and accompanying text (discussing arguments for and against raising insurance premiums). As explained by the PBGC, The Pension Benefit Guaranty Corporation (PBGC) protects the retirement benefits of 44.4 million workers and retirees without the use of tax dollars from the general
dollars per year per participant, although companies posing high risks of underfunding must pay an additional nine dollars per participant.\textsuperscript{37} Some advocates of ERISA reform, including President George W. Bush, recommend raising premiums as one possible solution to the ERISA crisis.\textsuperscript{38} A second source of funding is the money the PBGC earns on the returns from its investments of the premiums.\textsuperscript{39}

Finally, the PBGC receives funds from employer liability payments it collects when employers terminate their plans and cannot pay owed benefits.\textsuperscript{40} If the employer files for bankruptcy and terminates the plan, the PBGC may collect funds as an unsecured creditor.\textsuperscript{41} In a bankruptcy, creditors are ranked according to their statutorily determined priority status, and lower ranked creditors cannot be paid until the debts of higher ranked creditors are satisfied.\textsuperscript{42} Often, the PBGC is not able to collect the full amount owed after other higher priority creditors are paid.\textsuperscript{43} Many experts contend that the purpose of ERISA and its language suggest that the PBGC should be granted higher priority status.\textsuperscript{44}

The PBGC insures defined benefit plans.\textsuperscript{45} Defined benefit plans are plans in which an employer determines the benefits it will pay its
employees and contributes the necessary amount to a pension fund.\textsuperscript{46} In many cases, the amount of retirement income an employee will receive depends on how long the employee worked for the company.\textsuperscript{47} In addition, the employer must pay insurance premiums to the PBGC in case the employer later terminates its plan and the PBGC assumes responsibility.\textsuperscript{48} ERISA and the Internal Revenue Code (IRC) determine the amount of the required minimum premiums.\textsuperscript{49} Not all plans are defined benefit plans. Instead, many employers have defined contribution plans. In these plans, "the plan sponsor contributes a certain amount for each participant, but no promise is made as to the ultimate benefit or amount that will be received."\textsuperscript{50} Defined contribution plans, such as 401(k) plans, are not guaranteed by the PBGC.\textsuperscript{51}

\textsuperscript{46} Daniels, supra note 3, at 33.
\textsuperscript{47} Korobkin, supra note 5, at 20. A defined benefit plan may calculate owed benefits by two methods. It may simply provide the retiree a specific dollar amount. \textit{Frequently Asked Questions about Pension Plans and ERISA}, Department of Labor, at http://www.dol.gov/ebsa/FAQs/faq_compliance_pension.html (last visited Feb. 18, 2005). More often however, the plan "may calculate a benefit through a plan formula that considers such factors as salary and service—for example, 1 percent of average salary for the last five years of employment for every year of service with an employer." \textit{Id.}
\textsuperscript{48} Elliot, supra note 26, at 4.
\textsuperscript{49} Daniels, supra note 3, at 33 (citing 29 U.S.C. § 1082 (1994)).
\textsuperscript{50} \textit{Id.} Advantages of a defined benefit plan compared to a defined contribution plan are: (1) defined benefit plans are useful to the "unsophisticated investor" employee because the more sophisticated employer bears the investment risk; and (2) defined benefit plans offer more security to a retiree, because defined contribution plans give retirees lump sum payments, which are often spent in the employee's first retirement years. Michael J. Collins, \textit{Reviving Defined Benefit Plans: Analysis and Suggestions for Reform}, 20 VA. TAX REV. 599, 600-01 (2001). In contrast, defined contribution plans are often preferred by employers because they have much lower administrative costs. \textit{Id.} at 601. "A 1998 study estimated that the cumulative effect of the changes in the regulatory environment increased the cost of maintaining a defined benefit plan from about 140 percent of the cost of maintaining a defined contribution plan in 1981, to more than 210 percent in 1996." \textit{Id.} A disadvantage of defined contribution plans "is that the employee bear the risk of return on the investment because there is not a guaranteed level of benefits promised to the employee." Kathleen H. Czarney, \textit{The Future of Americans' Pensions: Reviving Pension Plan Asset Allocation to Combat the Pension Benefit Guaranty Corporation's Deficit}, 51 CLEV. ST. L. REV. 153, 169 (2004) (citing David A. Pratt, \textit{Nor Rhyme Nor Reason: Simplifying Defined Contribution Plans}, 49 BUFF. L. REV. 741, 761, 759 (2001)). Employees covered under this type of plan receive the amount of the plan's assets, "regardless of whether the plan experienced gains or losses." \textit{Id.}
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B. Termination of Defined Benefit Pension Plans

Under ERISA, there are several ways in which pensions may terminate. First, an employer can voluntarily move to terminate its plan in a standard termination. In this scenario, the plan must have enough money to pay all benefits before the plan can end, and employers will be liable to the PBGC for one hundred percent of the plan benefit liabilities. Second, an employer can voluntarily act to terminate its plan in a distress termination. Here, the employer must prove it will face financial difficulty if forced to continue the plan. The PBGC will assume responsibility for guaranteed benefits while making efforts to collect funds from the employer. Third, the PBGC can move to terminate a company’s pension plan if the company has not met minimum funding requirements and the PBGC will face an unreasonable risk in the long run if the plan continues.

Typically, when an employer is facing Chapter 11 bankruptcy, the employer is required to balance many competing interests. These interests arise because the company is planning to reorganize and is hoping to emerge from bankruptcy and continue to function after the

proximately one-fifth of employees covered by defined benefit plans participate in multi-employer plans. Single- and Multi-Employer Defined Benefit Plans Differ, Bureau of Labor Statistics, U.S. Department of Labor, at www.bls.gov/opub/ted/1999/Apr/wkl/artO3.htm (Apr. 7, 1999). Single-employer plans encompass all other plans. In this situation, a single employer establishes a plan for all employees, and the employer alone is responsible for the support and management of the plan. Cohen, supra note 51, at 2444. The scope of this Comment will include only single-employer plans, such as the plan sponsored by United.

52. Author Mark Daniels noted: Section 4021 of ERISA addresses which plans are within ERISA's termination scheme... . a plan must: (1) be a defined benefit plan; (2) which is established or maintained by an employer or labor organization or both, in any industry or activity affecting commerce; and (3) which has operated as a tax-qualified plan for the past five years or has been determined by the Secretary of the Treasury to be a tax-qualified plan under the IRC.

Daniels, supra note 3, at 48.


54. Id.

55. Id.

56. Id. Daniels stated: [T]he PBGC must determine whether a plan qualifies for distress termination under any of the three possible criteria. The three possible situations which will support a distress termination are: (a) liquidation in bankruptcy; (b) a reorganization in bankruptcy in which the court determines that a termination is necessary to facilitate said reorganization; and (c) a non-bankruptcy situation where termination is necessary.

Daniels, supra note 3, at 54.


58. Hazan et al., supra note 51, at 501.
bankruptcy. Thus, the employer must first weigh its promises to its employees against its own capacity to meet those needs.\textsuperscript{59} Employers make many different promises to its employees—"commitments . . . for wages, for benefits, and even future employment."\textsuperscript{60} Unfortunately, when the business encounters turmoil, it may become a challenge to meet these promises, and "the business may have to close plants, lay off employees, or reduce certain wages or benefits."\textsuperscript{61}

In the event that an employer terminates its pension plan during bankruptcy, formal obligations imposed by legislation may further complicate these conflicting interests. On one hand, ERISA is geared toward ensuring that the employer meets its obligations to its employees.\textsuperscript{62} For example, "[u]nder ERISA, if a pension plan is terminated, the employer is required to ensure payment of all benefits earned to the date of termination. If the employer is in bankruptcy, this obligation may be reduced, but plan participants are guaranteed a minimum amount of benefits."\textsuperscript{63} Thus, the PBGC may make a claim on the assets of a company in bankruptcy.\textsuperscript{64} A reorganizing company, however, has other parties whose interests it must consider. "A reorganizing company must reach an accommodation with its creditors to continue in operation and pay at least a portion of its obligations."\textsuperscript{65}

C. The Necessity of ERISA Reform

Experts assert three primary reasons why ERISA must be reformed to ensure the survival of the PBGC so that employees' retirement benefits are protected.\textsuperscript{66} First, employees typically cannot protect

\begin{footnotesize}
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\item \textsuperscript{59} Korobkin, supra note 5, at 11.
\item \textsuperscript{60} Id.
\item \textsuperscript{61} Id.
\item \textsuperscript{62} Daniels, supra note 3, at 32.
\item \textsuperscript{63} Id.
\item \textsuperscript{64} Id.
\item \textsuperscript{65} Id.
\item \textsuperscript{66} For the purposes of this Comment, the author is assuming that the ultimate goal of ERISA reform is to ensure the survival of the PBGC and defined benefit plans. This Comment does not argue that defined benefit plans should be replaced with defined contribution plans, or that employer-based pension plans should be eradicated. Employer-based pension plans are important for several reasons. Although they work in tandem with Social Security and individual retirement plans like Individual Retirement Accounts (IRAs), these other retirement plans only provide a fraction of the benefits that employer-based plans offer. Daniel Halperin, Employer-Based Retirement Income—the Ideal, the Possible, and the Reality, 11 Elder L.J. 37, 40 (2003). For example, the highest benefit offered by Social Security is currently approximately $20,000 per year. \textit{Id.} (citing Benefit Examples for Workers with Maximum Earnings, Social Security Administration, \textit{at} http://www.ssa.gov/OACT/COLA/examp (Oct. 12, 2002)). Thus, "it is unlikely that Social Security benefits will achieve full income replacement." \textit{Id.} Private savings, such as IRAs, are also often insufficient because many workers fail to take advantage of these plans. \textit{Id.} "[O]nly a small minority of households earning less than $25,000 have taken advantage of the
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themselves and their interests before a company terminates its plans. As one commentator has noted, "Generally, employees are unable to assess the present and future creditworthiness of their employer, and it is often difficult for them to monitor their employer's financial condition during the course of their employment." Furthermore, employees' ability to take action may be limited. "Even if they happen to learn of an employer's financial troubles in time to act, workers may lack the mobility to change jobs." Therefore, it is important that a neutral third party, like a government agency, promulgates regulations that protect employees from being left without pension benefits when employers encounter financial difficulty.

Second, and perhaps more importantly, because the PBGC is facing severe financial problems due to the collapse of many industries and the subsequent need to rescue the plans of many steel companies and airlines, many experts argue that it is essential that ERISA is reformed so taxpayers do not shoulder the burden of paying the owed pensions. The magnitude of the PBGC's problems have not gone unrecognized. In July 2003, the Government Accountability Office opportunity to establish an IRA. Id. (citing Daniel I. Halperin & Alicia H. Munnell, How the Pension System Should Be Reformed, Address at the Brookings Institute Conference at the National Press Club 54 (Sept. 17, 1999), available at http://www.brook.edu/dybdocroot/es/events/erisa/99papers/erisa10.pdf). For these reasons, employer-based plans play a vital role in many workers' retirement plans. Id.


68. Korobkin, supra note 5, at 6.

69. Id.

70. Id.

71. Id.

72. Since the PBGC's "creation, the airline and steel industries have accounted for more than 70 percent of all claims while representing less than 5 percent of all insured participants." Jeff St. Onge, Pension Crisis Looming, Taxpayers May Get Stuck with Tab, Study Warns, BLOOMBERG NEWS, Aug. 25, 2004, at C3, available at www.lexisnexis.com.

(GAO) "placed the PBGC single-employer pension program on [its] 'high risk' list of troubled federal programs." At the end of 2003, the PBGC held thirty-five billion dollars in assets but had a deficit of $11.2 billion. The PBGC's current deficit is more than nine billion. United's pension plans cover 58,000 current retirees—a number which does not include future retirees. Since United's four plans were terminated, more than five billion in pension liabilities have fallen on the PBGC. While the PBGC is in "no immediate danger of running out of money," United's underfunding of its pension plans, if considered together with underfunded pension plans at other airlines, may threaten the survival of the PBGC.


76. Geisel, supra note 25.

77. Griffin, supra note 4.

78. Id. Like United, US Airways is also trying to terminate its pension plans, thus potentially contributing to the disaster facing the PBGC. Danielle DiMartino, Pension dominoes lining up, Dallas Morning News, Sept. 15, 2004, at 4D. On September 14, 2004, US Airways, also in bankruptcy, announced that it may terminate two of its pension plans. Id. The next day US Airways failed to make a $110 pension payment that was due. Boselovic, supra note 28. "Among US Airways' baggage as it heads into its second bankruptcy is an estimated $2 billion pension liability that the airline hopes to shift to the PBGC." Id.

79. Geisel, supra note 25.

total underfunding of airline plans amounts to thirty-one billion dollars.  

Some experts predict that "[w]ithout changes to its funding and premium rules, the PBGC's deficit is likely to swell to $18 billion in the next 10 years and may reach more than $50 billion." Consequently, should the PBGC's deficit become overwhelming, the nation's taxpayers may be forced to rescue the agency in order to ensure that pensioners can continue to receive their benefits. Bradley Belt, the Executive Director of the PBGC, said that "[W]hen underfunded pension plans terminate, three groups can lose: workers face the prospect of benefit reductions; other companies, including those that are healthy and have well funded plans, may face higher PBGC premiums; and, ultimately, taxpayers may be called upon by Congress to bail out the pension insurance fund. . . ." The PBGC announced that it will guarantee the pensions owed to employees of United and US Airways, but to continue successfully protecting employee pensions, the PBGC argues that Congress must pass certain reforms providing the PBGC adequate funding from the companies it insures.

Third, given the history of the PBGC and pension crises that occurred in the 1990s, it has become clear that a dramatic change in legislation is necessary. That is, these issues have arisen before, and

81. Geisel, supra note 25. It should be noted that this figure is based on circa 1980 mortality tables, and some actuaries estimated it would increase it by "$7 billion by 2006 if the tables were updated." DiMartino, supra note 78.  
82. St. Onge, supra note 72. The Cato Institute, a Washington-based policy research group, published a study reporting that "a $350 billion pension shortfall among US companies may force the federal agency that insures retirement plans to seek a taxpayer bailout similar to the one required during the savings-and-loan crisis." Id. Richard A. Ippolito, the former PBGC chief economist, is the author of the Cato study. Id.  
84. The Effect of Federal Bankruptcy and Pension Policy on the Financial Situation of the Airlines: Hearing Before the S. Comm. on Commerce, Sci. and Transp., 108th Cong. (2004) (testimony of Bradley D. Belt, Executive Director, Pension Benefit Guaranty Corporation) [hereinafter Belt testimony], available at http://commerce.senate.gov/hearings/testimony.cfm?id=1332&wit_id=3891. There are those who argue a taxpayer bailout may be a real possibility: This situation is analogous in some ways to the Savings and Loan crisis. The insurance fund for the Savings and Loan didn't have any claim on the federal government either. However, it's impossible for me to believe that the politicians will let the checks to gramma and grampa just stop—just as it was impossible for the politicians to let people lose money on their deposits in the savings and loans. Who Will Rescue the Pension Benefit Guaranty Corp.?, BCD NEWS AND COMMENT, October, 5, 2004, available at www.lexisnexis.com [hereinafter Who Will Rescue the PBGC?].  
85. Pension Protections, supra note 13.  
86. Both the metal and airline industries have faced increasing numbers of crises in the 1990s. PBGC, Pension Insurance and the American Workforce, at http://www.pbgc.gov/publications/factshs/INDUSTRY.htm (edited Apr. 8, 2002) [hereinafter Pension Insurance]. By 1998, the PBGC
unless a change is made, they will happen again. As David Walker, Comptroller General of the United States has stated:

First, this is not the first time we have witnessed the simultaneous struggles of the airline industry and airline pension underfunding . . . . Since [the 1980s] we've seen PBGC take over a number of badly underfunded plans including Pan American, Eastern, Braniff, and TWA . . . . Second, the airlines' experience illustrates the speed with which a pension funding crisis can develop. In 2001, PBGC reported that as a whole the air transportation industry had more than enough assets to cover the liabilities in its pension plans. Yet just 3 years later the industry threatens to saddle PBGC with its biggest losses ever from plan terminations. [Third,] serious pension underfunding is not confined to the airline industry. Of the 10 most underfunded pension plan terminations in PBGC's history, 5 have been in the steel industry . . . . Looking ahead, in addition to airlines, automotive related firms may present the greatest ongoing risk to PBGC, with over $60 billion in underfunding as of 2003.87

The history of defined benefit pension plans has made it clear that reform is necessary in order to permanently solve the dramatic issues facing the PBGC.

III. ANALYSIS OF PROPOSED REFORMS

Based on the two ways in which the PBGC collects funding from the companies it insures, there are two major reforms being advocated to save the PBGC from financial ruin. First, some experts urge an increase in the variable-rate premiums that some employers are required to pay to the PBGC.88 Many assert that the premium rate structure should more accurately reflect the risk that a financially unstable company with an underfunded plan poses to the PBGC.89 Second, there are many who argue that to collect funding to support the pension plans the PBGC is assuming, the PBGC should be able to

87. Walker statement, supra note 13.
88. Who Will Rescue the PBGC?, supra note 84.
89. Belt testimony, supra note 84.
place an effective lien upon a company's assets when the company is in bankruptcy.\textsuperscript{90} To achieve this, the PBGC's status in a Chapter 11 bankruptcy would have to be elevated above that of a general unsecured creditor.\textsuperscript{91} Some experts contend that the PBGC should have administrative or tax priority status.\textsuperscript{92} In order to demonstrate that raising the PBGC's status in bankruptcy is the better solution, this section will propose components of an "ideal" solution and apply both proposed reforms to the ideal solution.

\textbf{A. Premiums}

Although the premium structure has undergone much change since the enactment of ERISA thirty years ago, there are many who would argue that the PBGC's deficit demonstrates that further reform of the premium structure is necessary.\textsuperscript{93} This section first examines the evolution of the premium structure and its inadequacies.\textsuperscript{94} This section next examines the advantages and disadvantages of raising premiums, particularly focusing between the balance of ensuring the PBGC's ability to cover terminated pension plans while not discouraging companies from offering defined benefit plans because of higher costs.\textsuperscript{95} Finally, this section argues that the best way to adjust the premium structure would be to modify the variable-rate premium to reflect the financial risk the employer poses to the PBGC.\textsuperscript{96}

\textbf{1. The Premium Structure Does Not Adequately Allow the PBGC to Pay Projected Pension Benefits}

The current premium structure is flawed because it does not allow the PBGC to pay the pension benefits experts are projecting the PBGC will owe in light of United's and US Airways's bankruptcies and the other large pension plans the PBGC assumed control of in the 1990s.\textsuperscript{97} Ideally, the premium structure should allow the PBGC to

\begin{itemize}
\item \textsuperscript{90} \textit{Id.}
\item \textsuperscript{91} \textit{Id.}
\item \textsuperscript{92} Hazan et al., \textit{supra} note 51, at 501.
\item \textsuperscript{93} For example, raising premiums is one solution being advocated by Douglas Holtz-Eakin, Director of the Congressional Budget Office. \textit{Solvency of Pension Benefit Guaranty Corporation: Current Financial Condition and Potential Risks: Hearing Before the S. Budget Comm.,} 109th Cong. (2005) (statement of Douglas Holtz-Eakin, Director, Congressional Budget Office).
\item \textsuperscript{94} \textit{See infra} notes 97–107 and accompanying text.
\item \textsuperscript{95} \textit{See infra} notes 108–126 and accompanying text.
\item \textsuperscript{96} \textit{See infra} notes 127–129 and accompanying text.
\item \textsuperscript{97} \textit{See, e.g.}, Belt statement, \textit{supra} note 73.
\end{itemize}
meet its revenue needs and "appropriately reflect the risks that it covers." \textsuperscript{98}

The premium structure has been modified several times since ERISA's enactment in 1974. Originally, the single-employer premium was a flat rate of one dollar per participant. \textsuperscript{99} There were several increases in the premium rates over the years, but the most significant adjustments occurred in 1988. \textsuperscript{100} That year there was an increase in the basic premium rate, and the Omnibus Budget Reconciliation Act of 1987 introduced a variable-rate premium, which would be imposed on plans that were significantly underfunded. \textsuperscript{101}

The PBGC is not collecting enough from its premium structure to cover its costs. In 2003, all single-employer pension plans paid a basic "flat-rate premium of $19 per participant per year," and "[u]nderfunded plans were required to pay an additional variable-rate charge of $9 per $1,000 of unfunded vested benefits." \textsuperscript{102} Thus, the PBGC collected $973 million of insurance premiums in 2003, seventy percent of which came from the basic flat-rate payments and thirty percent of which came from the variable-rate premium charged to underfunded employers. \textsuperscript{103} As of 2003, the PBGC insured pensions with an estimated value of $1.5 trillion but only had thirty-five billion dollars in assets. \textsuperscript{104} Although it is true that the PBGC also collects funds from companies in bankruptcy, it is clear that the pension premiums will not enable the PBGC to meet its obligations. \textsuperscript{105}

The inadequacies of the premium structure are well-illustrated by a close examination of United's situation. The PBGC reports that United, which maintains a $6.4 billion pension benefit plan, only contributed fifty million dollars in premiums. \textsuperscript{106} Belt has noted that

\textsuperscript{98} Id. Belt testified: "Currently, PBGC's premium income is inadequate to cover projected claims, and the premium structure provides minimal incentives for plans to remain funded." \textit{Id.}

\textsuperscript{99} \textit{Premiums, supra} note 36. This low amount was set because "when Congress established the PBGC, 'the program was not expected to be big or costly.'" Suffoletta, \textit{supra} note 24, at 313 (citing K. Utgoff, Executive Director of the PBGC, Remarks before the Employee Benefits Conference Board (Mar. 16, 1987)).

\textsuperscript{100} \textit{Premiums, supra} note 36. For example, Congress raised the premium to $2.60 in 1978 and again to $8.50 in 1986. \textit{Id.}

\textsuperscript{101} \textit{Id. See} ERISA § 4006(a)(3) (2000).

\textsuperscript{102} \textit{Premiums, supra} note 36. \textit{See} ERISA § 4006(a)(3). The "variable rate premium" is the sum of the basic premium rate and a risk related amount equal to $9 for each $1,000 of unfunded vested benefits. \textit{Id.}

\textsuperscript{103} at 24.

\textsuperscript{104} \textit{Id.} at 4–6.

\textsuperscript{105} \textit{See} Belt statement, \textit{supra} note 73.

\textsuperscript{106} Boselovic, \textit{supra} note 28.
United only had to pay this relatively minor amount "even though its credit rating has only been good enough for junk bonds and its pension have been underfunded by five billion dollars on a termination basis for at least the past four years."¹⁰⁷ That is, for its plan to be fully funded and cover all current and future pension benefits, United would have to pay five billion dollars. Because United is terminating its plan without paying this amount, and the fifty million dollars it has paid in premiums to the PBGC is not nearly enough to cover its obligations, the PBGC must assume United's share of the obligation.

2. Is Raising Premiums a Solution?

A major question remains: is raising premium payments—either by requiring employers to pay the full amount or adjusting premium payments to reflect risk—a correct solution to the problems facing the PBGC?¹⁰⁸ Even before discussing the best way to raise premiums, it must be acknowledged that there are many arguments for and against raising premiums at all.

a. Arguments for Raising Premiums

The PBGC is urging Congress to raise premiums because premiums are one of the two ways that the PBGC receives the revenue it uses to pay pensions when an employer terminates its plans.¹⁰⁹ Increasing premiums would better allow the PBGC to meet its obligations if companies terminate their defined benefit plans.¹¹⁰ Increased premiums are one very real way to close the increasing disparity between the amount of benefits the PBGC pays out each year and the amount the PBGC takes in each year.¹¹¹

¹⁰⁷. Denise Marois, PBGC Can Still Bank Airline Pensions, But Deficits Loom, AVIATION DAILY, Oct. 14, 2004, at 4, available at www.proquest.com. Even more dramatic are the problems at Kaiser Aluminum Corporation, which declared bankruptcy in October 2004. The plan is 48 percent funded, with about $301 million in assets to cover $629 million in liabilities. The PBGC has now taken on $555 million of Kaiser Aluminum's benefit promises. Kaiser Aluminum has transferred to the PBGC, in addition to the hourly pension plan, the liabilities of its pension plans for salaried and inactive workers. The company has paid a total of about $19 million in premiums for the three plans since 1994, the PBGC said.


¹⁰⁸. See Belt testimony, supra note 84; see also Walker statement, supra note 13.

¹⁰⁹. Daniels, supra note 3, at 36.

¹¹⁰. See Walker statement, supra note 13.

Furthermore, if premiums were related to the funding level of the pension plan or the financial soundness of a company, premiums could be used to encourage companies to properly manage their pension plans.\textsuperscript{112} That is, companies may have an incentive to adequately fund their pension plans if the consequence of underfunding is a higher premium payment to the PBGC.\textsuperscript{113}

Finally, raising premiums ensures that the PBGC would be able to pay pension benefits if the company underwent bankruptcy, which benefits employers and employees by adding stability to the pension plan. Employees have a guarantee that their benefits will be provided in case the employer encounters financial difficulty that prevents it from paying the plan.\textsuperscript{114} Employers are able to pay lower wages because they can offer attractive pension packages.\textsuperscript{115} Having a federal agency back the pension plans means that employees are more willing to accept the lower wages because they can feel secure that they will receive the promised pensions later.\textsuperscript{116}

b. Arguments Against Raising Premiums

There are several general objections against raising premium payments. First, although raising premium payments would theoretically increase the PBGC's revenue such that it would be better able to pay terminated pension plans, some experts question whether having the PBGC pay terminated pension plans is really an adequate solution.\textsuperscript{117} In some cases, because the PBGC caps its annual payments to retirees at $44,386, the PBGC may distribute only a fraction of the pension owed to retirees by the employer.\textsuperscript{118} Thus, "PBGC premiums, at best,

\begin{itemize}
\item \textsuperscript{112} Belt testimony, \textit{supra} note 84. “PBGC premiums can also play a useful role in encouraging sound plan funding and discouraging risky behavior.” \textit{Id.}
\item \textsuperscript{113} As Martin Slate, the former Director of the PBGC, stated: “The variable rate charge gives companies with underfunded plans a greater financial incentive to properly fund their plans.” \textit{Retirement Protection Act of 1993: Hearing on H.R. 3396 Before the Oversight Subcomm. on Ways and Means}, 103rd Cong. (1993) (statement of Martin Slate, Exec. Director, PBGC).
\item \textsuperscript{114} Daniel Keating, \textit{Pension Insurance, Bankruptcy and Moral Hazard}, 1991 \textit{Wis. L. Rev.} 65, 92.
\item \textsuperscript{115} \textit{Id.}
\item \textsuperscript{116} \textit{Id.} at 73.
\item \textsuperscript{117} Wolfe, \textit{supra} note 3, at 177.
\item \textsuperscript{118} This result is further exacerbated by the PBGC's distinction between employees who retire before or at age sixty-five. McCain statement, \textit{supra} note 111. The PBGC is required to reduce its payouts to employees who retire before age sixty-five. PBGC, \textit{Termination Fact Sheet, available at} http://www.pbgc.gov/publications/factshts/TERMFACT.HTM (last edited Jan. 26, 2005). Thus, these employees cannot be paid even $44,386 per year, the maximum amount guaranteed by the PBGC, even if the employees would have qualified for much more if paid by the employer. See generally \textit{The Effect of the Federal Bankruptcy and Pension Policy on the Financial Situation of the Airlines: Hearing Before the S. Comm. of Commerce, Sci. and Transp., 108th Cong. (2004)} (statement of Captain Duane Woerth, President, Airline Pilots Association Inter-
provide limited security that the government will provide an insufficient benefit payment.”

Second, raising premiums may adversely affect solvent companies with defined benefit plans who are playing by the rules and not relying on the PBGC to bail them out. Some experts argue that the PBGC is in financial trouble because it has been mismanaged in the past and because of the problems it has run into with other companies that terminated underfunded plans. For example, some experts have accused the PBGC of “shoddy enforcement” of pension plans, including poorly monitoring plans, “failing to perfect potential liens,” and being tardy “in terminating underfunded plans.” It would not only be unfair to place the burden on these solvent companies, but it would also require the companies to dedicate their own limited resources to fixing a problem that they did not create. Senator James M. Jeffords of Vermont has thus argued: “If Congress increases premiums to solve the PBGC’s problems, they would send a message to companies that are meeting their pension obligations that not only do they have to pay for their own pension benefits, at some point they will pay for the benefits of their competitors.”

Finally, companies may actually decide not to offer defined benefit plans if the premiums are too high. One commentator has predicted, “If premiums are raised too much for employers with well-funded plans, the attractiveness of offering defined benefit plans will decrease.” New employers may decide not to establish defined benefit plans, or current employers with defined benefit plans may voluntarily terminate the defined benefit plan and instead offer a de-
fined contribution plan. 125 Although there are many reasons why an
employer may choose to provide employees with defined contribution
plans, it would not be in line with Congress's intent if employers who
could offer stable defined benefit plans decided not to do so because
the premiums were too high. 126

3. A Possible Reform to the Premium Pension Structure May
Include Changes to the Variable-Rate Premium

One possible reform advocated by the PBGC and other experts, to
save the PBGC from bankruptcy, is to modify the variable-rate premi-
ums. 127 In particular, the criteria for determining whether a com-
pany's plan is so underfunded that the employer must pay the
premium rate could be reformed. Under the current formula, many
firms do not pay a variable-rate premium. If, however, a straightforward underfunding test were applied, more plans would be required
to pay the premium. 128 As one commentator notes,

[F]irms are not charged if they had reached the full funding limit on
contributions. (Because potentially very different liability assump-
tions are used for the two calculations, many firms have been un-
derfunded for variable rate premium purposes and yet subject to
the full funding limit, which would impose excise taxes on further
contributions.) 129

Thus, the premium rules could be restructured to include employers
who are not currently identified as high-risks.

B. Raising the PBGC's Status in a Bankruptcy Proceeding

First, this section examines the PBGC's current status in a com-
pany's bankruptcy proceeding and explains why its status is too low. 130

125. Wolfe, supra note 3, at 155 (citing Celia Silverman, Pension Evolution in a Changing
Economy, EBRI SPECIAL REPORT/ISSUE BRIEF (Employee Benefit Research Institute, D.C.),
Sept. 1993, at 4–5). "If PBGC premiums increase or the benefits PBGC insures decrease to a
level where employers believe they are paying more in premiums than the value of the insur-
ance, employers may decide to terminate or not to establish the defined benefit plans." Id.

126. Moreover, Congress's intent in enacting ERISA was to add stability to pension plans.
Czarney, supra note 50, at 159. One could argue that reforming ERISA so that defined benefit
plans are disadvantageous to employers would be contrary to Congress's intent of increased
security because defined contribution plans are not insured by the PBGC. Id. at 169. Thus,
defined contribution are less secure than defined benefit plans because "in the event of a market
failure, employees will receive only the balances of their individual plans." Id.

127. Belt statement, supra note 73. Most experts who advocate reform of the premium struc-
ture, as well as the PBGC, suggest that the variable-rate premium be adjusted according to the
method described in this section. Id.

128. Elliot, supra note 26, at 24.

129. Id.

130. See infra notes 133–159 and accompanying text.
Next, this section evaluates the arguments for and against raising its priority status.131 Finally, this section argues that if the PBGC's status is elevated, the PBGC should have administrative priority.132

1. Low-Priority Status Is Problematic

Many experts argue that during bankruptcy, the PBGC should be given a higher priority than that of an unsecured creditor.133 In accordance with the Bankruptcy Code, there are two kinds of creditors in a bankruptcy proceeding: secured creditors and unsecured creditors.134 The difference between secured and unsecured claims lies in whether the creditor has a right to claim the debtor's property, in addition to monetary payment, in case of a bankruptcy. A secured creditor has a claim on the debtor's property while an unsecured creditor only has the right to monetary payment.135 When ranking claims, unsecured claims fall below secured claims and are divided into nine different priority ranks.136 The rank of a creditor's claim is very important because each higher ranked claim is entitled to payment in full before any lower ranked claims are paid.137 Consequently, "[t]he 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."138 Because of its low status, the PBGC recovers only about twelve percent of its claims from bankrupt corporations.139

There are two kinds of liens the PBGC may assert against a company, both of which can hinder the PBGC's ability to recover funds as a secured creditor.140 The PBGC can assert a lien for unfunded bene-

131. See infra notes 160–176 and accompanying text.
132. See infra notes 177–182 and accompanying text.
133. Uylaki, supra note 41, at 93.
134. Id. at 92 (citing 11 U.S.C. § 506 (1994)).
135. Id.
138. Keating, supra note 121, at 825. In a Chapter 7 bankruptcy, the priority status determines how a creditor will be paid. Daniels, supra note 3, at 64. The priority status is important in a slightly different way in a Chapter 11 bankruptcy, where a company is reorganizing and plans to emerge from bankruptcy. Id. High priority claims are still paid before low priority claims, although high priority claims are not fully satisfied. Id. Also, low priority claims can be negotiated with the debtor company so that the claim can be satisfied at least in part. Id. at 64–65.
139. See PBGC: A Primer, supra note 26, at 4.
140. The PBGC may also assert a lien for unpaid premiums, but this lien will not be discussed in this Comment because of its relative unimportance to the problem addressed.
Liabilities, a claim for unpaid minimum contributions, or both. The PBGC can only assert this lien after it has made a demand on the plan sponsor, and the agency is limited in asserting this lien because the lien amount cannot exceed thirty percent of the aggregate net worth of the employer's control group. The PBGC can also assert a lien for the amount of the employer's required minimum funding contributions. If an employer has filed Chapter 11 bankruptcy and has not terminated its defined benefit plan, the employer still must meet its minimum contribution payments. If the PBGC has made a demand on the company, it can assert a lien for this amount in the same manner that it can assert a lien for unfunded benefit liabilities. The PBGC can also automatically assert a lien for minimum contribution payments against the plan sponsor if the missed contributions exceed one million dollars in the aggregate.

Thus, the problem is not that the PBGC cannot assert liens, but that the liens are often ineffective because of the way the Bankruptcy Code limits the liens available to the PBGC. For the PBGC to be classified as a secured creditor, the employer must terminate the plan prior to filing for Chapter 11 bankruptcy and the PBGC must perfect its lien against the company before it files for bankruptcy. If these two events do not occur before the employer files for bankruptcy, the Bankruptcy Code prevents the PBGC from having secured creditor status. Consequently, the Code's "automatic stay" provision frustrates the PBGC's claim. Section 362(a)(4) of the Bankruptcy Code

143. Keating, supra note 121, at 825-26. A control group is "a group of trades or businesses under 'common control.'" Terry A.M. Mumford, Retirement, Deferred Compensation, and Welfare Plans of Tax-Exempt and Government Employers, AMERICAN LAW INSTITUTE-AMERICAN BAR ASSOCIATION CONTINUING LEGAL EDUCATION 11, 43 (2004) available at www.westlaw.com (quoting ERISA, § 3(40)(B)(ii)). According to PBGC standards, trades or businesses are under common control "if they are 'two or more trades or businesses under common control' as defined in regulations prescribed under section 414(c) of the [Internal Revenue] Code." Id. (quoting 26 C.F.R. § 1.414(c)-2).
144. Keating, supra note 121, at 826.
146. Keating, supra note 121, at 826.
148. Keating, supra note 121, at 827.
149. Uylaki, supra note 41, at 94-95.
"stays 'any act to create, perfect, or enforce any lien against property of the estate.'" The effect of these provisions is that in most cases, the PBGC cannot file a lien because the employer typically does not file a plan termination until bankruptcy. The lien that arises automatically for unpaid funding contributions encounters the same problem with the stay provision because the lien must be perfected before bankruptcy to be effective. Any liens that are not perfected before the company enters Chapter 11 bankruptcy may not obtain priority status.

The recent announcements by United and US Airways that they will stop paying contributions into their pension plans as required by ERISA demonstrate this problem. Because the Bankruptcy Code hampers the PBGC's ability to place a lien on these companies, employers can continue to violate federal law, virtually without consequence, by not paying the required contributions. Belt argues that "[p]roviding for an exception to the automatic stay would better enable the PBGC to protect the interests of the workers and retirees that it insures and make it clear that [the PBGC] place[s] a high priority on meeting pension promises made to workers and retirees."155

Besides resulting in the PBGC's inability to collect the funds from the delinquent plan sponsors, these provisions may result in another very disturbing consequence. Both the employer and the PBGC have incentives to abuse ERISA. An employer, aware of his financial instability and imminent Chapter 11 bankruptcy, may delay terminating its pension plans until filing for Chapter 11 so that the PBGC's lien may not be granted priority. In addition, the ability of the PBGC to impose the lien provides the PBGC with an incentive to force the company to involuntarily terminate its plan when its finances look shaky but before the company enters bankruptcy. The PBGC's forcing involuntary plan termination has some undesired consequences. For example, as a result of involuntary termination, some companies may be required to downsize, and "[t]he mere thought

151. Id. at 839.
152. Id.
153. Uylaki, supra note 41, at 102.
154. Belt testimony, supra note 84.
155. Id.
156. Uylaki, supra note 41, at 105–06.
158. Wolfe, supra note 3, at 179.
of forced downsizing of corporations with the most significant underfunding . . . would send shockwaves throughout the economy.”

2. Should the PBGC Be Granted Priority Status in Bankruptcy Proceedings?

In all proposed reforms to the PBGC, one must be mindful of the ultimate goals of ERISA—to ensure pension benefits while not overburdening the benefit system so that employers opt not to offer the plans at all. There are thus arguments for and against raising the PBGC’s status in bankruptcy. This section examines the additional security that the raised priority status may afford the PBGC and employees, and also the disadvantages that may sway some employers to eliminate defined benefit plans completely.

a. Arguments for Raising the PBGC’s Priority Status

There are several arguments for raising the PBGC’s priority status in bankruptcy proceedings regardless of whether the PBGC perfected its liens prior to the company’s bankruptcy filing. First, other creditors would have an incentive to monitor the employer’s pension plans. As the situation stands, other creditors are generally unconcerned with the company’s pension plans because the PBGC’s claims fall below most creditors in a bankruptcy proceeding. Therefore, the employer may make unrealistic pension promises to employees and save on current wages in order to meet the demands of other creditors. If the PBGC had priority in a bankruptcy proceeding, other creditors’ recoveries would be affected, and consequently the creditors would have an incentive to monitor the abuse of pension plans.

Second, allowing the PBGC to have priority status regardless of when the lien was perfected would be consistent with the original purpose of ERISA and the statutory scheme prior to the enactment of the Bankruptcy Code in 1978. Under ERISA’s original language, and before the enactment of the Bankruptcy Code in 1978, PBGC liens perfected after a company filed for Chapter 11 bankruptcy would

159. Id.
160. See infra notes 161–176 and accompanying text.
161. Uylaki, supra note 41, at 106.
162. Id.
163. Id. at 106–07.
164. Id. As Bradley Belt stated, “With such a change, we could expect creditors to encourage better plan funding to counteract PBGC’s strengthened claim in bankruptcy.” Belt testimony, supra note 84.
165. Uylaki, supra note 41, at 100.
be afforded fourth priority status, similar to "taxes due and owing to the United States." The Bankruptcy Code, which was enacted four years after ERISA, replaced the phrase "taxes legally due and owing to the United States" with a more specific list of priorities. ERISA's language was not modified, however, and the PBGC's claims were given eighth-level priority status, which is the priority reserved for "allowed unsecured claims of governmental units." If the liens had tax priority, the PBGC could assert a secured creditor priority claim—which is substantially higher than the unsecured creditor status the PBGC has today.

Third, there is an argument that basic fairness demands that employee pension plans receive priority status in a reorganizing bankruptcy. Many employees rely solely on their pensions for retirement and have made concessions in the form of wage reductions to preserve their pension benefits. Their pensions should be secure, and the federal agency that provides this security should be given a priority when the courts are deciding which creditors to satisfy.

b. Arguments Against Raising Priority Status

As with reforms to increased premiums, some argue that raising the PBGC's priority status does not solve the root of the problem. Be-

166. Id. at 99. "ERISA provides, 'In a case under Title 11 or in insolvency proceedings, the lien imposed under subsection (a) of this section shall be treated in the same manner as a tax due and owing to the United States for purposes of Title 11 or Section 3713 of Title 31.'" Id. at 97 (citing 29 U.S.C. § 1368(c)(2) (1994)) (emphasis omitted).

167. Id.

168. Id. Many argue, however, that because Congress failed to update ERISA correspondingly, Congress intended to lower the priority status of the PBGC's claims. Id.

169. Daniels, supra note 3, at 90.

170. Korobkin, supra note 5, at 5.

171. For example, in 2003, the United Airline International Association of Machinists (IAM) agreed to wage givebacks ranging from six to seven percent and forfeited the first four days of vacation pay through 2007. Todd Neff, United Union Chiefs Say Cuts Crucial, ROCKY Mtn. News, Nov. 25, 2002, at 4A, available at www.lexisnexis.com. In return for these concessions, United employees were promised future benefits, including a seven percent increase in pension benefits for employees retiring after November 2004. Id. US Airways also used pension benefits to secure wage concessions from its employees. Kirstin Downey, Airlines' Pension Problems Growing; Industry's Woes Seen in Shortfalls, WASH. POST, Jan. 21, 2003, at E1. Jerrold Glass, Senior Vice President for Employee Relations at US Airways, informed the US Airways' machinist union that the union's pension plan would not be terminated if the union ratified a proposed wage concession contract. Id. The union agreed, and the pension plans were not terminated at that time. Id. This promise, however, was not kept. In September of 2004, in the midst of US Airways' second bankruptcy proceeding, the airline failed to make a $110 million payment to its pension plan, thereby completing a first step towards terminating its pension plan altogether. Francine Knowles, United Union Asks Congress To Protect Pension Plans, CHI. SUN-TIMES, Sept. 17, 2004, at 71.

172. Wolfe, supra note 3, at 179.
cause the PBGC places a cap on the amount of benefits retirees can receive, having the PBGC take over a plan is not necessarily in the best interests of the employees. As one commentator has noted, "[T]he long-term solution of the PBGC's woes lies in funding pension promises, thereby, making priority in bankruptcy extraneous." For example, this solution does not help the PBGC's claims against a company in nonbankruptcy liquidation because

[most firms that liquidate do so without ever filing a bankruptcy petition. While it is true that the PBGC's largest claims will probably be against companies that become debtors under the Bankruptcy Code, several of the agency's most substantial reimbursement claims were against companies that were not in bankruptcy.]

Finally, it would be difficult to obtain congressional approval for this solution. As one commentator noted:

Elliot [President of COFFI] thinks [this solution is] unlikely, however. "That would require the Judiciary Committees of the two Houses to change the Code, and it's not clear that they feel a strong motivation to do it." He adds that, it would be difficult economically either for the creditors, if it takes effect immediately, or given a long lead time, for the companies, because creditors will look at pension underfunding the same way they look at enormous amounts of secured debt.

Given the urgency of the airline crisis and the potential pensions the PBGC will have to shoulder, it is important that any proposed reform is one that can have an immediate effect.

3. **The PBGC Should Have Administrative Priority Status**

If the PBGC's priority status in bankruptcy is raised, the PBGC should be granted administrative priority status. Section 503 of the Bankruptcy Code governs administrative priority status. Administrative priority is granted to claimants who can demonstrate that their claims: 

(i) arose from a post-petition transaction with the debtor; and

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173. Id.
174. Id.
176. Who Will Rescue the PBGC?, supra note 84.
177. Hazan et al., supra note 51, at 503–06.
178. Id. at 503.
The PBGC has argued that it is entitled to this status because its Unfunded Benefits Liability Claim and its Minimum Funding Contribution Claim, both post-petition transactions, are "actual and necessary costs of preserving the estate." Alternatively, the PBGC has argued that it should be granted administrative priority because both its claims should be considered the equivalent of a tax under 11 U.S.C. § 503(b)(1)(B)(I). This component of the PBGC's argument is based on § 4068 of ERISA, which states that in "a case under [T]itle 11 of the United States Code or in an insolvency proceeding, the lien imposed . . . shall be treated in the same manner as a tax due and owing to the United States."
C. The "Ideal" Solution Is Raising the PBGC's Priority Status in Bankruptcy

Of the two solutions—modifying premiums and raising the PBGC's status in bankruptcy—the latter proposal best solves the PBGC's current crisis and ensures the PBGC's future viability. This section considers the components of an ideal solution and explains why elevated bankruptcy status better meets its criteria.183

1. Components of the Ideal Solution

Although both solutions have their critics, giving the PBGC a higher priority status is a better solution to save the PBGC from insolvency because it better fits the components of an "ideal solution."184 The ideal solution would: (1) allow a company's effective reorganization; (2) prevent or eliminate moral hazards that encourage abuses of the PBGC's insurance; (3) minimize or eliminate factors that distort a company's behavior; (4) minimize or eliminate factors that distort an employee's behavior; and (5) encourage employers to continue using defined benefit plans.185

a. The Ideal Solution Would Allow Corporate Reorganization

First, the ideal solution would allow a company undergoing a Chapter 11 bankruptcy to reorganize effectively so that it will stay in business while protecting the interests of the employees. "When bankruptcy law improves the chances that viable businesses will survive financial distress as going concerns, it indirectly benefits employees of those businesses. Conversely, if Congress moves in directions that make successful reorganizations more difficult to achieve, employees as a group are likely to suffer."186 That is, legislation that makes it easier for a company to survive Chapter 11 bankruptcy will ultimately benefit the employees of that company.

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183. See infra notes 184–213 and accompanying text.

184. The "ideal solution" is a compilation of important issues that this author argues any solution must address.

185. These components of the "ideal solution" are not listed in any particular order.

186. Korobkin, supra note 5, at 13. Making reorganization easier to achieve indirectly benefits employees because the company's management is able to prioritize obtaining the additional resources to ensure the company's long-term survival. Id. This directly benefits employees by ensuring that they will continue to receive wages. Id. at 14.
b. The Ideal Solution Would Prevent Moral Hazards

Second, the ideal solution would prevent the "moral hazard" inherent in ERISA today.\textsuperscript{187} A moral hazard is a flaw in the system that actually provides an incentive to engage in improper behavior.\textsuperscript{188} Modifying the premium structure and giving the PBGC a priority in bankruptcy address different moral hazards.\textsuperscript{189}

In the context of the premium structure, a company having financial difficulty may increase pension benefits to its employees in lieu of increasing the current salaries of its employees.\textsuperscript{190} The company currently can increase its benefits without paying more in premiums.\textsuperscript{191} Alternatively, the company may take financial risks at the expense of its pension plans.\textsuperscript{192} But, if the company must ultimately dissolve, the PBGC and other healthy companies paying premiums shoulder the responsibility for paying the dissolving company's pension benefits.\textsuperscript{193} Although the employees may not receive the full amount of the promised pensions, by this time, the plan has ceased to be the problem of the employer. Thus, the employer can pay low premiums while mismanaging its funds. The low premiums paid by the airlines is an example. As Executive Director Belt stated:

\begin{quote}
While United's credit rating has been junk bond status and its pensions underfunded by more than $5 billion on a termination basis since at least 2000, it has paid just $50 million in premiums to the insurance program. Yet the termination of United's plans would result in a loss to the fund of more than $6 billion.\textsuperscript{194}
\end{quote}

\textsuperscript{187} Belt statement, supra note 73.

\textsuperscript{188} Id. As Belt explained,

\begin{quote}
A properly designed insurance system has various mechanisms for encouraging responsible behavior that will lessen the likelihood of incurring a loss and discouraging risky behavior that heightens the prospects of claims. That is why banks have risk-based capital standards, why drivers with poor driving records face higher premiums, why smokers pay more for life insurance than non-smokers, and why homeowners with smoke detectors get lower rates than those without.
\end{quote}

\textsuperscript{Belt testimony, supra note 84.}

\textsuperscript{189} There are those who argue the current system is a "moral hazard" for employees as well. "In the absence of the PBGC, employees would have every reason to use what power they had to prevent their company from underfunding its pension plan." Keating, supra note 114, at 75. Because, however, the employees are cognizant that if the company terminates their pension plans their pensions are paid by the PBGC, employees have little incentive to monitor the funding levels of the plans. Id. This argument will not be addressed as it is outside the scope of this Comment.

\textsuperscript{190} Belt testimony, supra note 84.

\textsuperscript{191} Id.

\textsuperscript{192} Id.

\textsuperscript{193} Id.

\textsuperscript{194} Id. It should be noted that airlines are not the only industry subject to this moral hazard. "This subsidization extends across industry sectors—to date, the steel and airline industries have
The moral hazard inherent in not allowing the PBGC to have priority status in a bankruptcy arises for many of the same reasons. Again, a company can engage in risky behavior—underfunding its plans and raising pension benefits in exchange for wage concessions—without much consequence. A company is only responsible to secured creditors. Because the PBGC’s claim will be unsecured, neither the debtor-company nor the company’s secured creditors have an incentive to ensure that the company adequately funds its pension plans.

c. The Ideal Solution Would Minimize Distortions

Third, the ideal solution would minimize distortions on the behavior of the debtor company and the PBGC. That is, the company and the PBGC should make decisions affecting the pension plans in terms of what would ultimately be in the best interests of the company.

Under the current system, the premium structure does not have much effect on the behavior of the debtor company or the PBGC. The premium structure has a minimal impact on behavior because: (1) premiums are so low regardless of whether the company pays according to the flat-rate or the variable-rate, and (2) the company is obliged to pay premiums regardless of the state of funding of its pension plans.

Conversely, the current system distorts behavior due to the PBGC’s low status in bankruptcy. As mentioned previously, the fact that the PBGC’s liens have low priority in bankruptcy gives the debtor company an incentive to enter bankruptcy to minimize the PBGC’s claims. On the other side of the coin, the PBGC has an incentive to force a debtor company to involuntarily terminate its plan before bankruptcy so that the PBGC can maximize its claim on the company’s assets. Ideally, neither the decision to enter bankruptcy prematurely nor the decision to compel termination of a plan should be based on the size of the PBGC’s claims on a company’s assets.

accounted for more than 70% of PBGC’s claims by dollar amount while covering less than 5% of the insured base.” Id.

195. Keating, supra note 114, at 77.
196. Id. at 76.
197. All companies must pay a basic flat-rate premium of nineteen dollars per participant. Premiums, supra note 36. Companies maintaining underfunded pensions must pay an additional variable-rate premium of nine dollars per $1,000 of unfunded vested benefits. Id.
198. See supra note 156 and accompanying text.
199. See supra note 157 and accompanying text.
d. The Ideal Solution Would Not Affect Employees' Decisions

Another element of the ideal solution is that the employee's decision regarding how to take his or her retirement benefits would not be affected. When ERISA was enacted in the 1970s, most employees opted to take their retirement benefits in designated payments that were distributed each month.\(^{200}\) Today, in contrast, over fifty percent of retiring employees are able to take their pension in a lump sum, an option that a large majority of retirees exercise.\(^{201}\) According to one study, eighty-nine percent of all employees with the option to receive lump sum pensions do so.\(^{202}\) The reason that more employees are exercising this option is because they believe that if the plan terminates such that the PBGC has to take over, they will receive fewer benefits.\(^{203}\) This exacerbates the plan's underfunding because money is taken out sooner than anticipated, and thus cannot gain value as an investment for the company.\(^{204}\)

e. The Ideal Solution Does Not Discourage Employers from Using Defined Benefit Plans

Finally, it is important that any reform designed to add stability to defined benefit plans does not discourage employers from using these types of plans.\(^{205}\) ERISA's enactment recognized the balance between security and attractiveness to employers. That is, the more secure the plan, the more the employer must pay upfront—which, in turn, makes the plan less attractive.\(^{206}\) The ideal reform must also tread this careful balance. Because employers do have other options when selecting pension plans, any proposed reform must be cognizant of the threshold beyond which defined benefit plans become so onerous that employers may decide not to offer these plans at all.

2. Raising Priority Status Is the Ideal Solution

Although both solutions—modifying the premium structure and raising the PBGC's status in bankruptcy—would effectuate some elements of the ideal solution, the latter solution would most likely effectuate more of these elements. First, although both proposed reforms

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201. Id.
202. Id. at 11.
203. Id.
204. Walker statement, supra note 13.
205. See supra note 50 and accompanying text for a list of the advantages of defined benefit plans over other kinds of plans such as defined contribution plans. This Comment assumes that defined benefit plans should remain a viable pension plan offered by employers.
206. See supra note 28 and accompanying text for Congress's goals in enacting ERISA.
would enable troubled companies to emerge from Chapter 11 bankruptcy, granting the PBGC a priority status may better achieve this goal. Imposing higher premiums on an already financially-troubled company would only add an additional expense to the company, and perhaps ensure its ultimate dissolution.\(^\text{207}\) On the other hand, giving the PBGC a priority in the short-term may hurt a company’s reorganization, but in the long run, the priority status may not be such an obstacle to reorganization. The debtor-company and other creditors would be aware of the PBGC’s priority status and thus the company will have an incentive to manage its own finances in a responsible way such that the PBGC’s claim will not scare off its other creditors.\(^\text{208}\)

Similarly, giving the PBGC priority status reduces the moral hazard more effectively than modifying premiums. Modifying the premium structure is a limited solution, because premiums can increase only to a certain point before employers are discouraged from establishing or continuing defined benefit plans.\(^\text{209}\) Moreover, even if the premiums only increase for companies at high risk for bankruptcy, it can be argued that raising their premiums may actually force the company into bankruptcy. Giving the PBGC priority status, however, would not have this detrimental effect. Although companies currently undergoing bankruptcy would face immediate hardship because of their obligations to their creditors, the PBGC’s elevated status would avoid this moral hazard in the long run.\(^\text{210}\) In fact, if the PBGC’s priority status was raised, companies would actually have an incentive to plan more effectively, because creditors would not be willing to extend loans to the company if there was a large outstanding obligation to pension funds.\(^\text{211}\)

Third, both solutions could potentially negatively affect a company’s behavior. There is a threshold at which premium rates become

\(^{207}\) High costs are particularly troublesome for airlines because of the instability of the oil industry. The year 2004 was “supposed to be the year that airlines recovered” from the losses incurred in the post-September 11 economy. *The Impact of Federal Pensions and Bankruptcy Policy on the Financial Health of the Airline Industry: Hearing Before the S. Comm. on Commerce, Sci., and Transp.,* 108th Cong. (2004) (statement of Sen. Frank Lautenberg), available at www.lexisnexis.com. However, “skyrocketing oil prices have shattered that optimism.” *Id.* It is uncertain what the costs of oil will be in the future. *Id.* Thus, one could argue that any additional costs to a struggling airline, in combination with high oil prices, may be too much in expenses and hinder the airline’s recovery.

\(^{208}\) Uylaki, *supra* note 41, at 106. For example, companies will have a greater incentive not to drastically underfund their plans because creditors, wary of the PBGC’s claim in bankruptcy, will be less willing to extend funds to high-risk companies. *Id.*

\(^{209}\) See *supra* note 50 and accompanying text for a discussion on the advantages of defined benefit plans.

\(^{210}\) Uylaki, *supra* note 41, at 106–07.

\(^{211}\) *Id.*
so high that companies cease to offer defined benefit plans. It may also be true that a company's obligations to the PBGC may be so onerous because of the PBGC's priority status that a company decides not to offer defined benefit plans. But, raising priority status would probably prevent other companies with existing defined benefit plans from terminating their plans arbitrarily, as United has done. For example, one may speculate whether United would have terminated its plan in July 2004 if United knew it would still be liable to the PBGC for the amount it owed. At the same time United said that it would not pay the $500 million a year it owed to its pension plans, United committed to pay the same amount to the City of Chicago for the city's plan to rebuild O'Hare Airport.\textsuperscript{212} If the PBGC had been able to effectuate a lien against United, perhaps United would not have committed its funds to another source.

Fourth, it is more likely that raising the PBGC's status in bankruptcy would have less of an effect on employee behavior. Again, modifying the premium structure is, at best, a limited solution. However, elevating the PBGC's status in bankruptcy would give the company and its creditors a strong incentive to manage its pension fund properly. If the pension fund is managed properly, it is more likely that the company will not terminate its plan. This added security may influence more employees to opt not to take their pensions in a lump sum, thereby preserving the solvency of the plan.

Finally, both solutions may discourage companies from using defined benefit plans. Any reform that benefits the PBGC necessarily means that companies using the plans will be held to higher standards. In this sense, modifying the premium structure, a milder reform, is probably less likely to turn away companies. The PBGC—if allowed a claim in bankruptcy—would have quite a large claim in many cases.\textsuperscript{213} Companies would be cognizant of this possibility, and may be less likely to adopt defined benefit plans.

For these reasons, the most effective solution would be to raise the PBGC's status in bankruptcy. This solution would best achieve the ultimate goals Congress envisioned in enacting ERISA—companies would have incentives to ensure that their pension plans are secure,


\textsuperscript{213} For example, the PBGC would have a claim of $6.4 billion against United. Geisel, \textit{supra} note 25.
and the burden of pensions in financially troubled companies would not fall on taxpayers.

IV. IMPACT: THE PBGC AND RAISED PRIORITY STATUS IN BANKRUPTCY IN THE CURRENT AIRLINE INDUSTRY CRISIS

By examining the impact of raising the PBGC's status in bankruptcy in light of the current airline situation, it becomes apparent that this reform would benefit the PBGC without unfairly burdening the airline industry. If the PBGC's status in bankruptcy was raised, it would benefit the PBGC by encouraging better planning by employers and by allowing the agency to collect the funds owed by the company. Most companies, aware of the pension liability and the consequences of terminating their plans, would be able to fund their plans more appropriately without undue burden.

This section first examines the status quo and the future of the airlines and the PBGC without the implementation of any reform. Because the PBGC is heading toward bankruptcy, it is apparent that reform is necessary. This section next analyzes how raising the PBGC's status in bankruptcy will affect the status quo and the future of the airline industry. This section will focus on United's bankruptcy. It will also examine the effect of this proposed reform on the other airlines with defined benefit plans that are in or on the brink of bankruptcy.

A. The Future of the Airlines and the PBGC Without ERISA Reform

The PBGC is heading for bankruptcy. The PBGC does not have the assets to cover current and future obligations and is operating at a dramatically increasing deficit. In 2003, the PBGC had a deficit of $11.2 billion and in 2004, its deficit grew to $23.3 billion. Furthermore, the PBGC is not taking in enough to cover its projected future obligations. Last year, the PBGC received premiums of only $1.5 billion, and it expects to receive $2.3 billion this year. Many experts have contended, however, that this amount is "nowhere near enough to cover the large losses it has recently experienced due to the failures of big pension plans in the steel and airline industries and other sec-

214. See infra notes 216-222 and accompanying text.
215. See infra notes 223-249 and accompanying text.
For example, COFFI predicts that the PBGC will become bankrupt by 2020. If the airline industry continues on its current course, it is almost certain to overburden the already financially strained pension agency. United Airlines and US Airways have already terminated their pension plans. Delta Air Lines, now in bankruptcy, has six billion dollars in unfunded pension liabilities. Similarly, Northwest Airlines, also in bankruptcy, has $3.7 billion in unfunded liabilities. Thus, it is probable that the PBGC’s very survival would be threatened if it assumed the pensions of the airline industry without any reform.

B. The Future of the Airlines If the PBGC’s Status in Bankruptcy Is Raised

If the PBGC’s status in bankruptcy were raised, the PBGC would have better access to funding if it were forced to assume responsibility for a company’s pension plans. Moreover, an examination of the application of this reform to the airline industry demonstrates that this reform would meet many of the components advocated in the “ideal solution”—this reform would allow for a company’s reorganization, prevent the moral hazard currently inherent in the system, and discourage distortions in employer and employee behavior.

1. Ensuring Successful Reorganization

If United had to recognize the PBGC as a priority debtor, United’s reorganization would potentially be jeopardized. When United announced it would cease payments to its pension plans in August 2004, it was motivated in large part by its reorganization strategy. United

218. Id.
222. Id.
223. This Comment assumes that the raised premium reform, if enacted, would be applied to United. There is the possibility that the reform would have a “grandfather clause” that would exempt United, as United’s bankruptcy began before the reform was enacted. A “grandfather clause” is a clause that would allow an individual who is already acting in a certain manner to continue his behavior, even after the legislature has determined that the action should be ceased. Heidi Gorovitz Robertson, If Your Grandfather Could Pollute, So Can You: Environmental “Grandfather Clauses” And Their Role In Environmental Inequity, 45 CATH. U. L. REV. 131, 132 (1997).
hoped that by shedding its pension plans, it would be able to attract the financing necessary to assure the company's successful reorganization. Therefore, if United was still liable for its pension plans, United's current reorganization plan would be in jeopardy.

But, if airlines had more responsibility for their pension plans, future airlines contemplating bankruptcy would not be able to bargain with creditors to terminate their pension plans and would have an incentive to reduce other expenses before terminating their pension plan benefits. For example, American Airlines has recently begun to reevaluate some of its smaller expenses. It has announced that it will no longer provide pillows on most domestic flights. While this is a relatively small expense, "these smaller savings add up." More importantly, this attitude reflects the reality that a company may reduce many unnecessary expenses—both large and small—before terminating pension plans. If other expenses can be reduced instead of pension plans, companies would be able to emerge from bankruptcy successfully, and less of the burden of the pension plans would fall on the PBGC.

2. Preventing Moral Hazards

As the situation stands now, many airlines with defined benefit pensions have severely underfunded plans. United's plans were underfunded by $8.3 billion. Similarly, Delta Air Lines's plan is underfunded by $5.8 billion, while US Airways' plan is unde...
derfunded by $2.5 billion. If companies were liable for their pension plans in bankruptcy, there would be a strong deterrent against such rampant underfunding. Alternatively, if a company had an underfunded plan and entered bankruptcy, it would still be liable for its promised pensions.

Moreover, another moral hazard inherent in the current system occurs when companies use the threat of bankruptcy as leverage when bargaining with employees. For example, in August 2004, US Airways was seeking concessions in the range of $750 million from its employees. In a letter to employees, Bruce Lakefield, the Chief Executive Officer of US Airways, mentioned bankruptcy as an option that the company was facing, and hoped that the company could win the necessary concessions from employees to avoid this possibility. Although companies would still be able to use the threat of bankruptcy to gain concessions from their employees, the threat would have less force if the PBGC had priority status. That is, an employer would be less likely to use the threat of bankruptcy as a method to negotiate with employees, because if the employer entered bankruptcy, it would still be liable to the PBGC.

3. Minimizing Distortions

Raising the PBGC’s priority status would minimize behavioral distortions by ensuring that airlines would not enter bankruptcy solely to avoid pension liabilities. Although United did not enter Chapter 11 bankruptcy to terminate its pension plans, that was the ultimate result. But, once it became apparent that United could unilaterally

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233. David Field, United Targets Pensions; As It Struggles to Emerge from Bankruptcy, United Airlines Has Brought to Centre Stage the Most Burdensome Legacy Affecting the Major U.S. Airlines: Their Pension Liabilities, AIRLINE BUS., Sept. 1, 2004, at 15, available at www.lexisnexis.com. Some have argued that the total underfunding of airlines pension plans might have even been as high as $31 billion in 2003. Torbenson, supra note 230. If one looks outside of the airline context, the underfunding picture is even more grim. “Employers that sponsor traditional private-sector pensions had a collective funding shortfall estimated of $450 billion last year, according to pension industry estimates.” Tumulty, supra note 232.


235. Id. Furthermore, employees are dissatisfied by the ability of employers to use the bankruptcy process to avoid pension obligations. Currently, employees at United are fed up and prepared to take drastic actions—such as striking—to protect their pension plans. Al Swanson, Analysis: Air Unions on Rollercoaster Ride, UPI, Jan. 7, 2005, at www.lexisnexis.com. Greg Davidowich, the president of the Association of Flight Attendants Master Executive Council at United, commented that, “United flight attendants have spoken loudly and clearly: they will not allow their employer to exploit the bankruptcy process and strip them of their rights. They are ready to fight.” Id.

stop payments to its pension plans without recourse because of bankruptcy protections, US Airways also terminated its plans. Some experts predict that other airlines will soon follow suit in order to stay competitive.

If, however, the PBGC was given priority status in bankruptcy, there would be no reason for a company to enter bankruptcy to avoid its pension obligations. Bankruptcy would no longer result in the elimination of pension plan obligations. Furthermore, because airlines in bankruptcy would not have an unfair advantage over their nonbankrupt competitors, healthy airlines would not have to make changes to their pension plans to stay competitive.

4. Affecting Employee Decisions

As the situation currently stands, most employees take their pension benefits in lump sums whenever possible. If employees fear that the PBGC will eventually take over the plan, most employees will continue this trend, because the PBGC pays out fewer benefits than the employer may have promised. Fewer employees would take lump sum pensions, however, if terminating pension plans became less attractive to employers.

This result would greatly alleviate the problems faced by airlines when their employees take benefits as lump sum payments. For example, almost 30% of Delta’s pilots—2,000 of 6,900 pilots—are currently eligible to retire. These workers have the option of taking half of their retirement benefits in a lump sum payment. Pilots fearing bankruptcy and its effects on their pensions are thus retiring at a high rate—up to 300 pilots are retiring each month. This has the negative effects of decreasing Delta’s eligible workforce while reducing payments into the airline’s pension plans.

237. Swanson, supra note 235.
238. Torbenson, supra note 230. Delta Air Lines, now in bankruptcy, is a prime example. Geewax, supra note 231. Delta has lost over $5.6 billion over the past three years. Id. Some experts expect that the pension crisis may snowball so that even relatively healthy airlines, such as Northwest Airlines, Continental Airlines, and American Airlines, will have to cut their pension plans. Whiteman, supra note 234.
239. See supra note 202 and accompanying text.
240. See supra note 118 and accompanying text.
241. Field, supra note 233.
242. Id.
243. Id.
244. Id.
5. Use of Defined Benefit Plans

One possible drawback of raising the PBGC's status in bankruptcy may be that less airline employers will be inclined to use defined benefit plans. Defined benefit plans are already more costly to administer than defined contribution plans, and this has led some airlines to convert their defined benefit plans to defined contribution plans. For example, United has announced that it would like to change its plans, and in furtherance of this goal has asked a bankruptcy judge to overturn existing collective bargaining agreements. Similarly, Delta Airlines, with the agreement of the pilots' association, froze the defined benefit plan and established a new defined contribution plan for future benefits.

This is not, however, the inevitable result of raising the PBGC's status in bankruptcy. There is an argument that the current airline crisis was not caused by pension plans, as evidenced by the fact that even airlines that have defined contribution plans, like ATA Airlines, are in financial trouble. Therefore, companies should examine other issues, such as high fuel costs, if they hope to solve their financial difficulties.

In fact, some have even asserted that defined benefit plans are better for airlines. Ralph Kruger, the pension committee head for the Allied Pilots Association, has advocated that defined benefit pensions are cheaper for airlines because "[y]ou end up spending less over time for the same benefit.

Raising the PBGC's status in bankruptcy is the best solution to preserve the PBGC's solvency. This solution would solve many of the issues inherent in the status quo, and allow for employees' protection in future years. This solution would also make clear that pensions must be a priority for an employer, and that it is not acceptable for an entire industry to disregard their employees and shift the burden of paying pensions to the PBGC.

245. Armstrong, supra note 236.
246. Torbenson, supra note 230.
247. Caroline Daniel, Old-style Carriers Learn How to Play Catch-up: Caroline Daniel Looks at How Traditional Airlines Are Successfully Grappling with High Costs, Fin. Times, Feb. 9, 2005, at 24. For example, only three low-cost carriers—Southwest Airlines, JetBlue Airlines, and AirTran Airways—reported a net profit in 2004. Id. Other low-cost carriers, such as America West and ATA Airways, have experienced significant financial difficulty in recent years. Id. ATA's problems were so severe that the airline sought Chapter 11 bankruptcy protection in October 2004. ATA to Sell Chicago Express, Orlando Sentinel, Feb. 8, 2005, at C3.
249. Torbenson, supra note 230.
In this era of retiring baby boomers, providing secure pensions must be one of our nation’s top priorities. Thirty years ago, Congress enacted ERISA with the intention of ensuring that major employers could not default on obligations promised to their employees. The PBGC was developed as a last resort—it was created to provide for those rare cases in which a company could not pay its employees their promised pensions.

Now that the PBGC is in financial trouble, Congress must again step up to the plate and protect this nation’s workers. Congress must reform ERISA so that the PBGC can obtain the necessary funding from the companies it insures. United illustrates how a company can currently abuse the PBGC, as well as what reforms are necessary to prevent future abuses. There are two proposed reforms strongly advocated by top officials in the PBGC: modification of the premium structure to more accurately reflect risk, and raising the PBGC’s status in a bankruptcy proceeding. Though not perfect, both solutions would provide valid means of increasing the PBGC’s revenue. This Comment proposed components of an ideal solution, and found that increasing the PBGC’s status in bankruptcy would better meet the components of that ideal solution. Now it is time for Congress to follow suit and pass a reform before the PBGC’s debt falls on this nation’s taxpayers.

Christine Stinson Matott*

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