At the Crossroads of Three Codes: How Employers Are Using ERISA, the Tax Code, and Bankruptcy to Evade Their Pension Obligations

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NICHOLAS J. BRANNICK*

The PBGC was established to insure defined benefit pension plans offered by employers in the United States, by offering a statutorily-established benefit to recipients of terminated pension plans. Since 2000, the number of employers terminating underfunded pension plans after seeking relief under Chapter 11 of the Bankruptcy Code has increased dramatically. The Bankruptcy Code strips the PBGC of protections against underfunded plans, leaving the PBGC with an unsecured claim. This Note explores the moral hazard that accompanies pension insurance and encourages underfunding, and the dysfunctional relationship between the Tax Code, ERISA, and the Bankruptcy Code, which places the PBGC at a disadvantage when employers terminate their pension plans after filing bankruptcy. This Note discusses proposed solutions to both the underfunding problem and the termination/liability paradox facing the PBGC and concludes that Congress should amend ERISA to give the PBGC control over funding waivers and allow the PBGC to perfect its claim against employers that underfund their pension plans on a “floating lien” basis.

I. INTRODUCTION: “A PAGE OF HISTORY IS WORTH A VOLUME OF LOGIC”

The economic downturn that began in the spring of 2000, and accelerated after the terrorist attacks of September 11, 2001, resulted in seven of the ten largest corporate bankruptcies in United States history. Several industries were

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1 New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921). One of the themes of this Note is that the rejection of pension plans by firms seeking to reorganize under Chapter 11 is an abuse of the reorganization process under Chapter 11. Similar abuse occurred following the Supreme Court’s decision in Nat’l Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S. 513 (1984), which allowed employers to unilaterally reject labor agreements in bankruptcy. Congress responded to Bildisco by amending the Bankruptcy Code to place limits on an employer’s use of this awesome power. Reasoning by analogy, it is time for Congress to consider, at the very least, changing the law to prevent further abuse of Chapter 11 among those who underfund their pension plans and then terminate them in bankruptcy.

2 See BankruptcyData.com, Largest Corporate Bankruptcies, 1980–Present, at http://www.bankruptcydata.com/Research/15_Largest.htm (last visited Nov. 10) [hereinafter Largest Corporate Bankruptcies]. BankruptcyData.com is a division of New Generation Research, Inc., a firm that provides research on distressed companies and bankrupt companies
particularly ravaged, including steel producers and passenger airlines. Many firms in these and other industries sought to reorganize under Chapter 11 of the Bankruptcy Code. While in Chapter 11, some of these firms terminated their pension plans after having systematically underfunded these plans. Upon for investors. For more information see New Generation Research’s website at http://www.turnarounds.com.


4 According to data available from the American Bankruptcy Institute, the number of Chapter 11 filings increased from 687 in 2000 to 930 in 2003, a 35.4% increase, reaching a peak of 986 in 2002. See American Bankruptcy Institute, Annual U.S. Non-Business Bankruptcy Filings by Chapter 2000–2003, available at http://www.abiworld.org/ContentManagement/ContentDisplay.cfm?ContentID=8170 (last visited Nov. 10, 2004) (data tabulated from source). While these data may include a small number of personal Chapter 11 cases, they reflect the dramatic increase in the number of corporate Chapter 11 filings over this period.

5 The number of single-employer plan terminations increased from 92 in 2000 to 152 in 2003 and some of these were the largest terminations in the history of the PBGC. These data and their implications are described more fully infra note 11 and accompanying text.


Because of the method by which plans are deemed adequately funded, employers often report higher funding levels than actually exist. See id. at 6. Kandarian stated:

[I]n its last filing prior to termination, Bethlehem Steel reported that it was 84 percent funded on a current liability basis. At termination, however, the plan was only 45 percent funded on a termination basis—with total underfunding of $4.3 billion. Similarly, in its last filing prior to termination, the US Airways pilots’ plan reported that it was 94 percent funded on a current liability basis. At termination, however, it was only 33 percent funded on a termination basis—with total underfunding of $2.5 billion.

Id. (citations omitted). See also Robert Kuttner, The Great American Pension-Fund Robbery, Bus. Wk., Sep. 8, 2003, at 24 (discussing methods by which “corporate sponsors of pension plans have been systematically looting” those plans); Nanette Byrnes, The Benefits Trap, Bus. Wk., July 19, 2004, at 64, 71 (“A recent study by analysts at CreditSights Ltd. found that 85% of the defined-benefit plans in the S&P 500 don’t have enough assets to cover their pension obligations.”). In addition, several companies met their pension obligations by contributing assets other than cash, such as real estate or stock to the plan. Id. at 72. With improvements in the stock market and rising interest rates, underfunding of covered plans again began to decline through the first half of 2004 to a total of $278.6 billion. See News Release, PBGC, Companies
termination of a plan covered by the Pension Benefit Guaranty Corporation (PBGC), the quasi-corporate governmental agency created under the Employee Retirement Income Security Act of 1974 (ERISA)\(^7\) to insure pension plans,\(^8\) the PBGC assumes the liabilities of the plan.\(^9\) This relieves the employer of its obligation to fund the plan,\(^10\) and frees up cash to help fund the firm’s reorganization. The number of plans terminated, the pension obligations assumed by the PBGC, and the number of retirees receiving benefits from the PBGC rose between 2000 and 2004 to levels never previously seen in the twenty-nine year history of the agency.\(^11\) Pension plans were terminated in the steel industry to


\(^8\) See 29 U.S.C. § 1321 (2000) (defining plans covered by PBGC insurance). The role of the PBGC is discussed infra Part II.


\(^10\) As addressed infra Part IV, the PBGC theoretically receives a lien against the assets of the corporation in the amount of the unfunded portion of the terminated plan. See 29 U.S.C. § 1362 (2000).

\(^11\) The following table illustrates the number of plans terminated, the amount of liabilities assumed by the PBGC from terminated plans, the number of beneficiaries receiving benefits from the PBGC, the PBGC’s annual net loss, and the PBGC’s net position (assets vs. liabilities) for the period between 2000 and 2004.

<table>
<thead>
<tr>
<th>Year</th>
<th>Plans Terminated</th>
<th>Liabilities Assumed</th>
<th>Participants</th>
<th>Annual Net Loss (millions)</th>
<th>Net Position (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>92</td>
<td>$126</td>
<td>541,000</td>
<td>$2,666</td>
<td>$9,704</td>
</tr>
<tr>
<td>2001</td>
<td>101</td>
<td>$1,102</td>
<td>624,000</td>
<td>-$1,972</td>
<td>$7,732</td>
</tr>
<tr>
<td>2002</td>
<td>157</td>
<td>$3,013</td>
<td>783,000</td>
<td>-$11,370</td>
<td>-$3,638</td>
</tr>
<tr>
<td>2003</td>
<td>152</td>
<td>$6,407</td>
<td>934,000</td>
<td>-$7,600</td>
<td>-$11,238</td>
</tr>
<tr>
<td>2004</td>
<td>192</td>
<td>$3,509</td>
<td>1,061,000</td>
<td>-$12,067</td>
<td>-$23,305</td>
</tr>
</tbody>
</table>


In 2002 the PBGC assumed the largest liability in its history following the termination of four pension plans at bankrupt LTV Steel. The termination of these plans caused the largest single loss in the history of the PBGC (about $1.9 billion), the largest single-source increase in participants (83,000), and contributed to the largest net loss ($11.37 billion) and largest net deficit ($3.6 billion) in the agency’s history. See 2002 PBGC ANN. REP. 1 (2003). In 2003, PBGC surpassed three of these milestones, absorbing its largest single-source loss (about $3.6 billion) and single source increase in participants (95,000) as a result of the termination of Bethlehem Steel’s pension plan, and accumulating its largest net deficit ($11.24 billion). See 2003 PBGC ANN. REP. 2 (2004).
facilitate the consolidation of that industry.\textsuperscript{12} U.S. Airways terminated its pilots' pension plan as part of its reorganization in 2003, imposing over $600 million in liabilities on the PBGC. In July of 2004, United Airlines ceased making payments into its pension plans, which are underfunded by at least $6.4 billion.\textsuperscript{13} 

\textsuperscript{12} See Nanette Byrnes, \textit{Is Wilbur Ross Crazy?}, \textit{Bus. Wk.}, Dec. 22, 2003, at 75, 80 (discussing the purchase of LTV Corp. and Bethlehem Steel by Wilbur Ross's International Steel Group (ISG) and pointing out that his purchase of these assets "was contingent on the companies' filing for bankruptcy and thereby shifting their pension obligations to the [PBGC]"). Ross and his family of funds control 41.9% of ISG. See Registration Statement Under the Securities Act of 1933, International Steel Group (Form S-1), July 31, 2003, at 95 available at \url{http://www.sec.gov/Archives/edgar/data/1231868/000095015203007226/0000950152-03-007226.txt}. This stake was valued at over $1 billion based on the firm's initial public offering price of $28 per share (with 95 million shares outstanding). \textit{Id.} In November of 2004 ISG agreed to be acquired by Mittal Steel Co. for $4.5 billion, or $42 per share. See Adam Aston et al., \textit{A New Goliath in Big Steel}, \textit{Bus. Wk.}, Nov. 8, 2004, at 47. It is estimated that Mr. Ross will make a personal profit of $300 million on the transaction, while ISG shareholders will make an additional $2.1 billion. See Michael Arndt, \textit{Melting Away Steel's Costs}, \textit{Bus. Wk.}, Nov. 8, 2004, at 48.

In return, the PBGC was saddled with an estimated $3.7 billion in pension liabilities from Bethlehem Steel and $2.2 billion in pension liabilities in LTV. See Christopher Mumma, \textit{Bethlehem Judge Allows Elimination of Benefits}, \textit{BLOOMBERG NEWS}, appearing in \textit{PITTSBURGH POST-GAZETTE}, Mar. 25, 2003, at C9; \textit{U.S. in Biggest Pension Takeover on Record}, \textit{N.Y. TIMES}, Mar. 30, 2002, at C5. According to Byrnes, "[p]eople close to [the PBGC] say its view of Ross is that he benefited from PBGC getting hit with billions of dollars in pension obligations and then had the gall to take public credit for saving the industry." See Byrnes, \textit{supra} at 80.

In early December 2002 the PBGC announced that it would seek to terminate bankrupt National Steel Corp.'s pensions, assuming $1.1 billion in pension liabilities. See Ashley McCall, \textit{Government Targets National Steel Pensions; Insurer Says Retirement Plan Underfunded by $1.5 Billion}, \textit{SOUTH BEND TRIB.}, Dec. 6, 2002, at A1. Shortly thereafter, a bidding war for the assets of National Steel erupted between U.S. Steel and A.K. Steel, with U.S. Steel ultimately winning control of National's assets. See Len Boselovic, \textit{National Bidding War Won by USS; Bankruptcy Court Seen Likely to Approve Its $1.05 Billion Offer}, \textit{PITTSBURGH POST-GAZETTE}, Apr. 18, 2003, at A1. As the Pittsburgh Post-Gazette succinctly stated in its year-end review of local business, "[n]one of the successes [of the steel industry] would have been possible without the Pension Benefit Guarantee [sic] Corp. assuming more than $7 billion of the bankrupt steelmakers' unfunded pension obligations." \textit{No. 4 Local Business Story of the Year; Steel Sees Big Changes}, \textit{PITTSBURGH POST-GAZETTE}, Dec. 24, 2003, at B9.

In addition, pensions among the eleven U.S. airlines offering defined benefit plans covering 444,000 participants were underfunded by $31 billion in the first half of 2004, while those of seven firms within the steel industry covering an additional 213,000 participants were underfunded by $6 billion. See Caroline Daniel, \textit{Airline Funds Plunge to Record $31bn. Shortfall}, \textit{FIN. TIMES}, Jun. 18, 2004, at 30. Since the PBGC was created, airlines and the steel industry have accounted for 70% of claims against the PBGC, while accounting for just 5% of insured participants. \textit{Id.}

\textsuperscript{13} Amy Borrus, \textit{Will the Bough Break?}, \textit{Bus. Wk.}, April 14, 2003, at 62 (reporting on U.S. Airways pension termination); see Albert B. Crenshaw, \textit{United Plan for Pensions Not
The consequences of pension termination are far-reaching and often severe. Because the amount of benefits that can be provided to participants once the PBGC assumes trusteeship over a plan is limited by law, plan participants may receive significantly less than what they were entitled to receive under their original plan. As a result of the unprecedented number of plans terminated and the amount by which those plans are underfunded, the PBGC's financial position has deteriorated to a dangerous level. As losses accumulate at the PBGC and the

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14 See 29 U.S.C. § 1322(b) (2000); see also infra notes 55–57 and accompanying text.


The experience of U.S. Airways' pilots and the instability of the defined-benefit pension system casts an ominous shadow upon the retirement security of 44 million Americans owed over $1 trillion by plan sponsors. See Byrnes, supra note 6, at 66.

16 The General Accounting Office labeled the PBGC's single-employer program a "high risk" in July 2003 when the PBGC's deficit stood at just $5.7 billion. Statement of Steven A. Kandarian, supra note 6, at 3. The PBGC has acknowledged that its pension insurance programs do not have "the resources to fully satisfy PBGC's long-term obligations to plan participants." PBGC, PERFORMANCE REPORT, supra note 11, at 16.

A recent study by the Center on Federal Financial Institutions estimated the net present value of the future claims that cannot be funded by the PBGC under current law and estimated the date at which the PBGC's cash and investments would be exhausted by benefit obligations and other costs. *See Douglas J. Elliott, CENTER ON FEDERAL FINANCIAL INSTITUTIONS, PBGC: WHEN WILL THE CASH RUN OUT? (2004), available at http://www.coffi.org/pubs/PBGC%20When%20Will%20the%20Cash%20Run%20Out%20v8. pdf. This study presumed a 5% return on PBGC assets, $900 million in annual premiums after 2004, $2.7 billion in present value of underfunding taken on each year, and an estimate of probable benefits paid. Id. at 6.*
number of premium-paying plans decline, solvent plan providers face higher premiums.\textsuperscript{17}

The increase in pension plans terminated by plan sponsors under Chapter 11 protection is reminiscent of a period in the early 1980s when employers used Chapter 11 to unilaterally reject their labor contracts. In \textit{National Labor Relations Board v. Bildisco \& Bildisco},\textsuperscript{18} the Supreme Court held that § 365(a) of the Bankruptcy Code\textsuperscript{19} permitted employers to unilaterally reject collective bargaining agreements "if the debtor can show that the collective-bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract."\textsuperscript{20} The \textit{Bildisco} decision opened the doors to employers seeking to reject their labor contracts when those contracts became too burdensome, or simply inconvenient, by obtaining relief in bankruptcy, even

The base case scenario showed that the PBGC would run out of cash and investments by 2020, with $67 billion in unfunded obligations outstanding. \textit{Id.} at 8. Possible solutions involved a $67 billion taxpayer bailout (today, with the price tag rising over time), increasing annual premiums from the approximately $900 million collected today to $3.9 billion, raising the annual return on PBGC investments to 9.6\% or reducing new claims to $200 million in present value per year. \textit{Id.} After 2019, assuming a constant level of premiums, cash inflow to the PBGC from premiums net of administrative costs would cover just 9\% of estimated obligations. \textit{Id.} at 17.

The study also estimated the consequences of United terminating its pension plans. \textit{Id.} at 18. When added to the model, United's termination shortened the life of the PBGC's assets by one year, causing cash insolvency at the end of 2018 with the taxpayer bailout option increasing to $68 billion. \textit{Id.} at 18–19.

It should be noted that this is not the first time the PBGC has faced a serious deficit. In the early 1990s the PBGC experienced a similar increase in liabilities over assets, with the deficit standing at $2.9 billion in 1993. See Leigh Allyson Wolfe, \textit{Note, 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, 153 (1994).

\textsuperscript{17} See Statement of Steven A. Kandarian, \textit{supra} note 6, at 1 ("When underfunded pension plans terminate, three groups can lose: participants can see their benefits reduced, other businesses can see their PBGC premiums go up, and ultimately Congress could call on taxpayers to support the PBGC."). Kandarian further addresses the free-rider problem created by plan termination, stating that

\begin{quote}
when PBGC takes over underfunded pension plans, financially healthy companies with better-funded pension plans end up making transfers to financially weak companies with chronically underfunded pension plans. If these transfers from strong to weak plans become too large, then over time strong companies with well-funded plans may elect to leave the system.
\end{quote}

\textit{Id.} at 2.


\textsuperscript{19} 11 U.S.C § 365(a) (2000).

\textsuperscript{20} \textit{Bildisco}, 465 U.S. at 526.
when the employer was not insolvent.21 Perhaps the most egregious abuse of *Bildisco* occurred when Continental Airlines used Chapter 11 reorganization to reject its labor contracts and cut wages in half, despite the fact that Continental was not yet insolvent and had held only nominal discussions with its unions regarding concessions.22 Congress reacted swiftly, adding a new section to the Code23 as part of the Bankruptcy Amendments and Federal Judgeship Act of 198424 to blunt the ease with which employers could reject their labor agreements.25 This new section sets out a process by which an employer must

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21 The Bankruptcy Code does not require that a debtor be insolvent before filing a petition, with the exception of municipalities. See generally 11 U.S.C § 109 (2000).


The competitive advantage to Continental from rejecting its labor contracts was significant. For instance, in 1988 American Airlines was paying its captains over $12,000 per month, while Continental was paying just over $5,000. See Mark C. Mathiesen, Comment, *Bankruptcy of Airlines: Causes, Complaints, and Changes*, 61 J. AIR L. & COM. 1017, 1031–32 (1996). Continental’s parent company purchased Eastern Airlines in 1986. When Eastern filed Chapter 11 in 1989, Continental agreed to a deal with the PBGC to cover a large portion of Eastern’s unfunded pension liabilities. Two months after the bankruptcy court presiding over the Eastern case approved this deal, Continental filed Chapter 11 again and rejected the pension agreement, making Continental a pioneer in the area of using Chapter 11 to evade employee commitments. See J. ROBINSON, FREEFALL 29, 40–87 (1992); Daniel Keating, Chapter 11’s New Ten-Ton Monster: The PBGC and Bankruptcy, 77 MINN. L. REV. 803, 815–16 (1993).


25 Senator Dole, then chairman of the Courts Subcommittee of the Senate Judiciary Committee, mentions Continental by name while speaking in support of this provision as it came out of the conference committee. See 130 CONG. REC. S20,083, 20,084 (1984) (statement of Sen. Dole), reprinted in 984 U.S.C.C.A.N. 576, 588 (“[T]he labor provision is prospective only in application, to ensure that it will not be applied to cases pending in the courts today, such as the Continental and Wicks cases, where its application after those companies are far into their reorganization plans would work an impossible burden upon the litigants.”). See also ROBINSON, supra note 22, at 42 (“Largely because of the intense lobbying by labor in reaction to [the] unilateral abrogation of Continental’s collective bargaining agreements, in 1984 Congress amended the bankruptcy laws making it much more difficult for debtors to void their union contracts.”).
negotiate with labor on the terms of the labor contract before a court may approve its rejection.26

The use of Chapter 11 to relieve failed firms of their pension obligations raises several questions, but none more important than whether or not the practice is fair. At the heart of this issue is the question of who benefits from pension underfunding and pension termination. Pension underfunding benefits shareholders, who see higher net income attributable to their shares.27 Corporate executives benefit from higher stock prices when they receive stock options and performance-based bonuses tied to movements in the stock price. Executives rarely lose when pension plans are terminated, largely because they receive separate plans from the firms they head.28 The greatest beneficiaries of plan terminations in Chapter 11 are pre-bankruptcy unsecured and priority creditors, who realize a higher recovery absent mandatory payments into pension plans.29


27 See David Henry, Tripping Over Pension Shortfalls, BUS. WK. ONLINE, May 14, 2003, available at http://www.businessweek.com/bwdaily/dnflash/may2003/id20030514_6402_db014.htm ("[C]omplex accounting for fund assets and liabilities inflated companies’ earnings during the bull market and propped them up another couple of years afterward. The plans essentially made the market look less expensive than it was."); Janice Revell, Beware the Pension Monster; It Lurks Behind Funny Accounting, Ready to Pounce on Unsuspecting Investors, FORTUNE, Dec. 9, 2002, at 99, 104 (reporting that if companies in the S&P 500 with large defined benefit plans were forced to reduce their pension growth projections to 6.5% from a median of 9.2%, profits for the S&P 500 as a whole would drop by $44 billion in 2003).

28 See 26 U.S.C. § 401(a)(17)(A) (2000), amended by Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 611(c), 115 Stat. 38, 97 (limiting annual compensation of each employee participating in the plan to $200,000, adjusted annually). Many firms establish separate plans for executives to which cash payments are made. These plans are held by the executives or a trustee, not the firm, and are not imperiled by bankruptcy. See Theo Francis & Ellen E. Schultz, Guess Whose Retirement Benefits Aren’t Endangered?; Many Companies Set Up Trusts to Protect Huge Pensions for Top Executives, WALL ST. J., Apr. 6, 2003, at B1. However, the creation of such plans is not entirely risk free. When it appeared as though American Airlines was funding such a plan in advance of a possible bankruptcy filing in 2003, unions “went ballistic,” costing then-CEO Donald J. Carty his job. See Kuttner, supra note 6, at 24.

29 Under a Chapter 11 plan, each impaired class of claims must receive the present value of what that class would receive under Chapter 7 (liquidation). See 11 U.S.C. § 1129(a)(7)(ii) (2000). This means that secured creditors will receive the amount of their allowed secured claim. See id. § 506(a). And undersecured creditors can choose to take the § 1111(b)(2) election, which will force the debtor to pay the full amount of the creditor’s claim, both the secured and the unsecured portion. See id. § 1111(b)(2). The plan must also provide for the full payment of priority claims upon confirmation. See id. § 1129(a)(9). Treating the PBGC’s claim as an unsecured claim rather than secured frees up resources that can be used to pay priority creditors and increases the potential dividend among the unsecured creditors, which would be significantly diminished if the PBGC’s claims were treated as secured and had to be paid in full.
those who provide debtor-in-possession financing, and those who purchase the assets of bankrupt firms unencumbered by pension obligations. The biggest losers are retirees and current employees whose retirement income or expectations of income are reduced and the PBGC. Any consideration of the equities involved in pension plan termination cannot overlook the possibility that failure to terminate may lead to liquidation of the company. But this risk must be balanced against the potential for abuse of PBGC insurance by employers. The recent use of Chapter 11 by employers with large unfunded pension obligations mimics the use of Bildisco and Chapter 11 by employers with unwanted labor contracts. As it did after Bildisco, Congress must intervene to prevent the abuse of Chapter 11 by employers seeking to reorganize.

Part II of this note briefly reviews the form and function of the PBGC. Part III introduces several of the aspects of PBGC insurance of single employer plans that create moral hazard, which causes employers to underfund their pension plans. Part IV focuses on the dysfunctional relationship between ERISA, the Bankruptcy Code, and the Tax Code, and the ways in which employers with large unfunded pensions take advantage of those relationships to avoid pension liabilities. Finally, Part V discusses previous proposals for change to prevent the abuse of Chapter 11 by employers who terminate their pension plans after entering bankruptcy and concludes that—while statutory change is necessary—amendments to ERISA that protect the PBGC’s claim against firms that underfund their pensions may prove more useful than changes to the Bankruptcy Code or ERISA that grant the PBGC some sort of priority.

II. FORM AND FUNCTION OF THE PENSION BENEFIT GUARANTY CORPORATION

The PBGC is a government-owned corporation created under the Employee Retirement Security Act (ERISA) in 1974 for the purpose of insuring

30 The Retirement System of Alabama (RSA), which provided debtor-in-possession (DIP) financing to U.S. Airways, agreed to invest up to $240 million in the airline for a 37.5% interest, contingent on the airline receiving a federal loan guarantee from the Air Transport Stabilization Board (ATSB). See Reeves, supra note 15. Ironically, the ATSB required U.S. Airways to reduce its pension obligations before receiving the guarantee. While increasing the value of RSA’s investment and mitigating the risk of U.S. Airways default, the ATSB thrust over $600 million in pension obligations on the PBGC. See Borrus, supra note 13.

31 See supra note 12 (discussing the use of bankruptcy to avoid pension obligations as the steel industry consolidates).

32 See supra notes 14, 17 and accompanying text.

33 See supra note 11.

34 See Keating, supra note 22, at 806 (The PBGC is “a wholly-owned United States government corporation modeled after the Federal Deposit Insurance Corporation.”). The board of directors consists of the Secretaries of the Treasury, Commerce, and Labor. See 29 U.S.C.
private pension plans.\textsuperscript{36} The PBGC’s mandate is “to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants, to provide for the timely and uninterrupted payment of pension benefits” covered under ERISA, and “to maintain premiums . . . at the lowest level consistent with carrying out its obligations” under ERISA.\textsuperscript{37}

The PBGC insures only defined benefit pension plans,\textsuperscript{38} or plans into which the employer makes regular contributions with the promise of an annuity upon the employee’s retirement.\textsuperscript{39} These plans are distinguishable from defined contribution plans, such as 401(k)\textsuperscript{40} plans and employee stock ownership plans (ESOPs), into which employers and employees make regular contributions, but the amount received upon retirement depends upon the return on those contributions.\textsuperscript{41} There is no need for government insurance of these plans because the only obligation assumed by the employer is its share of contributions to the plan, rather than the promise of an annuity, and this obligation is met when contributions are made.\textsuperscript{42} Special exemptions from coverage exist for
professional service providers with fewer than twenty-five employees, churches, plans for highly-compensated executives, and all government plans. Defined benefit plans are divided into single-employer plans, provided voluntarily by an employer, and multi-employer plans, which are plans provided by several employers under a collective bargaining agreement, and these plans are insured separately.

There is little reason for the federal pension insurance program to cover defined contribution plans because employers fulfill such funding obligations when they make contributions. Under defined benefit plans, in contrast, a plan sponsor meets its obligation when the participant's benefits are paid fully or it purchases an annuity contract on behalf of the participant.

Some might question the assumption that defined contribution plans need not be insured, particularly those at Enron, who lost billions in retirement savings invested in Enron stock. See Enron Workers Sue to Recover $1 Billion in Lost Pension Funds, 11 Andrews' Prof. Liability Litig. Rep. 3 (2002). However, under ERISA, the employer serves as a trustee over the pension plan, creating at least a civil remedy against an employer who misappropriates plan funds or deceives employees into buying inflated shares of company stock. See id.; 29 U.S.C. §§ 1101–1109 (2000); Canan, supra note 34, § 16.9.


See id. § 1321(b)(3) (2000).

See id. § 1321(b)(6) (2000).


See Canan, supra note 34, § 19.1 ("A single-employer plan is any defined benefit plan . . . which is not a multi-employer plan. . . . A single-employer plan can be sponsored by more than one employer in the same controlled group or by employers not otherwise related to each other.").

See Canan, supra note 34, § 19.1. Canan describes:

A multi[-]employer plan means a plan (i) to which more than one employer is required to contribute, (ii) maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer, and (iii) which satisfies such other requirements as the Secretary of Labor may prescribe by regulation.

See 29 U.S.C. § 1322(a) (2000) (guarantee of single-employer plans); § 1322a(a) (guarantee of multi-employer plans); Uylaki, supra note 34, at 87–88 (distinguishing between single-employer and multi-employer plans).

There are two separate funds established for each type of plan. See 29 U.S.C. § 1305(a) (2000); Canan, supra note 34, § 19.4. Historically the single-employer fund has been the victim of underfunding and economic downturn, but in 2002 the multi-employer fund reported a negative net position for the first time in twenty years. See 2003 PBGC Ann. Rep. 5 (2004). The net position of a fund is the amount by which liabilities exceed assets. By comparison, at the close of fiscal year 2002, the negative net position of the single-employer fund was $11.2 billion, while the negative net position of the multi-employer fund was $261 million. Id. at 23,
The PBGC generates revenue through the payment of premiums, which are set by statute.\textsuperscript{51} The PBGC is wholly self-sustaining, receiving no contributions from general revenues.\textsuperscript{52} The benefits guaranteed by the PBGC are also limited by statute.\textsuperscript{53} To qualify as a guaranteed benefit under a single-employer plan, the benefit must be a non-forfeitable pension benefit to which the participant or beneficiary is entitled and be payable directly or indirectly to a living person.\textsuperscript{54} The single-employer benefit guaranteed by the PBGC is a straight life annuity, commencing at age sixty-five and payable monthly.\textsuperscript{55} The actual monthly amount

\footnote{See 29 U.S.C. § 1306(a)(3)(A)–(E) (2000). The premiums for single-employer plans are capped at $19 per participant, plus an additional premium of $9 for each $1,000 of unfunded vested benefits under the plan divided by the number of participants. \textit{Id.} § 1306(a)(3)(A)(i), (E)(i)–(ii). For a more detailed description of the way in which premiums are calculated, see CANAN, supra note 34, § 19.5 (single-employer). The contribution this statutory premium structure makes to the general moral hazard created by PBGC insurance is discussed \textit{infra} Part III.B.}

\footnote{See Uylaki, supra note 34, at 88 (“Unlike the archetypal federal agency, the [PBGC] receives no funding from general tax revenues.”). Uylaki states that because the PBGC receives no funding from general revenues “the taxpayer need not lament that the PBGC will dip into taxpayer coffers in order to resuscitate failed pension plans.” \textit{Id.} This statement is not entirely accurate. The PBGC has a put option that authorizes it to place up to $100 million in notes with the Secretary of the Treasury. See 29 U.S.C. § 1305(c) (2000); CANAN, supra note 34, § 19.1 (“The borrowing is to be used, if necessary, to fund employee benefits guaranteed by the PBGC.”). And while the PBGC may not use general revenues to bail out failed pension plans, this does not mean that general revenues may not prove necessary to bail out the PBGC, despite the fact that the government is not technically liable for any of the PBGC’s obligations. \textit{Cf. id.} § 19.3(A); Kudlow & Cramer: Bradley Belt, Executive Director of Pension Benefit Guaranty Corporation, Discusses the Airlines’ Pension Problems (CNBC television broadcast, Aug. 31, 2004) (Mr. Belt states that “there is some risk if we don’t address [the termination of underfunded pensions] that the American taxpayer is going to be called upon to bail out the pension insurance system”); \textit{see also} Elliott, supra note 16, at 8, (estimating that the bailout could be in excess of $67 billion).}


\footnote{See CANAN, supra note 34, § 19.6(A)(1). To qualify as a pension, the benefit must generally be payable as an annuity. \textit{Id.} Non-forfeitability generally means that the accrued benefits will vest fully upon termination of the plan. \textit{Id.} The beneficiary is entitled to the benefit if he or she is receiving benefits when the plan terminates or would have received the benefit at retirement. \textit{Id.} Finally, “[t]he benefit must be payable to a natural person, or to a trust or estate for the benefit of one or more natural persons.” \textit{Id. See also} 29 C.F.R. § 4022.1 to .7 (2003).}

\footnote{See 29 U.S.C. § 1322(b)(3) (2000); CANAN, supra note 34, § 19.6(A)(2). The PBGC defines a straight life annuity as “a series of level periodic payments payable for the life of the recipient, but does not include any combined annuity form, including an annuity payable for a term certain and life.” 29 C.F.R. § 4022.2 (2004). A straight life annuity is “the original and basic type of annuity.” JEROME B. COHEN & ARTHUR W. HANSON, PERSONAL FINANCE: PRINCIPLES AND CASE PROBLEMS 478 (1972). Traditionally such an annuity is purchased for a lump-sum premium and payments begin immediately. \textit{Id.} The annuity itself has no cash value
paid to a beneficiary by the PBGC is the lesser of either one-twelfth the beneficiary's annual salary over the five-year period during which he or she earned the most or a fixed amount indexed to changes in the cost of living. In 2004 the guaranteed maximum annual amount paid out by the PBGC will be $44,386.32, or $3,698.86 per month.

The PBGC is obligated to pay benefits to retirees when an underfunded pension plan is terminated. There are three means by which a plan is terminated: (1) standard termination, (2) distress termination by the plan provider, or (3) involuntary termination by the PBGC. Under a standard termination the plan is terminated by the employer and plan assets are distributed. A standard termination is most likely to occur where the assets of the pension plan exceed the plan's obligations and, by terminating the plan, the employer can capture that surplus for itself. A standard termination could occur during the course of a

and, as a result, payments cease upon the death of the annuitant regardless of when he or she dies. Id. Multi-employer plans are outside the scope of this Note. For a discussion of the benefits guaranteed under such plans see CANAN, supra note 34, § 19.16.


See Pension Benefit Guar. Corp., Fact Sheets: PBGC’s Pension Guarantees, at http://www.pbgc.gov/Publications/factshts/GUARFACT.HTM (last visited Nov. 10, 2004) [hereinafter PBGC’s Pension Guarantees]. The benefits of those who retire before age 65 are reduced along a fixed scale. See 29 C.F.R. § 4022.23(c) (2003). “For example, the maximum guarantee for a participant who retires at age 62 is $35,065.20 yearly ($2,922.10 monthly) for a single-life annuity. At age 55, the maximum guarantee is $19,973.88 yearly ($1,664.49 monthly).” PBGC’s Pension Guarantees, supra. Benefits are also reduced if the annuity is a joint and survivor annuity. See 29 C.F.R. § 4022.23(d)(2)-(3) (2003).


When a plan that is fully funded is terminated, the plan sponsor must purchase annuities to cover those entitled to benefits under the terminated plan. See 29 U.S.C. § 1341(b)(3)(A) (2000); 29 C.F.R. § 4041.28 (2003); EDWARD THOMAS VEAL & EDWARD R. MACKIEWICZ, PENSION PLAN TERMINATIONS § 6.1 (1989).

Chapter 11 reorganization if the employer has over-funded the plan and the surplus could be used to help fund the reorganization plan. Yet, even in the event of a Chapter 11 filing, neither employees nor the PBGC is harmed by a standard termination.62

Distress termination occurs where the employer seeks to voluntarily terminate an underfunded pension plan.63 In order to voluntarily terminate a plan as a distress termination, the employer must meet one of four distress criteria.64 These criteria are met where: (1) the employer seeks to terminate during the course of business liquidation under Chapter 7 of the Bankruptcy Code or similar state law;65 (2) the business shows that continuing to fund a pension plan will prevent successful reorganization under Chapter 11;66 (3) funding the pension plan will prevent the firm from paying its debts as they come due;67 or (4) the plan must be terminated to avoid unreasonably burdensome pension costs caused by a decline in the number of plan participants.68 After the PBGC determines that one of the distress criteria has been met, the PBGC assumes the plan and its assets and liabilities.69

Finally, the PBGC itself may initiate an involuntary termination proceeding against an underfunded plan when it determines that: (1) the plan is not meeting the minimum funding standard established under the tax code;70 (2) the plan will

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62 If a plan is terminated under a standard termination, ERISA requires that "when the final distribution of assets occurs, the plan is sufficient for benefit liabilities." 29 U.S.C. § 1341(b)(1)(D) (2000). See also 29 C.F.R. § 4041.28(b) (2003) ("If, at the time of any distribution, the plan administrator determines that plan assets are not sufficient to satisfy all plan benefits . . ., the plan administrator may not make any further distribution of assets to effect the plan's termination and must promptly notify the PBGC."); Keating, supra note 22, at 808 ("A standard termination does not implicate the PBGC's insurance function.").

63 See Keating, supra note 22, at 808 ("A distress termination ... is a voluntary termination in which an employer with an underfunded pension plan can demonstrate to the PBGC that it is in financial distress."). For a detailed description of the process of distress termination see CANAN, supra note 34, § 19.10.


65 See id. § 1341(c)(2)(B)(i); 29 C.F.R. § 4041.41(c)(1) (2003).


be unable to pay benefits when due;\textsuperscript{71} (3) certain events have occurred that must be reported to the PBGC;\textsuperscript{72} or (4) the long-run loss to the PBGC will "increase unreasonably" if the plan is not terminated.\textsuperscript{73} A trustee is then appointed to administer the plan\textsuperscript{74} and the PBGC seeks a decree from a U.S. District Court to terminate the plan and assume its assets and liabilities.\textsuperscript{75}

### III. MORAL HAZARD IMPLICIT IN THE ERISA INSURANCE SCHEME

The pension termination insurance system established in ERISA creates what economists and those in the insurance industry call "moral hazard."\textsuperscript{76} A moral hazard arises when the risk of one party's conduct is removed to a second party, leading the first party to engage in riskier conduct than he might otherwise engage in.\textsuperscript{77} By its very nature, insurance creates moral hazard by enabling the insured to engage in conduct that tends to lead to insured-against events to a greater degree than they might otherwise if they bore the full cost of their actions. But the insurance scheme created under ERISA exacerbates this natural tendency by encouraging employers to allocate resources away from pension obligations, charging premiums below market rates that displace a disproportionate amount of risk away from employers and onto the PBGC, and by encouraging poorly performing firms to distribute assets to shareholders and then seek bankruptcy protection.\textsuperscript{78}

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\textsuperscript{71} See id. § 1342(a)(2). The PBGC must terminate a plan that "does not have assets available to pay benefits which are currently due under the terms of the plan." Id. § 1342(a).

\textsuperscript{72} See id. §§ 1342(a)(3), 1343.

\textsuperscript{73} See id. § 1342(a)(4). For more detail on involuntary termination see CANAN supra note 34, § 19.11.

\textsuperscript{74} 29 U.S.C. § 1342(b)(1).

\textsuperscript{75} See id. § 1342(c).

\textsuperscript{76} See IPPOLITO, supra note 36, at 41 ("The policies pursued at the PBGC represent serious violations of fundamental insurance principles. The pricing system makes no attempt to require insureds to face the cost of the insurance, and moral hazard is seemingly encouraged.").

\textsuperscript{77} See Daniel Keating, Pension Insurance, Bankruptcy and Moral Hazard, 1991 WIS. L. REV. 65, 68 (1991) ("[T]hose who are insured against certain risks have an incentive to use less than optimal care to avoid those risks."); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 121 (5th ed. 1998) (defining "moral hazard" as "[t]he tendency of an insured to relax his efforts to prevent the occurrence of the risk that he has insured against because he has shifted the risk to an insurance company").

\textsuperscript{78} See generally DAN M. MCGILL, GUARANTY FUND FOR PRIVATE PENSION OBLIGATIONS 50–52 (1970) (discussing possibilities for abuse of guaranty system that allows firms to terminate plans without also being required to terminate); IPPOLITO, supra note 36, passim; Keating, supra note 77, at 67–68.
A. Employers’ Reallocation of Resources

Pension insurance allows employers to reallocate resources away from labor costs and toward capital spending or shareholders. Keating describes this behavior as "[e]mployers, realizing that the PBGC’s insurance can subsidize their company’s pension promises for an expected cost to the company of less than one hundred cents on the dollar, [giving employers] an incentive to spend capital in ways other than funding pension plans."79 Employers can spend this capital by either investing in new technology or ventures,80 or returning the savings captured to shareholders. These savings are generated in an overlapping process. Employers first use the promise of a defined benefit pension to replace a portion of employees’ current wages.81 If the employer actually makes sufficient contributions into the plan to fund those promises, those contributions will be less than what the employer would have to pay to replace the pension-portion of a labor agreement with current wages because of the time value of money.82 If the employer fails to make sufficient contributions it simply saves even more on labor costs.83 Employees are lulled into accepting the promised pension as part of their benefits package, in part because of the promise of government insurance.84

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79 Keating, supra note 77, at 67.
80 See Keating, supra note 77, at 76–77.
An employer, by underfunding its pension plan, can use the money saved to engage in speculative enterprises. If the risk-taking pays off, the upside potential for the stockholders and senior managers is theoretically unlimited. If the risky ventures fail, the worst that can happen is that the corporation liquidates and the underfunded pension plan terminates.

Id.
81 See Statement of Steven A. Kandarian, supra note 6, at 8.
Pension insurance creates moral hazard, tempting management and labor at financially troubled companies to make promises that they cannot or will not fund. The cost of wage increases is immediate, while the cost of pension increases can be deferred for up to 30 years. In exchange for smaller wage increases today, companies often offer more generous pension benefits tomorrow, knowing that if the company fails the plan will be handed over to the PBGC. This unfairly shifts the cost of unfunded pension promises to responsible companies and their workers.

Id.
82 See Keating, supra note 77, at 72 (“By offering insured pension benefits to their employees, businesses are able to devote fewer resources to current wages.”).
83 Although pensions are subject to minimum funding requirements, these requirements can be waived for three years by the IRS. See 26 U.S.C. § 412(d) (2000). This waiver is discussed at length infra Part IV.A.
84 Cf. Keating, supra note 77, at 73 (“Employers could . . . promise pensions that are not guaranteed by the PBGC. Such uninsured pension obligations would not, however, be as attractive to employees as pension promises . . . backed by the PBGC. Thus, the PBGC’s
Second, while saving on labor costs by deferring wages, firms can use overly-optimistic projections of the return on the plan's assets to reduce the amount contributed to the plan during the current period.\footnote{See Keating, supra note 77, at 73–74.} The result is that the employer can use the cash that would otherwise go to pay wages for fixed investment or to pay dividends, transferring the risk of that fixed investment to employees and the PBGC\footnote{See David F. Bean & Richard A. Bernardi, Underfunding Pension Obligations While Paying Dividends: Evidence of Risk Transfers, 11 CRIT. PERSP. ON ACCT. 515, 518 (2000) ("The economic and legal reality of the decision to underfund pensions is that management can, and does, unilaterally impose a creditor status on employees/retirees. . . . External financing involves administrative, underwriting, and other costs . . . [and therefore] internal sources are favored over external sources . . . .") See also Keating, supra note 77, at 77 ("When a company underfunds its pension plan, the firm is in effect 'borrowing' money from the PBGC on an unsecured basis similar to a firm's drawing down an unsecured line of credit.").} or enriching shareholders at the expense of employees and the PBGC.\footnote{Although there are federal minimum funding standards for insured pension plans, the employer retains a tremendous amount of discretion as to the level of funding that each plan will have. There are . . . a number of actuarial assumptions that need to be made in order to determine whether employers are complying with minimum funding standards. Although these assumptions must be "reasonable," there is nevertheless a significant range within which employers can accommodate their own preferences on funding.}
The plan retains a lien against the employer when the minimum funding standard is not met, and the PBGC theoretically receives a lien against the employer when the plan is terminated. However, these liens prove to be of little value when the employer seeks to reorganize under Chapter 11 because the plan simply becomes another creditor and the PBGC often cannot perfect its lien.

B. Premiums Unrelated to Risk

Premiums paid to the PBGC to fund the insurance program are set by Congress at a fixed amount per plan participant. These premiums are adjusted to account for the amount by which a plan is underfunded, but do not in any way...

87 See Bean & Bernard, supra note 86, at 520.

The payment of dividends in the context of increasing pension liabilities suggests that the firm considers the fiduciary obligation to its shareholders to be of paramount importance. However, if employees perceive that pension funding is not problematic due to eventual payment by the PBGC, there is no factual basis to assume deterioration in management's fiduciary obligations to its employees. However, if all or a portion of a pension plan is ultimately funded by the PBGC then the recipients do incur risks in terms of expectations versus actual disbursements as well as in terms of both time and money. Thus the underfunding of pension plans is a unilateral and uncompensated transfer of risk. Furthermore, the shareholders of the firm become de facto recipients of wealth transfers via the discretionary payments made to shareholders versus the discretionary payments made to the pension plan.

Id.

Of even greater concern is the finding by Bean and Bernardi that firms with increasing pension liabilities showed declining cash flows yet higher dividends. Id. at 527. This suggests that these firms may be diverting corporate resources from pension contributions to shareholders. Such conduct is to be expected where the value of the firm is less than the present value of the cash shareholders can squeeze out of the firm. See George A. Akerlof & Paul M. Romer, Looting: The Economic Underworld of Bankruptcy for Profit, 1993 BROOKINGS PAPERS ON ECON. ACTIVITY 1, 6 (1993).

90 See 11 U.S.C. § 545(a) (2000). The conflict between ERISA and this section of the Bankruptcy Code is discussed further infra Parts IV, V.
91 See 29 U.S.C. § 1306(a)(3) (2000); Uylaki, supra note 34, at 88; Keating, supra note 77, at 97. Keating notes:

[T]he formula which drives the variable rate premiums looks solely to differences in the amount of underfunding among plans. The formula does not attempt to factor in the reality that two plans, equally underfunded, might pose greatly different risks to the PBGC based on the relative likelihood that the PBGC will be forced to assume responsibility for the plans.

Id.
reflect the risk of plan termination.\textsuperscript{92} The result is that premiums do not reflect the risk assumed by the PBGC or displaced by employers;\textsuperscript{93} the PBGC provides maximum (statutory) coverage for nominal premiums. Premiums unrelated to the risk assumed by the insurer disproportionately shift the risk related to the insured-against event (in this case, termination) from the insured to the insurer.\textsuperscript{94} Where the costs of engaging in behavior that increases the risk of the insured-against event are below what the market would require to insure against the risk of such

\textsuperscript{92} See Richard A. Ippolito & Steven Boyce, The Cost of Pension Insurance, 69 J. RISK & INS. 121, 124 (2002) ("[T]he pricing schedule currently enforced by the PBGC only vaguely resembles one that meets a market standard...[T]he overall premiums now collected amount to about 50 percent of those that would be charged in the private sector for the same coverage."). Ippolito and Boyce also estimate that the current premium structure amounts to $4.60 per $1,000 of exposure to liability from termination, while premiums determined in the market would be about $24.60 per $1,000 of exposure. \textit{Id.} at 153. That is, PBGC premiums are about 20\% of what the market would charge to insure the same obligations insured by the PBGC. \textit{See also} 29 U.S.C. § 1306(a)(3)(E).

As an indication of just how bizarre the premium structure is, the PBGC has revealed that United has paid only about $50 million in total premiums since ERISA was enacted in 1974, while it will likely saddle the PBGC with $6.4 billion in obligations. \textit{See} Boselovic, \textit{supra} note 13; John Plender, \textit{A Slow Motion Re-Run of the S&L Disaster: Stand By for Pension Bail-Out}, FIN. TIMES, Sept. 13, 2004, at 24.

\textsuperscript{93} Keating points out that "the PBGC has found it difficult to assess the risk that a given plan will terminate." Keating, \textit{supra} note 77, at 97. Yet Ippolito and Boyce, both of whom have worked for or work at the PBGC, have shown that the market risk can be priced. \textit{See} Ippolito \& Boyce, \textit{supra} note 92. Current director of the PBGC, Bradley D. Belt, has announced his commitment to imposing risk-based premiums on plans covered by the PBGC. \textit{See} Vineeta Anand, \textit{Ready To Work: New PBGC Head Set to Fix System}, PENSIONS \& INVESTMENTS, May 17, 2004, at 2.

For now, Mr. Belt's basic premise...is that the PBGC must be allowed to function like any other private insurance company. To that end, it should charge varying premiums depending on the risks plan sponsors present to the agency, measured by the companies' credit ratings, asset allocation of the pension plans, exposure to interest rate changes and structural risk in a particular industry sector.

\textit{Id}.


[B]y purchasing pension insurance, plan sponsors effectively acquire pension put options written by the PBGC. If the pension insurance is correctly priced, no wealth transfers should occur between the PBGC and plan sponsors in the event of funding level or pension asset mix changes. On the other hand, if the premiums are not correctly priced, changes in plan funding levels or the pension asset investment strategy could be undertaken by plan sponsors to increase the PBGC insurance put option values.

\textit{Id}.
an event, the insured party is more likely to engage in such conduct (e.g., underfunding).\textsuperscript{95}

C. Bankruptcy for Profit

While government insurance of private obligations may be necessary in markets where private insurers are simply incapable of providing coverage, there may be situations where government insurance of business obligations creates an incentive to divert assets away from those obligations for a period and then default on those obligations and seek bankruptcy protection, or to file “bankruptcy for profit.”\textsuperscript{96}

The incentive to engage in high-risk behavior to maximize short-term returns to equity holders that arises out of government insurance and the destructive results that follow was best illustrated by the collapse of the Savings and Loan (S&L) industry in the late 1980s and early 1990s.\textsuperscript{97} Beginning in 1980 the

\begin{itemize}
\item the normal economics of maximizing economic value is replaced by the topsy-turvy economics of extractable value . . . . Once owners have decided that they can extract more from a firm by maximizing their present take, any action that allows them to extract more currently will be attractive—even if it causes a large reduction in the true economic net worth of the firm.
\end{itemize}

\textit{Id.}

\textsuperscript{95} See supra note 77 and accompanying text.

\textsuperscript{96} Akerlof and Romer describe this type of conduct as “bankruptcy for profit,” or “looting.” Such conduct will arise where “poor accounting, lax regulation, or low penalties for abuse give owners an incentive to pay themselves more than their firms are worth and then default on their debt obligations.” Akerlof & Romer, \textit{supra} note 87, at 2. Akerlof and Romer note that “[b]ankruptcy for profit occurs most commonly when a government guarantees a firm’s debt obligations,” specifically noting the insurance of pension obligations as such a guarantee. \textit{Id.} Where the government’s requirements of the insured with regard to the insured-against event (e.g., minimum funding requirements) are below the benefit to owners of depleting the firm of resources (e.g., paying dividends), the firm will have an incentive to distribute assets toward owners and default. \textit{Id.} In such a situation,

\begin{itemize}
\item the normal economics of maximizing economic value is replaced by the topsy-turvy economics of extractable value . . . . Once owners have decided that they can extract more from a firm by maximizing their present take, any action that allows them to extract more currently will be attractive—even if it causes a large reduction in the true economic net worth of the firm.
\end{itemize}

\textit{Id.}

\textsuperscript{97} See generally Elijah Brewer III & Thomas H. Mondschean, \textit{Ex Ante Risk and Ex Post Collapse of S&Ls in the 1980s,} J. ECON. PERSP., July 1992, at 2 (showing that most highly leveraged S&Ls engaged in riskiest investment strategies and had higher relative stock prices before the S&L collapse); Bert Ely, \textit{Regulatory Moral Hazard: The Real Moral Hazard in Federal Deposit Insurance,} 4 INDEP. REV. 241 (1999) (concluding that regulatory “laxity” is the true cause of the moral hazard attending depository insurance); Daniel M. Gropper & T. Randolph Beard, \textit{Insolvency, Moral Hazard and Expense Preference Behavior: Evidence from US Savings and Loan Associations,} 16 MANAGERIAL & DECISION ECON. 607 (1995) (assessing the tendency among insured S&Ls to allocate assets toward wages, salaries, and fringe benefits as insolvency approached); Dale K. Osborne & Seokwon Lee, \textit{Effects of Deposit Insurance Reform on Moral Hazard in US Banking,} 28 J. BUS. FIN. & ACCT. 979 (2001) (assessing the change in bank lending habits in response to regulatory change in depository insurance, including higher premiums, intended to reduced moral hazard accompanying such insurance);
Federal government insured deposits at S&Ls through the Federal Savings and Loan Insurance Corporation (FSLIC). In addition, S&Ls were regulated by the Federal Home Loan Bank Board (FHLBB). After phenomenal growth and success throughout the 1960s, S&Ls came under pressure as interest rates rose along with inflation in the 1970s. With the promise of government insurance backing deposits, and with the imprimatur of Congress, S&Ls began investing in high-income, high-risk assets to cover losses. Ultimately the S&L industry collapsed, costing taxpayers over $186 billion as the government intervened to resolve the liabilities of insolvent S&Ls. At least one study by Brewer and Mondschean shows that during the 1980s, the most highly leveraged S&Ls engaged in the riskiest investment strategies and had significantly higher stock prices relative to assets than S&Ls that were less leveraged and did not engage in similarly risky investment strategies. In the absence of depository insurance, the ability of shareholders to engage in risky investment strategies is limited by the imposition of "market discipline" on those investments by depositors. With deposit insurance, however, this market restraint falls away. Shareholders at S&Ls were free to engage in high-risk investment strategies, which resulted in

David C. Wheelock & Subal C. Kumbhakar, *Which Banks Choose Deposit Insurance? Evidence of Adverse Selection and Moral Hazard in a Voluntary Insurance System*, 27 J. Money, Credit & Banking 186 (1995) (concluding that it is the weakest banks that seek out depository insurance when it is not mandated by law and that such insurance promotes riskier practices).

However, perverse incentives arise from other government programs as well, such as programs through which the government serves as a "lender of last resort." See Eddy L. LaDue, *Moral Hazard in Federal Farm Lending*, 72 Am. J. Agric. Econ. 784 (1990). Professor LaDue argues that a government program providing below-market loans to farmers when those farmers generate insufficient cash flow to service debt at market rates provides an incentive to avoid increasing cash flow, spend more on personal items, and avoid capital investment. See id. at 776.

98 See Brewer & Mondschean, supra note 97, at 2.

99 Id. at 4.

100 Id. S&Ls essentially provided fixed-rate long-term home mortgages funded through short-term deposits earning interest. Id. As long as short-term rates remained below the rate of return on the mortgages, S&Ls remained profitable. Id. However, as short-term rates increased during the 1970s, profits at S&Ls were squeezed and generally eliminated. Id. In addition, the amount of interest S&Ls could pay on deposits was limited by federal law, causing deposit outflows at S&Ls. Id. To avert disaster, Congress lowered capital requirements, freeing up assets, and allowed S&Ls to expand the pool of assets in which they could invest to include much riskier assets. Id.

101 See id. at 4; Akerlof & Romer, supra note 87, at 23–36.

102 Brewer & Mondschean, supra note 97, at 2.

103 See id. at 9–10.

104 Id. at 6.

105 Id.
temporary increases in share prices.\textsuperscript{106} Thus, "it was moral hazard . . . that led to the S&L crisis and increased its cost."\textsuperscript{107} The ability of pension plan sponsors to engage in similar behavior as a result of the insurance provided by the PBGC is eerily reminiscent of the federal government's experience with S&Ls and depository insurance.\textsuperscript{108}

Consider the case of a highly leveraged firm with union contracts calling for the maintenance of a defined-benefit pension plan.\textsuperscript{109} Because the firm has few unencumbered assets, its liquidation value to the shareholders is low, possibly zero. Yet, the firm pays dividends during periods of profitability, or even during a period of unprofitability.\textsuperscript{110} The firm is required by law to pay premiums to the government to insure the pension plan.\textsuperscript{111} The firm must meet the minimum

\textsuperscript{106} Id. at 10.

\textsuperscript{107} Id.

\textsuperscript{108} The financial status of the PBGC and the potential liability to taxpayers is distinguishable from the S&L scandal in at least one regard. As Bradley Belt points out, unlike the S&Ls that collapsed, the PBGC does not face an immediate liquidity crisis. See Weekend All Things Considered: Bradley Belt Discusses Companies Defaulting on Their Pension Contributions (NPR radio broadcast, Aug. 28, 2004). Belt stated:

[The S&L crisis] was a cash crisis . . . . It had to be addressed because people wanted their deposits form those thrifts. That's not the same issue here. PBGC has $40 billion in assets . . . . The problem is we've got a deep hole, $10 billion deficit, huge contingent liability . . . and no real ability to fill that hole. That raises the prospect of a future taxpayer bailout . . . .

\textsuperscript{109} This analysis is consistent with Cooper and Ross, who argue that pension underfunding will arise in situations where capital market inefficiencies leave the employer undercapitalized. See Russell W. Cooper & Thomas W. Ross, \textit{Pensions: Theories of Underfunding}, 8 LAB. ECON. 667, 683 (2002); Russell W. Cooper & Thomas W. Ross, \textit{Protecting Underfunded Pensions: The Role of Guarantee Funds}, 2 J. PENSION ECON. & FIN. 247, 255 (2002) [hereinafter Cooper & Ross, \textit{Protecting}]. According to Cooper and Ross, "a firm with sufficiently large . . . capitalization will offer . . . a fully funded pension, efficient risk sharing and efficient decision on continuation. In contrast, a firm with small [capitalization] will underfund its pension . . . and will exit too often relative to the socially efficient decision." \textit{Id.} at 256.

\textsuperscript{110} According to Bean and Bernardi, United Airlines borrowed to pay dividends during the 1990s. See Bean & Bernardi, \textit{supra} note 86, at 517. This may have been a consequence of United being majority-owned by its own employees.

funding standard to avoid penalties\textsuperscript{112} and termination of the pension plan.\textsuperscript{113} The firm may use "reasonable" estimates of the return on plan assets to determine the amount it must contribute to meet the minimum funding standard.\textsuperscript{114} Any firm has an incentive to use aggressive estimates of the return on plan assets to make the smallest possible contribution to the plan to meet the minimum funding standard.\textsuperscript{115} The risk that this contribution may not actually be enough to cover future payments to retirees is borne by the insuring government agency, so even a solvent firm has an incentive to use aggressive estimates. However, this hypothetical firm, being barely solvent, has an even greater incentive to make the smallest possible contributions allowed by law to its pension plan and to redistribute the cash not placed in its plan to shareholders.\textsuperscript{116} Shareholders will seek to maximize dividends to extract as much value as possible from the firm in the short term, knowing that liquidation would leave them with next to nothing.\textsuperscript{117} The result is the reallocation of cash away from the insured pension plan and into the hands of shareholders, followed by a Chapter 11 filing. If the firm can then avoid its unfunded pension obligations by terminating its plan, the process can be repeated with a new set of shareholders, namely former creditors.\textsuperscript{118} If not, the firm’s bankruptcy case is converted to Chapter 7\textsuperscript{119} and

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\textsuperscript{112} See infra notes 123–132 and accompanying text (discussing minimum funding standard). The plan itself receives a lien against the employer in the amount by which the plan is underfunded. See 26 U.S.C. § 412(n) (2000). In addition, an excise tax of ten percent on the accumulated deficiency is assessed against the employer. See 26 U.S.C. § 4971(a) (2000). If the employer fails to make up this shortfall within a "correction period" an excise tax of one-hundred percent of the shortfall is assessed. See 26 U.S.C. § 4971(b) (2000); CANAN, supra note 34, § 12.8(C)(2). This tax is discussed infra note 144–46 and accompanying text.


\textsuperscript{115} See supra Part III.A (discussing the incentives employers have to reallocate resources away from pension obligations).

\textsuperscript{116} "A dollar in increased dividends today is worth a dollar to owners, but a dollar in increased future earnings of the firm is worth nothing because future payments accrue to the creditors who will be left holding the bag." Akerlof & Romer, supra note 87, at 2.

\textsuperscript{117} Akerlof and Romer describe this activity in a series of inequalities. If $V$ equals the true value or net worth of a corporation and $M$ equals the government restriction on the use of the corporations assets (i.e., the minimum funding contribution) then: (a) where $M > V$ there is an incentive to "borrow" enough from the government to pay owners $M$ and then default; and (b) where $M < V$ there is an incentive to maximize $V$. Akerlof & Romer, supra note 87, at 6.

\textsuperscript{118} Keating’s proposed "super-priority," discussed infra Part V.A, rests upon the presumption that imposing a blanket lien on the assets of the firm in favor of the PBGC upon termination of the plan would give creditors incentive to monitor the employer’s funding of these plans. See Keating, supra note 77, at 102–03. The reasonable inference to be drawn is that secured creditors are indifferent toward pension plan underfunding because they know that their claims will not be affected by the PBGC’s claim for unfunded benefits. Yet there is some evidence that pension plan underfunding decreases a firm’s debt ratings. See Thomas J. Carroll & Greg Niehaus, Pension Funding and Corporate Debt Ratings, 65 J. RISK & INS. 427, 439
the firm is liquidated. This process of reallocation may explain, in part, evidence indicating that firms increase interest rate assumptions on pension plan assets in the years leading up to termination.

The moral hazard created by government insurance of private pension plans is expressed as an incentive on the part of the employer to underfund its pension plan. The tangled web of code that governs the maintenance of defined-benefit pension plans, contributions to those funds, and how those plans are dealt with in bankruptcy allows firms that succumb to this moral hazard to abuse the bankruptcy code and shift the costs of reorganization onto employees.

IV. THE DYSFUNCTIONAL RELATIONSHIP AMONG THE BANKRUPTCY CODE, TAX CODE, AND ERISA

Outside of bankruptcy, defined benefit pension plans are governed generally by the Tax Code and ERISA. The Tax Code describes which plans will qualify for the tax advantages provided to employers who make contributions to retirement plans, minimum participation, vesting and funding standards, limitations on contributions and benefits, and other criteria. ERISA prescribes mechanisms intended to protect pensions and establishes reporting requirements plan administrators must meet, as well as defining participation and vesting standards, the fiduciary responsibilities of plan administrators, (1998). This finding may reflect the fact that a firm with an underfunded pension plan places its secured creditors at greater risk should the PBGC terminate the plan outside of bankruptcy.


120 Under this model the shareholders are indifferent toward the outcome of the bankruptcy case because they have no equity left in the firm. Under the rule of absolute priority, shareholders in this hypothetical firm receive nothing, regardless of whether the firm reorganizes or liquidates. Cf 11 U.S.C. §§ 726(a), 1129(b)(2) (2000) (establishing order of priority for distribution of assets in liquidation and for treatment of creditors and equity holders in a reorganization plan, respectively).

121 See IPPOLITO, supra note 36, at 120. Of course, firms are also likely increasing their actuarial assumptions to preserve cash to keep the firm afloat. Either way cash is being allocated away from the pension plan and toward shareholders.


125 See id. §§ 410–412.

126 See id. § 415.

127 See generally id. § 414 (definitions and special rules); id. § 416 (special rules regarding benefits provided executives); id. § 417 (rules regarding survivorship rights).


129 See id. §§ 1051–1086.

130 See id. §§ 1101–1114.
and the system of pension insurance administered by the PBGC.\textsuperscript{131} Because the Tax Code and ERISA have different goals, their interaction can lead to situations that undermine both statutory schemes, such as IRS contribution waivers that relieve financially burdened firms from making minimum funding contributions and suspend penalties for not making such contributions, while imperiling the PBGC, which must continue to insure the unfunded pension obligations.\textsuperscript{132} When a pension plan is terminated after the employer has filed bankruptcy, certain portions of the Bankruptcy Code strip employees and the PBGC of the protections granted under ERISA.\textsuperscript{133}

\textbf{A. How the IRS Increases the PBGC's Exposure to Unfunded Pension Liabilities}

Both the Tax Code\textsuperscript{134} and ERISA\textsuperscript{135} contain provisions setting forth minimum funding standards that operate in similar fashion.\textsuperscript{136} These minimum funding standards are established for the dual purposes of ensuring that firms receiving tax benefits from plan contributions are taking advantage of these tax benefits in good faith, and establishing criteria that allow the PBGC to monitor its exposure to plan liabilities.\textsuperscript{137} The plan administrator is left the task of choosing an actuarial method for valuing plan assets and making assumptions regarding employees (turnover, disability, mortality, age differences in mortality between employee and spouse, the probability that an employee will retire early, and

\begin{itemize}
\item \textsuperscript{131} See id. §§ 1301–1453.
\item \textsuperscript{132} See infra Part IV.A.
\item \textsuperscript{133} See infra Part IV.B.
\item \textsuperscript{134} 26 U.S.C. § 412(a) (2000).
\item \textsuperscript{135} 29 U.S.C. §§ 1081–1086 (2000).
\item \textsuperscript{136} See CANAN, supra note 34, § 12.2(A).
\end{itemize}

There is considerable overlap in coverage for minimum funding standards purposes between the Internal Revenue Code and [ERISA]—virtually all qualified plans covered by IRC § 412 will also be covered by... ERISA... , 29 U.S.C.A. §§ 1081 through 1086, except to the extent the qualified plans do not have sufficient connection with interstate commerce or are excluded from the coverage of... ERISA.

\textit{Id.}

\textsuperscript{137} See CANAN, supra note 34, § 12.1 ("[I]f the government is effectively to exercise control over the level of contributions the employer makes to such plans, there must be a standard or standards such that both the employer and the government know when the plan is properly funded, and when it is not."). Congress intended to ensure that there was sufficient oversight to prevent abuse of the insurance system. See H.R. REP. NO. 93-533, at 14, reprinted in 1974 U.S.C.C.A.N. 4639, 4652 ("To create a plan termination insurance program without appropriate funding standards would permit those who present the greatest risk in terms of exposure to benefit at the expense of employers who have developed conscientious funding programs.").
compensation levels) and the return on plan assets.\textsuperscript{138} All actuarial assumptions must be “reasonable,”\textsuperscript{139} and the rate of return on plan assets is limited to a “permissible range” of not more than ten percent above or below the interest rate on 30-year Treasuries.\textsuperscript{140} Each plan administrator is required to establish a “minimum funding account,” against which the administrator makes charges and to which the administrator applies credits.\textsuperscript{141} At the end of the plan year, if


\textsuperscript{140} Id. § 412(b)(5)(B)(ii)(I). The Pension Funding Equity Act of 2004 temporarily amended this language to give relief to employers providing pensions for plan years beginning after December 31, 2003 and before January 1, 2006. See Pension Funding Equity Act of 2004 § 101(b), Pub. L. No. 108-218, 118 Stat. 596. Under this Act, the 30-year Treasury would be replaced by “a rate of interest which is not above, and not more than 10 percent below, the weighted average of the rates of interest on amounts invested conservatively in long-term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.” Id. § 101(b)(1)(A)(II), 118 Stat. at 597. This change will allow plan administrators to use higher estimates of the return on plan assets in making actuarial assumptions than are currently permitted because the rate of return on corporate debt is higher than that on outstanding 30-year Treasuries. See Kathy Kristof, Panel to Debate Pension Measure, L.A. TIMES, Feb. 2, 2004, at C1 (“Interest rates remain at historically low levels, but pension experts maintain that the big problem is that the interest rate federal law dictates for pension calculations—the 30-year Treasury bond—is artificially low. The reason: The 30-year Treasury bond hasn’t been issued in more than two years.”). While this change will help employers facing large pension liabilities, it further endangers the solvency of the PBGC and the retirement security of employees. See Nanette Byrnes, supra note 6, at 66 (“While these moves lighten the corporate burden, they increase the chances taxpayers will have to step in.”). This change in the interest-rate index will save plan sponsors an estimated $80 billion by reducing plan contributions. See Carl Hulse & Micheline Maynard, $80 Billion Pension Bill Is Approved by the Senate, N.Y. TIMES, Apr. 9, 2004, at C5.

The Act also contains a provision that allows plan sponsors in the airline and steel industries to contribute just twenty percent of the minimum funding standard for the plan for plan years 2004 and 2005. See § 102, 118 Stat. at 599–602 (2004). It is estimated that this provision will save airlines and steel producers $1.6 billion over this two year period. See Hulse & Maynard, supra.

\textsuperscript{141} See 26 U.S.C. § 412(b) (2000); 29 U.S.C. § 1082(b) (2000). The charges against this account include: (1) the normal cost for the plan year, which is the amount that must be contributed per plan participant and is based upon the actuarial assumptions made; (2) payments necessary to amortize any unfunded past service liability, or payments necessary to account for employees who will receive benefits but who were employed before the plan was created and, therefore, before any contributions were being made on their behalf; (3) net experience loss, or the difference between the expected return on plan assets and actual return; (4) losses resulting from changes in actuarial assumptions; (5) the amount necessary to amortize waived funding deficiencies; and (6) certain other liabilities arising under § 412(l). See id. § 412(b)(2); CANAN, supra note 34, § 12.4(B). The credits to this account include: (1) contributions during the plan year; (2) the amount necessary to amortize a decrease in the unfunded past service liability; (3) the amount necessary to amortize any net experience gain;
charges to the account exceed credits there is an accumulated funding deficiency. If an accumulated funding deficiency exists at the end of the year, the Tax Code imposes an excise tax equal to ten percent of the deficiency upon the employer, which is not tax deductible. If the accumulated funding deficiency is not cured within the taxable period, an excise tax of one hundred percent of the accumulated funding deficiency is imposed upon the employer. The employer or the employer’s control group is liable for this tax.

Theoretically, providing the carrot of tax deductibility for contributions and the stick of excise taxes upon failure to meet minimum funding standards should encourage consistent plan funding. But this scheme is undermined by the ability of employers to receive waivers from the IRS that relieve them from making minimum funding contributions. If an employer cannot meet the minimum funding requirement for a plan year because of “temporary business hardship” and application of the funding standard would be “adverse to the interests of plan participants in the aggregate,” the IRS may grant a waiver of all or a portion of the minimum funding requirement for that year. Such waivers may only be granted in three of any fifteen consecutive plan years. The criteria for establishing business hardship include whether or not (1) the employer is operating at a loss; (2) there is substantial unemployment or underemployment in

(4) the amount necessary to amortize any net gain from changes in actuarial assumptions; and
(5) the amount waived under § 412(d). See id. § 412(b)(3); CANAN, supra note 34, § 12.4(C).  
143 See id. § 4971(a). There is, however, an exception to this penalty. If the employer contributes an amount equal to the “full funding limitation,” which is essentially a limit on the amount of tax-deductible contributions an employer can make to the plan in any given year, the excise tax is not imposed, even if the funding account is left with a deficit for the year. See 26 U.S.C. § 412(c)(6)-(7) (2000); CANAN, supra note 34, § 12.5. And there is an exception to this exception. The maximum amount deductible shall not be less than the “unfunded current liability” of the plan. See 26 U.S.C. § 404(a)(1)(D)(i) (2000). The “unfunded current liability” equals the liabilities to all employees and their beneficiaries under the plan. Id. § 412(b)(7). In effect this means that, as a general rule, the full funding limitation cannot be less than what is necessary to cover the plan’s normal cost. See supra, note 141. The problem is that the full funding limitation may be less than what is necessary to meet contributions to cover past service liability, net experience loss, or other losses, leaving the plan underfunded.

145 Defined by ERISA, “‘controlled group’ means, in connection with any person, a group consisting of such person and all other persons under common control with such person.” 29 U.S.C. § 1301(a)(14)(A) (2000). A “person” is defined as “an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization.” Id. §§ 1301(a)(20), 1002(9).
147 See id. § 412(d).
148 Id. § 412(d)(1).
149 Id.
the employer's industry; (3) the sales and profits of the industry are depressed or declining; and (4) it is reasonable to assume the plan will be terminated if the waiver is not granted. Conspicuously absent from this list is any consideration of the amount by which the plan is underfunded on a termination basis, or any other consideration of the PBGC's interests in the minimum funding contribution to be waived. No liability to the IRS, the PBGC, or the employees arises when a minimum funding waiver is granted. These waivers can significantly increase the PBGC's exposure upon termination and the only relief the PBGC realizes comes in the form of a nominal increase in premiums.

B. How the Bankruptcy Code Leaves the PBGC Holding the Bag

Under ERISA, when an underfunded plan is terminated, either under distress termination or by the PBGC, the employer or the employer's control group is subject to two forms of liability: liability to the PBGC for unfunded benefit liabilities and liability to the trustee appointed to administer the plan for the outstanding balance of accumulated funding deficiencies, waived funding deficiencies, and any decreases in the minimum funding standard allowed before termination. Liability in favor of the trustee appointed upon termination arises for the amount of waived funding deficiencies. See 29 U.S.C. § 1362(c)(2) (2000). However, this liability proves to be a paper dragon in the bankruptcy context, as discussed infra Part IV.B.

The use of waivers has on occasion significantly increased the liability of the PBGC. For example, when Rath Packing terminated its pension plans in 1982, accumulated unpaid waivers totalled $29.5 million, about half of the plans' total unfunded liability at termination. Rath had received waivers for the then-maximum five consecutive years.

Id.

See supra note 92, discussing adjustments to PBGC premiums based on the amount by which a plan is underfunded on a termination basis.

See supra notes 59–75 and accompanying text.


See id. § 1342(b)–(c); see also supra notes 74–75 and accompanying text.

interest "at a reasonable rate" from the termination date,\textsuperscript{160} is due and payable to the PBGC as of the termination date in cash or securities acceptable to the PBGC,\textsuperscript{161} and is limited to thirty percent of the collective net worth\textsuperscript{162} of the employer or the employer's control group.\textsuperscript{163} Similarly, liability to the trustee accrues interest from the date of termination and is due and payable to the trustee as of the termination date.\textsuperscript{164}

There are certain provisions within the statute that attempt to prevent the use of asset transfers, non-bankruptcy reorganizations, and mergers to avoid liability for pension termination. Under ERISA, the transfer of assets of the employer for the purpose of evading termination liability within five years before termination will result in the transferee being treated as if it was a contributing sponsor of the plan.\textsuperscript{165} Reorganizations that are nothing more than name changes, the consolidation of a subsidiary into a parent corporation, or mergers result in successor liability under ERISA.\textsuperscript{166}

Failure or refusal to pay the liability created upon termination after demand gives rise to a lien in favor of the PBGC in the amount of that liability, covering "all property and rights to property, whether real or personal" belonging to the employer or its control group.\textsuperscript{167} This lien, like the liability arising upon termination, is limited to thirty percent of the net worth of the employer or control group.\textsuperscript{168} The lien is treated as a tax lien for purposes of priority and perfection.\textsuperscript{169} The lien is to be treated as a "tax due and owing to the United

\textsuperscript{160} Id. § 1362(b)(1)(A).

\textsuperscript{161} Id. § 1362(b)(2)(A).

\textsuperscript{162} The employer's net worth is not simply the amount by which the assets of the employer or its control group exceed its liabilities, but is the fair market value of the firm, determined in light of (1) any sale, agreement to sell, or offer to purchase the business of the employer; (2) the sale or agreement to purchase the stock of the business; (3) the price of publicly traded stock; (4) the price/earnings ratios and prices of stocks of similar companies; (5) the economic outlook for the firm, based on projections of earnings and dividends; (6) the economic outlook for the industry; (7) the appraised value of all assets, tangible and intangible; (8) the value of equity assumed in a plan of reorganization under title 11 or similar state law; and (9) any other factor relevant to determining net worth. See 29 C.F.R. § 4062.4(c) (2003); Canan, supra note 34, § 19.12(A)(1).


\textsuperscript{164} Id. § 1362(c).

\textsuperscript{165} See id. § 1369(a).

\textsuperscript{166} See id. § 1369(b)(1)–(3). For a case exploring the application of this section see In re Doskocil Cos., 130 B.R. 858 (D. Kan. 1991).


\textsuperscript{168} Id.

\textsuperscript{169} See id. § 1368(c)(1). Under the Tax Code such a lien must be perfected either where the state in which the property is located requires such filings or with the United States district court for the district in which the property is located. See 26 U.S.C. § 6323 (b), (f) (2000).
States” in proceedings under the Bankruptcy Code or state insolvency proceedings.\footnote{170}{See 29 U.S.C. § 1368(c)(2) (2000).}

Despite the appearance of protection for the PBGC’s interest in the event of termination, the Bankruptcy Code frequently strips the PBGC of the protection provided under ERISA. Under ERISA, termination liability may arise on the date of termination, but the lien that protects the PBGC’s interest in that liability must be perfected.\footnote{171}{See supra note 169 and accompanying text.} When an employer or the PBGC terminates an employer’s plan \textit{after} the employer has filed a petition in bankruptcy, the Bankruptcy Code prevents perfection of the PBGC’s lien arising out of the employer’s liability in two ways. First, the automatic stay prevents the PBGC from taking any “act to create, perfect, or enforce any lien against property of the estate.”\footnote{172}{11 U.S.C. § 362(a)(4) (2000); cf. Pension Benefit Guar. Corp. v. Belfance (In re CSC Indus., Inc. & Copperweld Steel Co.) 232 F.3d 505, 510 (6th Cir. 2000) (holding that tax lien arising under 26 U.S.C. § 412(n)(4) for unpaid contributions could not be perfected after filing of the petition because of the automatic stay). This provision applies to security interests, as well as judicial and statutory liens. See 3 COLLIERS ON BANKRUPTCY ¶ 362.03[6] (Lawrence P. King ed., 15th ed. rev. 2004).} Second, § 545 of the Code prevents “the fixing of a statutory lien on property of the debtor” where that lien is not perfected or enforceable against a bona fide purchaser before the commencement of the bankruptcy proceeding.\footnote{173}{11 U.S.C. § 545(2) (2000). Collier explains the implications of § 545(2) within the context of a federal tax lien: The tax lien arises at the time of the assessment. The lien, however, is not valid against “any purchaser, holder of a security interest, mechanic’s lienor, or judgment lien creditor until notice thereof . . . has been filed.” If, therefore, notice of the tax lien has not been filed before bankruptcy, or has been imperfectly filed, it would not be valid as against a hypothetical bona fide purchaser as required by section 545(2), and thus would be subject to avoidance by the trustee. 5 COLLIERS ON BANKRUPTCY ¶ 545.03[4] (Lawrence P. King ed., 15th ed. rev. 2004) (footnotes omitted).} Thus the PBGC faces a termination/liability paradox—its lien cannot arise until after termination, but termination in bankruptcy prevents perfection of the PBGC’s lien. The PBGC has attempted to use language in ERISA suggesting that the lien it holds is a tax\footnote{174}{See 29 U.S.C. § 1368(c)(2) (2000) (“In a case under title 11 [of the United States Code] . . . , the lien imposed [for failure to pay liability arising upon termination] shall be treated in the same manner as a tax due and owing to the United States for purposes of title 11 [of the United States Code] . . . .”).} to achieve tax priority status under the Bankruptcy Code.\footnote{175}{There are two potential tax priorities available. The first is a tax priority treated as an administrative expense under §§ 503(b)(1)(B) and 507(a)(1) of the Bankruptcy Code. See 11 U.S.C. §§ 503(b)(1)(B), 507(a)(1) (2000). This priority arises where the tax is “incurred by the [bankruptcy] estate.” \textit{Id.} (legislative statements). The second is simply an excise tax priority}
Notwithstanding dicta suggesting that the Supreme Court recognizes the PBGC's liens as tax liens,\textsuperscript{176} two cases from the Tenth Circuit illustrate the difficulty that the PBGC has had convincing lower courts to grant its liens administrative expense or tax lien priority.\textsuperscript{177}

In Pension Benefit Guaranty Corp. v. Reorganized CF&I Fabricators, Inc. (\textit{In re CF&I Fabricators, Inc.}),\textsuperscript{178} the PBGC attempted to use priority arguments to recover the unpaid minimum contributions\textsuperscript{179} and unfunded benefit liabilities\textsuperscript{180} of a firm seeking to reorganize under Chapter 11.\textsuperscript{181} CF&I Fabricators had unpaid minimum funding contributions of approximately $71 million and unfunded benefit liabilities of $200 million when its plan was under § 507(a)(8)(E)(ii) of the Bankruptcy Code. See 11 U.S.C. § 507(a)(8)(E)(ii) (2000). The nature of these two priorities is explored further \textit{infra} Part V.A.1.

\textsuperscript{176} See United States v. Reorganized CF&I Fabricators, Inc., 518 U.S. 213, 224–25 (1996) (distinguishing the excise tax imposed on employers who fail to meet the minimum funding requirement under 26 U.S.C. § 4971(a) from the PBGC’s claim for unfunded benefit liabilities under 29 U.S.C. § 362(b)(1)(A) in a decision holding that the excise tax could not be given tax priority status). However, the Tenth Circuit later held that the PBGC’s claim is not a tax because it is not used to defray governmental expenses. See Pension Benefit Guar. Corp. v. Reorganized CF&I Fabricators, Inc. (\textit{In re CF&I Fabricators, Inc.}), 150 F.3d 1293, 1298 (10th Cir. 1998).

\textsuperscript{177} Other cases have lead to similar results. See generally Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (\textit{In re Sunarhauserman, Inc.}), 126 F.3d 811 (6th Cir. 1997) (distinguishing portion of PBGC claim that arose pre-petition from portion that arose post-petition and granting administrative expense priority to only the post-petition portion); LTV Corp. v. Dole (\textit{In re Chateaugay Corp.}), 130 B.R. 690, 696–97 (S.D.N.Y. 1991), \textit{opinion withdrawn}, 1993 U.S. Dist. LEXIS 21409 (S.D.N.Y. Jun. 16, 1993) (holding in original opinion that PBGC’s claims are pre-petition claims not entitled to administrative priority status or tax priority status); \textit{In re} Kent Plastics Corp., 183 B.R. 841, 845–49 (Bankr. S.D. Ind. 1995) (holding that ERISA claim is not the equivalent of a federal tax claim and that failure to perfect lien before filing strips the ERISA claim of priority provided under 29 U.S.C. § 1368(c) (2000)); \textit{In re} Divoce Philadelphia Sales Corp., 64 B.R. 232, 235 (Bankr. E.D. Pa. 1986).

While it is clear that an ERISA lien for employer liability is to be treated as a tax lien for purposes of priority, § 1368 does not state that the underlying ERISA liability is a tax liability. Section 1368(c) merely provides that an ERISA claim and a tax claim share one feature in common—liens of both share on a par. It is certainly a leap of faith then to say that because one shares a single trait in common with the other, the two are identical. Applying this logic, one could say that a donkey is the same as an elephant simply because they both have four legs. We accordingly conclude that 29 U.S.C. § 1368 does not render an ERISA claim a tax claim [under the Bankruptcy Code].

\textit{Id.}


\textsuperscript{180} See \textit{id.} § 1362(c).

\textsuperscript{181} See CF&I Fabricators, 179 B.R. at 706.
terminated by the PBGC.\textsuperscript{182} PBGC first argued that the claims for unpaid minimum funding contributions should be entitled to administrative expense priority as a post-petition tax under § 503(b)(1)(B)\textsuperscript{183} of the Bankruptcy Code.\textsuperscript{184} The court held that the PBGC's lien for the unpaid contributions had to be perfected to receive priority status, that the lien against CF&I was not perfected, and that the automatic stay prevented the PBGC from perfecting its lien.\textsuperscript{185} The court also refused to grant the unpaid minimum funding contribution claim priority status as a tax lien under § 507(a)(8)\textsuperscript{186} of the Bankruptcy Code, holding that the transaction giving rise to the necessity for those payments was the labor of the employees, which occurred pre-petition, rather than the due date for the quarterly contribution, which apparently occurred post-petition.\textsuperscript{187} The PBGC next tried to assert its claim for unpaid minimum funding contributions as an administrative expense under § 507(a)(1) of the Bankruptcy Code,\textsuperscript{188} arguing that contributions to pension plans qualify as administrative expenses as a "cost of doing business" during reorganization,\textsuperscript{189} and that "the costs of compliance with regulatory schemes qualify as administrative expenses."\textsuperscript{190} The court applied a two-part test to determine whether a claim qualifies as an administrative expense, requiring that: (1) the expense arise out of a transaction between the creditor and the DIP, and (2) the consideration provided by the creditor prove beneficial to the DIP in the operation of the business.\textsuperscript{191} The court held that payment of the minimum funding contribution arises out of transactions between the debtor and employees, not between the DIP and the PBGC, and that the only benefit the debtor would have received from the payments was goodwill with the employees.\textsuperscript{192} The PBGC then argued that the unfunded portion of the terminated

\textsuperscript{182} Id. at 706.
\textsuperscript{184} \textit{CF&I Fabricators}, 179 B.R. at 707. The PBGC argued that these claims should be treated as a tax incurred by the estate pre-petition. Id.
\textsuperscript{185} Id. at 708.
\textsuperscript{187} \textit{CF&I Fabricators}, 179 B.R. at 708.
\textsuperscript{188} 11 U.S.C. § 507(a)(1) (2000) (giving first priority status to "administrative expenses allowed under section 503(b)").
\textsuperscript{190} \textit{CF&I Fabricators}, 179 B.R. at 708.
\textsuperscript{191} Id. at 708 (citing \textit{In re Amarex Inc.}, 853 F.2d 1526, 1530 (10th Cir. 1988)).
\textsuperscript{192} Id. at 708-09.
pension plan, up to the amount allowed by ERISA,\textsuperscript{193} should be treated as a tax lien and granted priority under § 507(a)(8) of the Bankruptcy Code.\textsuperscript{194} Once again the court held that because no lien had been perfected before the filing, and the automatic stay prevented post-petition perfection, the PBGC’s claim could not achieve priority status.\textsuperscript{195}

On appeal from the district court’s decision, the PBGC again argued that its lien for unpaid mandatory contributions should be treated as a tax lien and granted priority as an administrative expense.\textsuperscript{196} The circuit court held that the PBGC’s claim for unpaid mandatory contributions could never qualify as a tax lien because the payments required under ERISA are not a tax,\textsuperscript{197} nor could this claim be granted priority status as an administrative expense because it arose pre-petition.\textsuperscript{198}

The PBGC also failed to obtain priority as an administrative expense for its claim arising out of unfunded benefit liabilities in \textit{In re Bayly Corp.}.\textsuperscript{199} In \textit{Bayly}, the PBGC relied exclusively on the argument that its claim for unfunded benefit liabilities should be treated as a tax lien and allowed as an administrative expense under § 503(b)(1)(B) of the Bankruptcy Code.\textsuperscript{200} That court refused to extend this priority, explaining that:

If a debtor becomes liable to a claimant before the bankruptcy petition is filed, but the liability is contingent on the occurrence of some future event, the claim to recover that debt is treated as a pre-petition claim even if the condition does not

\textsuperscript{193} This lien is limited to thirty percent of the net worth of the company. See 29 U.S.C. § 1362(b)(2)(B) (2000). In this case, that amount was $3 million despite unfunded pension obligations exceeding $200 million. See \textit{CF&I Fabricators}, 179 B.R. at 709.

\textsuperscript{194} Then § 507(a)(7). See supra note 186.

\textsuperscript{195} See \textit{CF&I Fabricators}, 179 B.R. at 709.

\textsuperscript{196} Pension Benefit Guar. Corp. v. Reorganized CF&I Fabricators, Inc. (\textit{In re CF&I Fabricators, Inc.}), 150 F.3d 1293, 1296–99 (10th Cir. 1998).

\textsuperscript{197} Id. at 1298.

\textsuperscript{198} Id. at 1300. Interestingly, the court points out that where Congress wanted to create an administrative priority to protect retirees’ healthcare benefits, it amended the Bankruptcy Code by adding § 1114, but “[i]n contrast, Congress has not amended the Bankruptcy Code to provide administrative status for the PBGC’s minimum funding contribution claim.” Id. See the discussion of § 1114 infra notes 235–37.

\textsuperscript{199} Pension Benefit Guar. Corp. v. Skeen (\textit{In re Bayly Corp.}), 163 F.3d 1205, 1210 (10th Cir. 1998). Unlike \textit{CF&I Fabricators}, in which the circuit court concluded that the PBGC’s claim for unfunded benefit liabilities could never be characterized as a tax, the \textit{Bayly} court assumed, \textit{arguendo}, that the PBGC’s claim was such a tax. See id. at 1208 n.4. (“[W]e find it expedient simply to assume without deciding that PBGC’s claim for unfunded benefit liabilities can properly be characterized as a tax claim . . . .”).

\textsuperscript{200} Id. at 1207.
occur and the right to payment does not arise until after the bankruptcy petition is filed.\textsuperscript{201}

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\ldots The consideration supporting PBGC's claim is the same as that supporting the right to pension benefits itself, the past labor of Debtor's employees. Plan termination simply matured Debtor's pre-petition contingent liability to fund the Plan adequately. Thus, PBGC's claim is not entitled to administrative expense priority as a post-petition tax.\textsuperscript{202}

While this view seems to misunderstand the consideration given to the employer as the employee's labor, rather than the insurance provided by the PBGC, the result is that where the PBGC fails to perfect its lien against the employer before the employer seeks bankruptcy protection, unpaid minimum funding contributions are treated as pre-petition debts arising out of the employer's relationship to its employees.\textsuperscript{203} Thus, unable to achieve priority status, the PBGC becomes an unsecured creditor of the bankrupt plan provider,\textsuperscript{204} receiving whatever dividend the plan provides for such creditors.\textsuperscript{205}

\textsuperscript{201} Id. at 1208-9.
\textsuperscript{202} Id. at 1210.
\textsuperscript{203} The PBGC seems to have initially accepted this fate. In the case of U.S. Airways' pilots' pension, the PBGC argued over the size of its allowed claim, rather than attempting to recover the whole of that claim through tax and administrative expense priorities. See In re U.S. Airways Group, Inc., 303 B.R. 784, 786 (E.D. Va. 2003). However, with United and U.S. Airways threatening termination of their plans, the PBGC has once again taken up this issue. The agency is now arguing that the PBGC should be able to perfect its lien post-petition and that plan sponsors should be required to give notification to employees within 30 days of the plan sponsor's filing regarding the amount by which the plan is underfunded and limits on PBGC benefits. See Albert B. Crenshaw, Pension Agency Seeks More Power, WASH. POST, Sept. 15, 2004, at E3; News Release, PBGC, PBGC Calls for Pension Protections: Actions of US Airways and UAL Underscore Need for Fix (Sept. 14, 2004), http://www.pbgc.gov/news/press_releases/2004/pr04_65.htm.
\textsuperscript{204} See 11 U.S.C. § 546(a) (2000) (distinguishing between secured and unsecured allowed claims); Keating, \textit{supra} note 77, at 91 (noting that the PBGC is "treated like just another unsecured creditor").
\textsuperscript{205} In the case of U.S. Airways, this amounts to two cents on the dollar, paid in stock of the reorganized company. See In re U.S. Airways Group, Inc., 303 B.R. at 786. The amount of PBGC's allowed claim for unfunded benefit liabilities exceeds $2 billion in that case, meaning the PBGC will receive $40 million in stock. Id. at 787 (tabulated from source). The PBGC has historically recovered "about eight cents on the dollar." See Keating, \textit{supra} note 77, at 66.
V. PREVENTING THE ABUSE OF CHAPTER 11 REORGANIZATION

The inability of the PBGC to recover against employers that terminate their plans in Chapter 11 threatens the stability of the PBGC itself. Depriving the PBGC of the opportunity to recover unfunded benefit liabilities gives employers incentive to reallocate resources away from their pension plans and to file bankruptcy even when the firm is otherwise solvent, and leads to abuse of both the insurance scheme created under ERISA and the Bankruptcy Code.

Similar abuse of the Bankruptcy Code arose after the Bildisco decision, leading to changes in the Bankruptcy Code to limit the ability of employers to unilaterally reject labor agreements in bankruptcy. If employers’ use of the bankruptcy code to surreptitiously avoid labor agreements warranted statutory change, use of ERISA, the Tax Code, and the Bankruptcy Code to evade pension obligations certainly merits consideration for similar change.

206 See supra notes 11, 16 (discussing the financial position of the PBGC) and Part IV.B (discussing the inability of the PBGC to perfect its lien).

207 See supra Part III.A.

208 See supra Part III.C.

209 At least one court recognized that “if ERISA goals are to be met, the [PBGC] claim must have priority,” but this decision appears to have had no influence on other federal courts. See Pension Benefit Guar. Corp. v. The Washington Group, Inc. (In re The Washington Group, Inc.), No. C-86-665-G, 1987 U.S. Dist. LEXIS 5686, at *20 (M.D.N.C. Mar. 9, 1987).

The Pension Benefit Guaranty Corporation has priority for its termination liability claim. Title 29, [U.S.C.], Section 1368(c)(1–4) grants priority to perfected and unperfected Agency liens. This statute gives priority to the claim because it directs courts to treat the Agency lien as a tax lien. Furthermore, policy considerations support the Agency’s contention that its claim has priority. The Agency had no opportunity to perfect its claim because the parties terminated the Plan six months after Washington Group filed its bankruptcy petition. Seldom, if at any time, will the Agency have the opportunity to file its claim before the bankrupt files the bankruptcy petition. If the Agency’s claim lacks priority, then it would defeat the purpose for which Congress created the PBGC.

Id. at *19–20.

210 See McGill, supra note 78, at 50. “There is serious doubt concerning the propriety—and feasibility—of invoking a pension guaranty when the firm that created the pension obligations continues to operate in one form or the other.” McGill further notes:

Not only should the [pension] guaranty be limited to complete plan terminations, it should be invoked only when the firm goes out of business. It would be grossly unfair to other employers, some of them competitors, if a firm could terminate its pension plan, transfer to the guaranty fund the responsibility for making good on the unfunded guaranteed benefits, and then continue in business, its competitive position improved by reduction in its labor costs.

Id. at 79.

211 See supra notes 18–26 and accompanying text.
A. Previous Recommendations for Change

Those who have addressed the issue of pension plan termination in the Chapter 11 context have recommended statutory change, either by granting the PBGC administrative expense or tax priority under the Bankruptcy Code\(^2\) or a non-lien super-priority that must be satisfied before the assets of an employer with unfunded benefit liabilities can be sold.\(^1\) Each of these proposals proves untenable after further scrutiny.\(^2\) However, statutory change giving rise to a pre-petition floating lien for unfunded benefit liabilities may prove an effective means for removing some of the moral hazard created by public insurance of pension plans and providing the PBGC with protection when an employer files bankruptcy.\(^2\) At the very least, the PBGC should be given the authority to grant the minimum funding waivers now granted by the IRS,\(^2\) since it is the PBGC—not the IRS—that insures against the risk of a plan being terminated without waived contributions having been made.

1. Priority Status for PBGC Claims

Granting heightened priority in bankruptcy to the PBGC's claim for unpaid benefit liabilities and minimum funding contributions has been advanced by some\(^2\) and criticized by others.\(^2\) In her student note, Jill L. Uylaki\(^2\) argues

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\(^2\) See Uylaki, supra note 34, at 110–11.

\(^1\) See Keating, supra note 77, at 100–07.

\(^2\) Priority status under the Bankruptcy Code has been rejected by federal courts and, in any event, would most likely prevent the confirmation of any plan under Chapter 11 where the employer has significant unfunded benefit liabilities. See infra notes 217–19 and accompanying text. Keating's super-priority would prevent a firm from selling assets or obtaining secured credit in bankruptcy, thus limiting the employer's ability to reorganize. See infra notes 228–41 and accompanying text.

\(^2\) See infra Part V.B.1.

\(^2\) See infra Part V.B.2.

\(^2\) See Uylaki, supra note 34, at 110–11 (recommending that the PBGC's lien against employers with unfunded or underfunded obligations receive priority status similar to tax liens under 11 U.S.C. § 507(a)(8)).

\(^2\) See Keating, supra note 77, at 92–96. Keating points out that this solution is not complete because many firms terminating their plans do not enter into bankruptcy. A heightened priority would create perverse incentives on the part of the PBGC, which would have an incentive to terminate a plan even where doing so forces an otherwise solvent firm into bankruptcy, and on the part of other creditors, who would have an incentive to avoid bankruptcy even if doing so would be best for the corporation. The National Bankruptcy Conference concurs, stating that ERISA problems should not be resolved by modifying the Bankruptcy Code. See THE NATIONAL BANKRUPTCY CONFERENCE, REFORMING THE BANKRUPTCY CODE 270–71 (Final Report, May 1, 1997) ("There is no justification for special provisions in the Bankruptcy Code to deal with [the PBGC's claims]. It would be inappropriate to resolve Bankruptcy Code priority issues through language in ERISA. In the absence of any compelling reason to change the statutes, it would be preferable to leave these issues to case law development.").
that the PBGC’s claims should be granted tax-lien priority—an eighth priority under the Bankruptcy Code. Such a priority would place the PBGC behind administrative expenses, DIP-financing provided in involuntary cases, employee claims for wages and pension payments, and customers who have paid for consumer goods or services. Alternatively, the PBGC’s claims could be granted priority status as an administrative expense, placing the PBGC ahead of all other priority creditors.

As the cases of In re CF&I Fabricators and In re Bayly Corp. illustrate, federal courts have been unwilling to recognize any sound basis for granting either form of priority. The principle stumbling block before priority status for the PBGC’s claims is that these claims arise pre-petition out of transactions with the debtor, not the debtor-in-possession, and that these transactions provide no benefit to the bankruptcy estate.

There is also a practical reason for not granting the PBGC’s claim tax-priority status: doing so could prevent the confirmation of most Chapter 11 reorganization plans filed in cases where the employer terminates its pension plan. Under §1129 of the Bankruptcy Code, the reorganization plan must provide for the payment of administrative expenses in full upon confirmation, and the payment of tax priorities in full over six years. For some firms in Chapter 11, unpaid benefit liabilities may be the largest single liability. Forcing those firms to pay that

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219 Uylaki, supra note 34, at 110–11 ("The present proposal recommends that the PBGC’s lien against employers with unfunded or underfunded...pension plans should receive an eighth priority status.").


221 See id. § 507(a)(1)–(8). Technically the PBGC would be behind certain agricultural and fishing creditors, alimony, and support payments, but it is assumed that these types of priorities will not arise in the usual case under examination here. The priority for pension contributions under this section is limited to a fixed amount under the Code—net of unpaid wages granted priority. See id. § 507(a)(4).

222 Administrative expenses are defined by the code to include “any tax...incurred by the estate, except a tax of a kind specified in section 507(a)(8).” 11 U.S.C. § 503(b)(1)(B) (2000).

223 See supra notes 178–205 and accompanying text, discussing the treatment of priority arguments advanced by the PBGC in these two cases. An argument could be made, but apparently was not advanced by the PBGC in either case, that the estate does, in fact, benefit from the insurance provided by the PBGC where the promise of such insurance lured employees into accepting less in current wages under labor contracts and those contracts are not rejected by the DIP. See supra notes 81–84 and accompanying text.

224 See supra notes 187, 202 and accompanying text (describing the application of this argument in CF&I Fabricators and Bayly).


226 See id. § 1129(a)(9)(C).

227 Anecdotally, in May of 2003 Business Week Online reported that General Motors had plan obligations of $92.2 billion, plan assets of $66.8 billion, and a market value of only $20.5
liability up front before confirmation, or even over a period of six years, may eliminate the benefit of reorganization, pushing the firm into liquidation.

2. Super-Priority Status

Professor Keating suggests granting the PBGC a so-called "super-priority," similar to the priority granted to workers for the amount of unpaid minimum wages under the Fair Labor Standards Act (FLSA). "Under this statute, the PBGC would be given the power to have a court enjoin the transfer of a company's assets until the agency's reimbursement claim was satisfied in full." This priority would block other creditors, including those with perfected security interests, from levying against assets of the employer. This lien would apply prospectively and be subordinate to purchase-money security interests. In addition, under Keating's super-priority mechanism, "the PBGC's reimbursement claim trumps even secured creditors and... retains its effectiveness in a company's bankruptcy proceeding."

According to Keating, one of the principle advantages to this super-priority is that it shifts the cost of monitoring employers' contributions to pension plans from the PBGC to creditors, who bear the risk of their collateral becoming unalienable.

It is ironic that Professor Keating would endorse such a priority, given his criticism of Congress' attempt to grant retiree claims for unfunded health benefits an administrative expense priority under the Bankruptcy Code.

In other words, GM's unfunded benefit liabilities were over three times its market value. See David Henry, Tripping Over Pension Shortfalls, BUS. WK. ONLINE, May 14, 2003, at http://www.businessweek.com/bwdaily/dnflash/may2003/nf20030514_6402_db014.htm.


Keating, supra note 77, at 100.

Id.

Id. See UCC § 9-103 (2000) for a definition of purchase-money security interest.

Keating, supra note 77, at 100.

See id. at 102 ("[C]reditors of the firm would have a more powerful incentive to investigate the funding status of the company's pension plans and would set their credit prices accordingly. In effect, the super[-]priority given to the PBGC would transfer most of the monitoring function from the PBGC to an employer's various creditors.").

In response to LTV's first bankruptcy, during which it sought to terminate both the pension plans and the health insurance benefits of its retirees, Congress added § 1114 to the Bankruptcy Code. This new section grants the retirees' claims for promised health benefits an administrative expense priority. See 11 U.S.C. § 1114(e)(2) (2000). Professor Keating has criticized Congress' attempt to deal with this problem. See generally, Daniel Keating, Bankruptcy Code § 1114: Congress' Empty Response to the Retiree Plight, 67 AM. BANKR.
Keating’s super-priority is broader than the priority granted to retiree health benefits in § 1114 of the Bankruptcy Code, applying even to solvent firms selling assets outside of bankruptcy. Thus, Keating’s super-priority avoids his primary criticism of § 1114, which is a post hoc solution to a problem that is created outside of bankruptcy. However, granting the PBGC this super-priority status could prevent the successful reorganization of potentially-viable firms by encumbering assets that otherwise might be used as collateral to secure financing. Under § 364 of the Code, the DIP may use a number of incentives to procure financing. The DIP may first attempt to obtain unsecured credit by offering the creditor administrative expense priority in return. If the DIP is unable to obtain unsecured credit in this fashion, the court may authorize the DIP to either (1) extend so-called super super-priority, which gives an unsecured lender priority over all other priority creditors, (2) use

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236 See Keating, Bankruptcy Code § 1114, supra note 235, at 18 (“[A]dding this new section to the Bankruptcy Code completely ignores the fundamental underlying problem, which is lack of mandatory prefunding for companies that promise retiree benefits.”); Keating, Good Intentions, supra note 235, at 163.

Because section 1114 applies only to Chapter 11 cases, the new legislation will affect only a small percentage of cases in which companies become insolvent. Although retirees now will receive a special priority for their benefits claims in Chapter 11 cases, they will have no similar preferred position in Chapter 7 liquidation cases or in nonbankruptcy dissolutions.

Id.

237 Keating points to this very same effect as a critical flaw with the administrative expense priority granted retiree benefits under § 1114. Cf. Keating, Good Intentions, supra note 235, at 163.

[S]ection 1114 may make it less likely that companies with significant retiree benefits liabilities will be able to reorganize successfully. If retirees receive a greater relative entitlement in a Chapter 11 case than in a Chapter 7 case, other unsecured creditors will see their recovery in a Chapter 11 case reduced. Thus, these nonretiree unsecured creditors may have an incentive to block a company’s Chapter 11 reorganization plan even when the company’s going-concern value would be realized best in the Chapter 11 forum.

Id.

239 See id. § 364(a), (b).
240 See id. § 364(c)(1). This term of art has gained judicial recognition. See In re Willingham Inv., Inc., 203 B.R. 75, 77 n.7 (Bankr. Tenn. 1996) (“If a debtor in possession or trustee is unable to obtain credit by granting the lender an administrative expense claim pursuant to § 364(b), the lender may be granted a super super[-]priority pursuant to Bankruptcy Code § 364(c) . . . .”).
unencumbered collateral to obtain secured financing, or (3) grant a subordinate security interest in already-secured property. Finally, if the DIP proves unsuccessful in obtaining credit through any other means, he may grant senior secured status to lenders using already-secured property as collateral. Under this process of obtaining DIP-financing, Keating’s super-priority would increase the DIP’s cost of borrowing. Because all property of the estate would be encumbered by Keating’s super-priority, the pool of potential assets from which priority creditors might collect is diminished, thereby eliminating the possibility for unsecured lending. Super super-priority status would be of dubious value, since even those with super-priority would fall in line behind the PBGC. Because the PBGC’s super-priority would serve to eliminate the alienability of estate assets, even if unencumbered assets or partially secured assets exist, the debtor would be hard pressed to find lenders willing to extend secured credit with those assets as collateral. If the DIP still believes obtaining credit is worth the cost, the question then becomes whether or not the bankruptcy court could use its authority to grant DIP-lenders overriding security interests in already-secured property to overcome the PBGC’s super-priority. If so, the purpose of Keating’s super-priority will be defeated.

Under § 363 of the Bankruptcy Code the DIP can “use, sell, or lease” property of the bankruptcy estate. The property can be sold “free and clear of any interest in such property of an entity other than” the DIP only if “applicable nonbankruptcy law permits sale of such property free and clear of such interest” or the interested party consents. The very purpose of the Keating super-priority would be to strip the DIP of the ability to sell the property and it is unlikely that the PBGC would consent to the sale of property unless it receives the proceeds. Thus, the bankruptcy estate would be permanently encumbered by property that might otherwise prove profitable to sell.

242 See id. § 364(c)(3).
243 See id. § 364(d)(1).
244 Technically, Keating’s super-priority is not a “lien,” but is instead a way of granting the PBGC authority to enjoin the sale of assets until unfunded benefit liabilities are met. The practical consequence is the same as that of a first-lien holder. In either case, lien or power to enjoin, the employer cannot dispose of its assets without PBGC approval, which limits the marketability of those assets in the same fashion as a lien on identified property.
247 See id. § 363(b)(1).
248 Id. § 363(f)(1), (2).
Finally, this super-priority would apply to executory contracts, which become part of the bankruptcy estate. Section 365 of the Bankruptcy Code gives the DIP general authority to assume, reject, or assign such contracts. Presumably, the DIP would not be able to assign such contracts for value without the PBGC’s authority. Thus, while Keating’s proposal does possess the benefit of imposing on creditors the cost of policing pension plan funding outside of bankruptcy, it may prove catastrophic inside bankruptcy, where creditors would be unwilling to lend to the debtor and the debtor would be stuck with unprofitable assets and contracts.  

3. *The Market Solution—Sponsor Pooling and Risk-Based Premiums*

Former PBGC chief economist Richard Ippolito has recommended that Congress convert defined benefit pension insurance from a government sponsored and guaranteed program to a private pooling mechanism, through which all plan sponsors would collectively bear the risk of an individual plan sponsor’s termination and market and sponsor-specific factors would set premiums. Under Mr. Ippolito’s plan, the federal government would transfer sufficient funds to the PBGC to eliminate the current PBGC deficit with a cushion to account for any understatement of existing PBGC obligations. After the PBGC is terminated, plan sponsors would belong to a self-insurance pool that would have a governing board to set premiums and policy. All plan sponsors in the pool would be jointly liable for unfunded liabilities that arise in the pool upon termination of a covered plan. After a given period of time, plan sponsors would be free to seek insurance in the private sector, giving weaker sponsors incentive to “reduc[e] their reliance on payments from well-funded plans so as to keep them as a source of some help in solving the underfunding problem.” Premiums would be set for each member of the pool according to the expected

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249 See id. § 541(a)(1).
250 Id. § 365(a).
252 Id. at 13. Mr. Ippolito suggests that Congress give the PBGC a total of $18.7 billion: $11.2 to cover the PBGC’s deficit and $7.5 billion to account for the assumption that “current conditions are most likely consistent with claims that outstrip revenues over the next 10 years.” Id.
253 Id. Presumably, this board would determine the level of benefits guaranteed by the pool, though Mr. Ippolito does not state whether the pool would guarantee the full amount of benefits promised or, as the PBGC, a maximum level of promised benefits.
254 Id.
255 Id. at 14.
loss to the pool from that member.\textsuperscript{256} According to Ippolito, the virtue of this plan is that “[t]he insureds themselves absorb market volatility instead of offloading it to a third party (namely, the taxpayer).”\textsuperscript{257} Because premiums are set according to the risk the individual plan sponsor poses to the entire pool, “there is no need for a complex set of funding rules.”\textsuperscript{258}

Mr. Ippolito’s plan has the virtue of eliminating the moral hazard associated with fixed premiums unrelated to risk.\textsuperscript{259} Premiums linked to risk would give plan sponsors at least some incentive, as Mr. Ippolito states, “to face up to the problems that their own underfunding creates.”\textsuperscript{260} However, by allowing the strongest plan sponsors to eventually seek insurance from the market (and presumably get out of the pool), only the weakest swimmers are left in the pool. In addition, Mr. Ippolito’s plan calls for all members of the pool to be held jointly liable for the deficiencies of those that drown, giving the strongest swimmers further incentive to seek insurance in the private market and get out of the pool.\textsuperscript{261} And, of course, while creating market premiums would give all sponsors an incentive to increase funding levels and reduce investment risk within their individual plans, struggling plan sponsors have much greater incentive to terminate their plans rather than continuing to make contributions and pay high premiums.\textsuperscript{262} While this reduces risk to the pool, it does nothing to protect the retirement security of those entitled to benefits under terminated plans.

Mr. Ippolito may also rely too heavily on market forces (i.e., higher premiums) as an incentive to adequately fund pension obligations and invest pension assets in less risky, long-term debt. Even if his method is applied, highly leveraged plan sponsors still have an incentive to roll the dice on riskier

\textsuperscript{256} Id. at 7, 14. Ippolito uses the following formula to express the expected loss from each member of the pool: $EL_i = p_i L_i * [(1-f) - a_i r_i] \geq 0$, where $EL_i =$ expected loss from insuring the $i^{th}$ plan in time $t$, $p_i =$ the market probability of bankruptcy within the entire pool, $f_i =$ funding value for the $i^{th}$ plan sponsor in time $t$, $a_i =$ share of equities in the $i^{th}$ plan at time $t$, $r_i =$ equity return on the $i^{th}$ plan at time $t$. This formula takes into consideration both the firm’s exposure to unfunded liabilities as well as the plan sponsor’s decision to invest in higher-risk equities rather than debt. Termination risk is estimated by proxy, using the probability of bankruptcy for the market.

\textsuperscript{257} See Ippolito, supra note 251, at 14.

\textsuperscript{258} Id. at 15.

\textsuperscript{259} See supra notes 91–95 and accompanying text.

\textsuperscript{260} Ippolito, supra note 251, at 15.

\textsuperscript{261} Cf supra note 17, discussing the incentive given those with better-funded pensions to withdraw from the PBGC insurance system as transfers within the system to those with poorly funded plans increase.

\textsuperscript{262} See Keating, supra note 77, at 97 n.174 (“[T]here is a... practical problem in instituting a strict variable-rate premium structure. The problem is that such a system might cause high-risk sponsors to go out of business as a result of their increased premium.”).
investments of plan assets, as they do under the current system. The highly leveraged plan sponsor can invest plan assets in high-risk equities in period $t_1$, hoping for a large return. If that sponsor wins his gamble and shifts out of equities and into long-term debt obligations before the end of period $t_1$, he can increase the level of funding within the plan upon which premiums will be based in period $t_2$ while avoiding an increase in premiums due to equity risk exposure. If that sponsor loses his gamble, he can simply terminate the plan in period $t_2$, throwing the deficit into the pool and exiting the market entirely. This scenario may be extreme, but if the gamble is large enough, the loss to the jointly liable pool could be staggering.

Furthermore, Mr. Ippolito’s plan does not wholly resolve the issue of chronic underfunders’ use of bankruptcy to evade pension obligations. Imposing a premium structure that accounts for both funding deficits and termination risk will at the very least penalize such plan sponsors. However, nothing prevents those same plan sponsors from filing Chapter 11, terminating their plans, and throwing those plans into the pension pool while remaining in business to the benefit of other creditors. Only a portion of the moral hazard implicit in the current system is resolved because those unwilling to meet their pension obligations could still use bankruptcy to evade those obligations. Nevertheless, Mr. Ippolito has clearly illustrated that pension insurance premiums can be linked to not only funding deficits but also termination risk, and therefore termination risk must be factored into PBGC premiums.

4. Piercing the Corporate Veil—Shareholder Liability

At least one author has suggested that ERISA should be amended to impose liability on shareholders for an employer’s failure to make contributions to

\[263 \text{ See supra note 85 and accompanying text (discussing incentives to use aggressive estimates of the return on plan assets to reduce contributions).} \]

\[264 \text{ Another criticism regarding Mr. Ippolito’s method for calculating premiums includes difficulty in predicting bankruptcies. See Vineeta Anand, } \text{Just a Suggestion: Privatize PBGC to Protect Taxpayers, Pensioners, Pensions & Investments}, \text{Sept. 6, 2004, at 8 (citing to interview with Ron Gebhardtsbauer, currently a senior fellow at the American Academy of Actuaries and former chief actuary at the PBGC). However, as Ippolito and Boyce discuss, there are several models that can be used to predict bankruptcy. See Ippolito & Boyce, } \text{supra note 92, at 130 n.28. The model as specified above uses the probability of bankruptcy across the entire pool to adjust for termination risk. See supra note 256. Mr. Ippolito has elsewhere acknowledged that this factor would be more useful if each firm’s premiums were adjusted to reflect the risk of bankruptcy across industry or firm-size. See Ippolito & Boyce } \text{supra note 92, at 140.} \]

\[265 \text{ Unless, of course, Mr. Ippolito’s plan also allowed the pool to perfect a security interest against the assets of the impecunious plan sponsor.} \]

\[266 \text{ See Ippolito, } \text{supra note 251; Ippolito & Boyce, } \text{supra note 92.} \]
pension plans. To some extent such liability is unnecessary because the Tax Code ostensibly imposes penalties on employers who fail to make mandatory contributions. But the suggestion could be extrapolated to hold shareholders liable for unfunded benefit liabilities and unpaid minimum funding contributions, particularly in light of the notion of bankruptcy for profit. According to DiSanto, "[t]he rationale for holding a shareholder liable [for failure of the employer to make contributions] is that the shareholder exerted tremendous control on the corporation sufficient enough to qualify the person as an employer under ERISA." However, when considering large firms with potentially hundreds of thousands of shareholders, it seems unlikely that those shareholders can reasonably be said to exert enough influence over the company to qualify as employers. In addition, it would seem counterproductive to impose liability on shareholders at a firm where the employees are the majority shareholders, such as United Airlines. Finally, one is left to ask what benefit would be left to the corporate form if such liability were imposed.

B. Toward a Workable Solution—Overcoming Incentives to Underfund

Alterations to the Bankruptcy Code may not solve the use of Chapter 11 reorganization to avoid unfunded pension obligations, as was the case twenty years ago when employers used the Bildisco decision to unilaterally reject their labor contracts. However, the pension insurance scheme under ERISA and the contribution mechanism under the Tax Code present several defects that encourage employers to underfund their pension plans. While an optimal solution to the pension underfunding problem would force employers to make sufficient contributions to their pension plans, legislation to achieve such a result

268 See supra notes 143–46 and accompanying text.
269 See supra Part III.C.
270 See supra note 267, at 511 (footnotes omitted).
272 "In July 1994, the stockholders of UAL approved a plan of recapitalization that provided an approximately 55% equity and voting interest in UAL to certain employees of United . . . ." UAL CORP., ANNUAL REPORT, FORM 10K (Mar. 28, 2003), available at http://www.sec.gov/Archives/edgar/data/100517/000010051703030007/ual.htm.
273 See THE NATIONAL BANKRUPTCY CONFERENCE, supra note 218, at 271 (stating that ERISA problems should not be solved by altering the Bankruptcy Code).
274 See supra Part III (discussing the moral hazard created by PBGC insurance), Part IV.A (discussing minimum funding waivers granted by the IRS).
seems unlikely, given the sympathetic ear employers have found in Congress. Yet there is a risk to Congressional inaction, namely the possibility that the PBGC could become insolvent, forcing Congress to fund it out of the general budget. Perhaps a more politically palatable solution would be to allow the PBGC to protect itself against the risk of post-petition termination of large underfunded plans. This goal may be achieved by amending ERISA to allow the PBGC to perfect a lien against the assets of those who fail to meet minimum funding standards at the end of each taxable period, and by moving the power to grant waivers for minimum funding from the IRS to the PBGC, which actually bears the risk of allowing such waivers.

1. The Floating Lien Mechanism

The first problem facing the PBGC in cases such as U.S. Airways, or most of the steel bankruptcies (National Steel a notable exception), is the termination/liability paradox. The second is the incentive given to employers to underfund their pension plans under ERISA. If the PBGC were able to perfect a lien against employers in the amount by which minimum funding contributions prove inadequate (in light of market realities) at the end of each tax year, the PBGC would not be left with a wholly unperfected security interest when an employer files Chapter 11 and then seeks to terminate its pension plan. The PBGC could be given the authority to determine the amount by which the minimum funding contributions prove inadequate at the end of each tax period, using actuarial assumptions that account for the rate of return on plan assets realized by similarly situated employers within that employer’s industry. On its

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275 See supra note 140. Senators Arlen Specter and Rick Santorum (R-PA) attempted to introduce legislation in the Senate to allow U.S. Airways to amortize the underfunded portion of its pilots’ pension plan over 30 years to avoid termination. This bill was blocked by Senator Charles Grassley (R-IA), who stated that what was needed was “a solution that would be nation-wide, not dealing with just one company.” See Specter to Hold Hearing on US Airways’ Employee Pension Plans, AVIATION DAILY, Jan. 14 2003, at 1. Representative Dave Camp (R-MI) attempted to provide airlines with relief from their unfunded pension liabilities with the Pension Preservation and Savings Expansion Act of 2003. Marilyn Geewax, Airlines Seek Special Break on Pension Funding Rules, Cox News Service, July 17, 2003. While this bill died in the House, airlines and steel producers received relief under the Pension Funding Equity Act of 2004, discussed supra note 140.

276 See supra note 52.

277 See supra Part IV.A.

278 See supra Part IV.B.

279 See supra Part III (discussing the moral hazard created by pension insurance that leads to underfunding).

280 Bradley D. Belt, director of the PBGC, has proposed requiring plan sponsors to mark plan assets to market rather than using “smoothed averages” of plan assets. See Anand, supra note 93. See also Ippolito, supra note 251, at 15 (“A large part of the problem would disappear
face such authority might appear to be simply an attempt to supplant the authority granted firms to set their own actuarial assumptions under ERISA. But the employer would be free to use “reasonable” actuarial assumptions to determine the contributions necessary to meet the minimum funding standards set for the Tax Code. However, the risk that those projections may prove overly optimistic is shifted to the employer, who will be forced to make up the deficit at the end of the year based on the actual rate of return realized by similarly situated firms in the employer’s industry. If the employer fails to do so, the PBGC will receive a lien in the amount by which the employer’s contributions prove inadequate.

This mechanism is distinguishable from the excise tax imposed on firms that fail to meet their minimum funding standard under the Tax Code, which depends on the employer meeting a funding target based on the employer’s actuarial assumptions. Instead, the firm will be penalized for using aggressive estimates of the rate of return on plan assets, investing those assets unwisely (e.g., in company stock), and failing to make minimum funding contributions. Such a policy need not result in huge cash contributions to the plan at the end of the tax period. Instead, the PBGC will calculate the amount by which the employer underestimated the amount necessary to sufficiently fund benefit liabilities, current portions of past service liabilities and previous waivers, and the amount by which plan assets are diminished by negative investment returns and request payment. If payment is not forthcoming, the PBGC will perfect a form of floating lien against the assets of the employer. The amount of the lien would not include non-current past service liabilities, which create a large portion of pension plan deficits but are subject to amortization over a 30-year period. However, all

even if the insurance were operated as it is now, with one change. Eliminate the loopholes that permit sponsors of underfunded plans to evade the variable rate premium and require sponsors to calculate market value underfunding.”) (emphasis added).

282 See supra note 143 and accompanying text.
283 In effect, this system compensates the plan for mistaken estimates of the normal cost and the actual experience loss. See supra note 141.

This section adopts the principle of a “continuing general lien” or “floating lien.” It validates a security interest in the debtor’s existing and (upon acquisition) future assets, even though the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral.

Id. at Official Comment 2. If the employer files bankruptcy, any improvement in the PBGC’s position during the 90 days before the filing would be avoidable as a preference. See 11 U.S.C. § 547(c)(5) (2000).
285 See Keating, supra note 22, at 811 ("[T]he biggest single cause of the PBGC's present financial crisis is the decision of Congress at the PBGC's inception to guarantee . . . 'past
waived funding deficiencies will be added to the amount of the lien. Thus, the lien would equal: (amount of normal cost miscalculation) + (experience loss) + (previous waived funding deficiencies) + (current past service liability payments due). The amount of property subject to the lien would be reduced in subsequent periods by excess contributions to the plan as a result of underestimating normal cost contributions (again, depending on PBGC calculations at year-end), experience gain, and repayment of waived deficiencies, hence the floating nature of this lien. At the end of each tax year the PBGC will conduct a new analysis of each plan and either add to or reduce the amount of the lien.

The minimum funding standard and the accompanying excise tax and the PBGC’s floating lien are not mutually exclusive. The minimum funding standard creates an ex ante target that firms must meet to receive tax benefits. That target is determined primarily by the firm’s actuarial assumptions. Failure to meet this target results in tax penalties imposed upon the employer. The PBGC’s floating lien mechanism creates ex post liability for the use of incorrect or aggressive assumptions and experience loss.

Creating a floating lien mechanism to protect the PBGC will reduce the incentive to divert assets away from pension plans by using aggressive actuarial assumptions.\textsuperscript{286} Although such a scheme would not achieve Professor Keating’s goal of moving monitoring responsibility from the PBGC to creditors,\textsuperscript{287} it would serve to put creditors on notice regarding the employer’s unfunded pension obligations, which would limit the employer’s access to credit and give the employer an incentive to meet its pension obligations. Arguably, eliminating the incentive to underfund a pension plan will eliminate the incentive to provide a defined benefit plan at all.\textsuperscript{288} One of the PBGC’s mandates is to keep premiums as low as possible,\textsuperscript{289} and ostensibly the purpose behind keeping premiums low is to encourage firms to provide pension plans. Employing a floating lien mechanism does not require an increase in premiums; it simply requires increased diligence in making plan contributions and investing plan assets. The only justification for perpetuating a system that encourages the reallocation of service liability.”); id. at 842 (“It is the insurance of these past service benefits, and not the Bankruptcy Code, that is the true cause of the current pension crisis.”).

\textsuperscript{286} See supra Part III.A.

\textsuperscript{287} See Keating, supra note 77, at 65 (recommending “a shift in the pension monitoring function away from essential reliance on the PBGC and toward employers’ creditors” by creating a PBGC non-lien “super-priority”).

\textsuperscript{288} See id. at 78 (“Merely tightening [minimum funding] standards as a response to the incentive problem brings on significant costs of its own, including employer exodus from the defined benefit arena.”); id. at 106 (“As the PBGC’s premium rates continue to skyrocket, many firms with properly funded plans have abandoned the defined benefit pension system altogether and have chosen instead to offer employees defined contribution pension plans or profit-sharing programs.”) (footnote omitted).

\textsuperscript{289} See supra note 37 and accompanying text.
resources away from pension plans would be that the system itself is intended to create such transfers rather than provide insurance.\textsuperscript{290}

The floating lien mechanism compares favorably against Keating's proposed super-priority. Keating's super-priority would prevent the employer from selling assets before the PBGC is repaid.\textsuperscript{291} Keating's proposal appears to encompass the full amount of liability created under ERISA upon termination,\textsuperscript{292} or thirty percent of net worth of the company.\textsuperscript{293} In contrast, the floating lien covers only the amount by which the employer's minimum funding contribution proves inadequate. Additionally, Keating's super-priority attaches to all assets of the employer, impairing the alienability of the entire bankruptcy estate.\textsuperscript{294} The floating lien would necessarily be subordinate to pre-existing secured credit,\textsuperscript{295} allowing fully secured assets to be transferred without PBGC approval both inside and outside of bankruptcy. Inside bankruptcy, the PBGC would be treated as any other secured creditor, entitled to adequate protection before property is sold, but without power to block the sale of secured assets.\textsuperscript{296} In addition, the PBGC's floating lien would not create a near-insurmountable barrier to post-petition financing because the court could allow the DIP to obtain credit secured by assets to which the PBGC's lien might attach, so long as the PBGC receives adequate protection.\textsuperscript{297}

Of course, as with any government monitoring activity, the costs of granting the PBGC authority to force employers to draw their minimum funding contributions into parity with market realities may exceed the benefits of this power. This Note has not attempted to quantify the amount by which the moral hazard created by PBGC insurance leads firms to underfund their pension plans because the data necessary to do such a study is not immediately available. This question merits future study within the PBGC.

\textsuperscript{290} See IPPOLITO, supra note 36, at 5 ("The lack of sound insurance principles embedded in ERISA suggests to some that the PBGC was not set up to be an insurance firm . . . [but was instead] a deliberate attempt to effect transfers to workers and shareholders in troubled firms.").

\textsuperscript{291} See supra Part V.A.2.

\textsuperscript{292} See Keating, supra note 77, at 87 (defining the PBGC's "reimbursement claim").

\textsuperscript{293} See supra note 162.

\textsuperscript{294} See supra notes 237-50 and accompanying text.

\textsuperscript{295} Even tax liens are subject to the rule of "first in time, first in right," under which perfected security interests in existence before the tax lien arises take priority over the tax lien. See 26 U.S.C. § 6323(a) (2000); United States v. Pioneer Am. Ins. Co., 374 U.S. 84, 88 (1963) ("Choate state-created liens take priority over later federal tax liens . . . while inchoate liens do not.").

\textsuperscript{296} See 11 U.S.C. § 363(e) (2000) (providing adequate protection to "an entity that has an interest in property used, sold, or leased").

\textsuperscript{297} See id. § 364(d)(1).
2. PBGC Authority Over Minimum Funding Waivers

Regardless of whether or not a floating lien system is implemented to make the PBGC a pre-petition secured creditor, the authority to grant minimum funding waivers should be transferred from the IRS to the PBGC. While the IRS bears the burden of ensuring that the minimum funding standard is met to determine eligibility for special tax treatment of contributions to pension plans, the PBGC bears the risk when minimum funding waivers are granted.\textsuperscript{298} Were the PBGC given authority to grant minimum funding waivers, the noticeable absence of any consideration of its interests when such waivers are granted by the IRS would be remedied.\textsuperscript{299} The PBGC is equally as competent to determine whether such waivers should be granted as the IRS and should, therefore, be given the authority to do so.

VI. CONCLUSION

The PBGC faces a crisis as the level of underfunding in the pension plans it insures has expanded rapidly over the last four years. The PBGC has terminated a record number of plans, assumed an immense amount of liability, and almost doubled the number of beneficiaries receiving benefits from the PBGC. Some of these plans have been terminated in bankruptcy by firms seeking to reorganize under Chapter 11. Because of the moral hazard created by the insurance scheme under ERISA, these firms have had incentives to divert assets away from their pension plans for the benefit of shareholders over a long period of time. Because the Tax Code allows the IRS to waive funding contributions to pension plans without considering the risk of doing so to the PBGC, and the Bankruptcy Code leaves the PBGC without the ability to perfect its lien against employers who terminate underfunded plans post-petition, the PBGC is left without the ability to protect itself in these situations. Although some commentators have suggested either granting the PBGC priority under the Bankruptcy Code or a non-bankruptcy, non-lien super-priority over the firm’s assets, these plans could prevent employers from reorganizing, leading to liquidation. Forcing firms to fully fund their pension plans could drive many firms to abandon those plans. On the other hand, there is no apparent benefit to allowing employers to continue capitalizing on the moral hazard created under ERISA. Therefore, this Note proposes adopting a floating lien mechanism that would force employers to use realistic projections when determining contributions to pension plans, make up for losses experienced by the plan, pay for previous waivers, and meet current portions of past service liabilities. If requiring firms to meet these minima would force those firms to liquidate, one is left to ask whether those firms are economically viable in the first place.

\textsuperscript{298} See supra note 137 and accompanying text.
\textsuperscript{299} See supra note 151 and accompanying text.
This Note has intentionally avoided the debate over whether or not defined benefit pension plans are necessarily better for retirees than defined contribution plans, though, as the old saying goes, a bird in the hand is better than two in the bush. In other words, it may be better for employees if their employers are forced to make some minimum contribution, even if that contribution is exposed to market risk when invested, rather than allowing employers to give their employees the promise of a retirement subject to grave moral hazard. At the very least, the PBGC should be given the authority to grant minimum funding waivers, a power that now rests with the IRS. Granting a minimum funding waiver exposes the IRS to no risk, but doing so can dramatically increase the PBGC’s exposure if the employer granted a waiver terminates its pension plan. Congress responded to abuse of Chapter 11 reorganization after the Bildisco decision by placing some constraint on the ability of employers to unilaterally reject labor contracts in bankruptcy. It is time for Congress to consider legislative change to prevent firms from using Chapter 11 to evade pension obligations.