
THE DECLINE OF TRADITIONAL PENSIONS, THE IMPACT OF THE
PENSION PROTECTION ACT OF 2006, AND THE FUTURE OF
AMERICA'S DEFINED-BENEFIT PENSION SYSTEM

JOSHUA GAD-HARF*

INTRODUCTION

Since the 1920s, most workers relied on their employers to provide them with steady requirement income as a reward for many decades of hard work and sacrifice.¹ Employers issued “traditional” pensions plans² to their employees, which provided employees with income long after their terms of employment had ended. Employees understood that, if they gave their working years to their employer, their employer would, in turn, provide them with a return on their investment—a worry-free retirement.

Today, that era has ceased to exist as we know it. Most employers have replaced traditional pension plans with defined-contribution plans that offer little or no guaranteed benefits. This is a relatively new phenomenon and it is important to discuss how and why our country has gotten to the point where employers are no longer expected to provide traditional pension plans for their employees. Traditional pension plans are a dying breed because many of these traditional pension plan sponsors are losing their economic viability—ironically, in part, because of their pension obligations. Pension promises are usually among the first cuts when companies recognize early signs of economic hardship.

Part I of this note discusses the background of the federal government's pension insurance corporation—the Pension Benefit Guaranty Corporation (PBGC). Part II elaborates on the downfall of the PBGC and traditional pension plans. Part III details the Pension Protection Act of 2006, which was intended to protect American workers from the failing

* Juris doctor candidate, May 2008, Chicago-Kent College of Law. The author would like to thank his parents, grandparents, aunts, uncles, cousins, Danielle Tobias, Professor Jeffrey G. Sherman, Clare Willis, the editorial staffs of the Chicago-Kent Law Review during the 2006-2007 and 2007-2008 school years, and the scholars on whose work he relies.

1. Susan J. Stabile, *Is It Time to Admit the Failure of an Employer-Based Pension System?*, 11 LEWIS & CLARK L. REV. 305, 307 (2007).

2. Throughout this note, the term “traditional pension plans” is used interchangeably with “defined-benefit pension plans.”

pension system. Finally, this note concludes by arguing that the Pension Protection Act cannot accomplish congressional goals. Traditional pension plans will soon be obsolete and workers will eventually be forced to be completely self-reliant for their retirement savings.

I. PRIMER: THE PENSION BENEFIT GUARANTY CORPORATION

Title IV of the Employee Retirement Security Act (ERISA) created the PBGC, a government-owned corporation, in 1974.³ Modeled after the Federal Deposit Insurance Corporation,⁴ the PBGC was designed “to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants,”⁵ as well as “to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans [that are terminated in accordance with ERISA]”⁶ and “to maintain premiums . . . at the lowest level consistent with carrying out [the PBGC’s] obligations.”⁷ Today, the PBGC guarantees the pensions benefits of 44.1 million American workers and retirees, who participate in 30,330 defined-benefit pension plans.⁸

In essence, Congress sought to create a fair system that would protect the benefits accrued by employees during a lifetime of labor.⁹ To do so, it enacted minimum funding standards, which required plan sponsors to fund their plans, and created a federal guarantee that workers’ pension promises would be insured in the event of plan insolvency.¹⁰

ERISA calls for plan sponsors to calculate their yearly obligation to retirees and any other costs from previous unpaid payments.¹¹ A plan hits its minimum funding standards if the credits to the plan are greater than the debits.¹² If the value of a plan’s assets is less than 90% of that plan’s liabilities, then the plan has fallen behind its funding requirements and the plan sponsor must pay into the plan.¹³

3. 29 U.S.C. § 1302 (2000).

4. Daniel Keating, *Chapter 11’s New Ten-Ton Monster: The PBGC and Bankruptcy*, 77 MINN. L. REV. 803, 806 (1993).

5. 29 U.S.C. § 1302(a)(1).

6. *Id.* § 1302(a)(2).

7. *Id.* § 1302(a)(3).

8. PENSION BENEFIT GUAR. CORP., 2005 PERFORMANCE AND ACCOUNTABILITY REPORT 1 (2005), available at <http://www.pbgc.gov/docs/2005par.pdf>.

9. *See Egelhoff v. Egelhoff*, 532 U.S. 141, 158 (2001).

10. *See* 29 U.S.C. § 1001(c).

11. 26 U.S.C.A. § 412(b) (West 2006).

12. 26 U.S.C. § 302(b)(2) (2000); 29 U.S.C.A. § 1082(b)(2) (West 2006).

13. 29 U.S.C.A. § 1082(d)(2).

The PBGC insures only defined-benefit pension plans¹⁴ and is funded by three different means. First, the PBGC generates revenue by charging premiums to those employers who maintain defined-benefit plans,¹⁵ which are currently set at \$33 per participant,¹⁶ plus \$9 for each \$1,000 of a plan's unfunded vested benefits divided by the total number of the plan's participants.¹⁷ Second, when an employer (also referred as the "plan sponsor") terminates an underfunded defined-benefit pension plan, the PBGC is awarded a \$1,250 termination premium per participant fee, which is paid by the employer.¹⁸ Finally, the PBGC generates returns from its investment of these fees.¹⁹

A defined-benefit pension plan can be terminated in three situations. First, a standard termination is defined by a sponsor who terminate its plan when the assets of the plan meet or exceed its liabilities. To do so, the plan sponsor must purchase annuities to cover its employees' accrued benefits.²⁰ Because the plan is sufficiently funded, the plan sponsor may terminate the plan whenever it chooses.²¹ The PBGC's insurance function need not be initiated because the assets exceed liabilities.

The second form of pension termination is a distress termination initiated by the plan sponsor.²² In such a termination, the sponsor of an underfunded plan must demonstrate to the PBGC that its plan is in financial distress. The PBGC will allow a distress termination and take over the plan's pension obligations if: (1) the plan sponsor seeks to terminate the plan during the course of a Chapter 7 bankruptcy proceeding or a similar state-law insolvency proceeding;²³ (2) the plan sponsor shows that continu-

14. Defined-benefit pension plans differ from defined-contribution pension plans, such as 401(k)s and Employee Stock Ownership Plans (ESOP), where the employer and employee are jointly responsible for the maintenance of the pension fund. This note focuses solely on defined-benefit pension plans; any future reference to pension plans refer to the defined-benefit variety.

15. 29 U.S.C. § 1306.

16. For funding obligations for single-employer pension plans, see *id.* § 1306(a)(3)(A)(i). See also Notice of PBGC Flat Premium Rates, 72 Fed. Reg. 67,765 (Nov. 30, 2007) (updating funding numbers for 2007).

17. 29 U.S.C. § 1306(a)(3)(E)(ii).

18. See Ann vom Eigen, *Legislative Highlights: Filing Fees and Pension Premium Increases Pending as Second Session Begins*, AM. BANKR. INST. J., Feb. 2006, at 8.

19. Johnathan E. Collins, Comment, *Airlines Jettison Their Pension Plans: Congress Must Act To Save the PBGC and Protect Plan Beneficiaries*, 70 J. AIR L. & COM. 289, 295 (2005).

20. *Id.* § 1341(c)(3)(D)(ii)(II). This note will not focus on standard terminations because the PBGC is not implicated. Even a company under Chapter 11 bankruptcy protection, engaging in a standard termination, does not need the assistance of the PBGC because its assets can fully fund any outstanding pension liabilities.

21. There are two other requirements: (1) the plan sponsor must provide sixty-days notice to each affected party that it intends to terminate the plan; and (2) the sponsor must adhere to any collective bargaining agreements. 29 U.S.C. § 1341(a)(2)–(3).

22. See *id.* § 1341(c).

23. *Id.* § 1341(c)(2)(B)(i).

ing the pension fund will prevent its successful reorganization under Chapter 11;²⁴ (3) the plan sponsor shows that it will not be able to pay its debts when they come due if it continues to fund the plan;²⁵ or (4) the plan sponsor convinces the PBGC that the plan must be terminated to avoid an unreasonably burdensome pension cost increase due to the decline in the number of plan participants.²⁶ If the PBGC determines that the plan sponsor has met one of these criteria, it will terminate the plan and assume the plan's assets and liabilities,²⁷ but the plan sponsor will remain liable to the PBGC for the plan's liabilities.²⁸ If the sponsor is under Chapter 11 bankruptcy protection,²⁹ the amount of the plan's unfunded liabilities usually becomes a general unsecured claim given to the PBGC.

The final form of termination is an involuntary termination initiated by the PBGC. The PBGC may involuntarily terminate a plan if it can show proper cause by arguing either: (1) the plan sponsor has not met minimum funding standards required under 26 U.S.C. § 412;³⁰ (2) the plan will not be able to pay benefits when they come due;³¹ or (3) the potential long term loss to the PBGC "may reasonably be expected to increase unreasonably if the plan is not terminated."³² Importantly, the PBGC may initiate an involuntary termination despite any collectively-negotiated agreements between the plan sponsor and its unions.³³ Just like a distress termination, the PBGC will take over the assets of the plan and assume liability for the guaranteed pension benefits.³⁴ The plan sponsor will then be liable to the PBGC for the unfunded portion of the plan.³⁵

To make up for any shortfall caused by terminated pension plans, the PBGC must perfect a lien against the plan sponsor and its control group.³⁶ Notably, when a plan is terminated, the PBGC does not guarantee the full payment of all pension benefits promised by the plan sponsor to the plan

24. *Id.* § 1341(c)(2)(B)(ii).

25. *Id.* § 1341(c)(2)(B)(iii)(I).

26. *Id.* § 1341(c)(2)(B)(iii)(II).

27. *Id.* § 1362(a).

28. *Id.*

29. Unless otherwise noted, whenever the term "bankruptcy" is used in this note, it will refer to a Chapter 11 bankruptcy proceeding.

30. 29 U.S.C. § 1342(a)(1).

31. *Id.* § 1342(a)(2).

32. *Id.* § 1342(a)(4).

33. *See In re UAL Corp.*, 428 F.3d 677, 681 (7th Cir. 2005).

34. 29 U.S.C. § 1342(a).

35. *Id.* § 1362(b)(2)(A).

36. *Id.* § 1368(a).

beneficiaries.³⁷ The 2008 cap of yearly pension payments by the PBGC is \$51,750 for every retiree who retires at age sixty-five.³⁸ Furthermore, once a plan is terminated, employees stop accruing interest on their pension promises after the date of the plan's termination.³⁹ The PBGC must rely on its investment of the premiums paid by plan sponsors to make up for any difference between the underfunding in the plan and the amount of the lien that the PBGC is able to perfect.⁴⁰

II. THE DOWNFALL: AMERICA'S DEFINED-BENEFIT PENSION PLAN RULES

One of the inherent flaws of the PBGC's structure is that Congress placed the heavy burden of monitoring all of the country's defined-benefit pension plans solely on the PBGC.⁴¹ The history of the PBGC proves that this burden is nearly impossible to bear.⁴² Not only does the PBGC lack the resources to gather sufficient, specific, and necessary information about private corporations and their pension plans,⁴³ but these private companies have been known "to exert undue influence over the efforts of the regulatory agency, thereby compromising the effectiveness of the regulators."⁴⁴ These flaws have led to a PBGC with an estimated deficit of between \$18 and \$23 billion.⁴⁵ Likewise, total underfunding of all PBGC-insured pension plans now exceeds \$350 billion.⁴⁶

37. Of course, this does not include voluntary terminations because plan sponsors who voluntarily terminate have enough assets to meet their pension liabilities.

38. Pension Benefit Guar. Corp., Pension Guarantees Fact Sheet, <http://www.pbgc.gov/media/key-resources-for-the-press/content/page13542.html> (last visited May 2, 2008). PBGC spokesperson Randy Clerihue stated that 90% of workers paid by the PBGC get 100% of what they were owed when their pension plan is turned over to the PBGC. A few exceptions exist, however, such as in the case of airline pilots, who will probably never get their full pension payouts because these promises are well in excess of the PBGC's maximum payout. See Kathleen Day, *Retirement, Squeezed*, WASH. POST, Sept. 17, 2006, at F1.

39. 29 U.S.C. § 1322(b)(6).

40. Generally, bankruptcy courts read the Bankruptcy Code to permit the debtor-in-possession to avoid certain statutory liens. Therefore, the PBGC's lien against a debtor-in-possession generally falls within the class of general unsecured claims, which rarely get paid in full by the debtor.

41. Daniel Keating, *Pension Insurance, Bankruptcy and Moral Hazard*, 1991 WIS. L. REV. 65, 78.

42. *Id.*

43. *Id.*

44. *Id.* Keating calls this phenomenon "agency capture." *Id.*

45. See PENSION BENEFIT GUAR. CORP., 2006 ANNUAL REPORT 34 (2006) [hereinafter 2006 ANNUAL REPORT]. For a discussion of the PBGC's deficit at the end of the 2004 fiscal year, which was \$23 billion and did not include United's pension terminations, see Michael S. Terrien & Brian I. Swett, *Feature: Pension Protection Act, New FASB Rule May Put Secured Lenders at Greater Risk of PBGC Liens*, AM. BANKR. INST. J., Dec./Jan. 2007, at 22.

46. See 2006 ANNUAL REPORT, *supra* note 45, at 34; see also Terrien & Swett, *supra* note 45, at 22.

One of the main reasons for the PBGC's enormous deficit, and one of the reasons why there was a need for pension reform in the first place, is that many major corporations that have filed for Chapter 11 bankruptcy protection and terminated their traditional pension plans in recent years. The airline industry and its large array of defined-benefit pension plans have posed one of the largest and most publicized threats to the PBGC. Many officials of bankrupt airlines have argued that bankruptcy was unavoidable because of high fuel costs, outdated cost structures, and the intense competition of low-cost carriers.⁴⁷ Nevertheless, the question remains: have some airlines sought bankruptcy protection primarily to dump their pension obligations on the PBGC so they can become more competitive with low-cost carriers, which do not offer traditional pension plans to employees?

Terminated pension plans of companies in the steel and airline industries have dogged the PBGC as its two largest liabilities. The *Chicago Tribune* noted that, in 2004, airline and steel companies made up 75% of the PBGC's liabilities, yet only represented 5% of the total number of employees covered by the PBGC's insurance.⁴⁸ In the airline industry alone, four of the nation's seven largest airlines filed for bankruptcy protection between 2002 and 2005.⁴⁹ Unfortunately for the PBGC, the automobile industry appears to be following in the footsteps of these two troubled industries. For instance, Delphi Corporation, formerly a part of General Motors and now one of the leading automobile parts suppliers,⁵⁰ initiated the largest bankruptcy filing ever in the automobile industry on October 8, 2005.⁵¹ Delphi's bankruptcy proceedings threatened its employees' traditional pension plans.⁵²

47. See generally Eva M. Dowdell, *The Chapter 11 "Shuttle"—Coincidence or Competitive Strategy?*, 71 J. AIR L. & COM. 669, 679–82 (2006).

48. Editorial, *The Future of Your Retirement*, CHI. TRIB., Nov. 21, 2004, § 2, at 8.

49. See Notice of Bankruptcy Case Filing, *In re* Delta Airlines, Inc., No. 05-17923 (Bankr. S.D.N.Y. Sept. 14, 2005) [hereinafter Delta Airlines Notice of Bankruptcy]; Notice of Bankruptcy Case Filing, *In re* Northwest Airlines Corp., No. 05-17930 (Bankr. S.D.N.Y. Sept. 14, 2005) [hereinafter Northwest Airlines Notice of Bankruptcy]; Notice of Bankruptcy Case Filing, *In re* UAL Corp., No. 02-48191 (Bankr. N.D. Ill. Dec. 9, 2002) [hereinafter UAL Corp. Notice of Bankruptcy]; Notice of Bankruptcy Case Filing, *In re* US Airways Group, Inc., No. 02-83984 (Bankr. E.D. Va. Aug. 11, 2002) [hereinafter U.S. Airways Notice of Bankruptcy].

50. Delphi, About Delphi, <http://delphi.com/about/main/> (last visited May 1, 2008) (calling itself "a leading global supplier of mobile electronics and transportation systems" and stating that it has "approximately 169,500 employees and operates 156 wholly owned manufacturing sites in 34 countries with sales of \$22.3 billion in 2007.").

51. Notice of Bankruptcy Case Filing, *In re* Delphi Corp., No. 05-44481 (Bankr. S.D.N.Y. Oct. 8, 2005) [hereinafter Delphi Notice of Bankruptcy].

52. Roger Lowenstein, *We Regret to Inform You that You No Longer Have a Pension*, N.Y. TIMES MAG., Oct. 30, 2005, § 6, at 58.

Generally, bankruptcy courts allow the debtor to either terminate its defined-benefit pension plans or negotiate with the PBGC or the debtors' various unions to come up with a settlement that allows the PBGC to voluntarily take over the debtor's pension obligations. Despite the large body of evidence that corporations would continue to try and shed their pension obligations in bankruptcy courts nationwide, the PBGC has generally sat by while these corporations have underfunded their traditional pension plans.⁵³

Many experts argue that there are too many loopholes in ERISA that allow companies to underfund their plans.⁵⁴ Even the former Executive Director of the PBGC, Bradley Belt, acknowledged that there were inherent flaws.⁵⁵ This shoddy enforcement and the significant underfunding of the nation's largest pension plans have enhanced what many have called the "moral hazard" inherent with insured defined-benefit pension plans. This moral hazard is evidenced by the United Airlines, Inc. ("United") bankruptcy case.

A. *The "Moral Hazard" Defined*

A moral hazard is created when "those who are insured against certain risks have an incentive to use less than optimal care to avoid those risks."⁵⁶ In other words, the hazard is created when individuals are tempted to take more risk than is healthy for the group as a whole.⁵⁷ For instance, most insurance contracts must take into account the moral hazard problem.⁵⁸ Once the insurance contract is purchased, it is virtually impossible for the insurance company to ensure that the purchaser is not taking risks that he would normally not take if he had not purchased the insurance.⁵⁹

The moral hazard inherent in the PBGC stems from the fact that the plan sponsor and its employees have incentives under ERISA's current rules to trade wages and health benefits for promises of increased pension

53. For example, Bethlehem Steel and United Airlines were each allowed to stop funding their pension plans years before they filed for bankruptcy and handed over their plans to the PBGC. See Justin Cummins & Meg Luger Nikolai, *ERISA Reform in a Post-Enron World*, 39 J. MARSHALL L. REV. 563, 570 (2006).

54. See *id.* at 570–71.

55. Belt offered as evidence United Airlines, U.S. Airways, Bethlehem Steel, LTV Steel, and National Steel, which all presented claims in excess of \$1 billion to the PBGC during their respective pension terminations. See *id.*

56. Keating, *supra* note 41, at 67–68.

57. Lowenstein, *supra* note 52, at 58.

58. Eric D. Chason, *Outlawing Pension-Funding Shortfalls*, 26 VA. TAX REV. 519, 530–32 (2007).

59. *Id.*

benefits upon retirement.⁶⁰ Furthermore, employees have little incentive to make sure that their employers fully fund their pension plans because they know that the PBGC is there to back up the plan sponsor's promise.⁶¹ In the absence of the PBGC's insurance function, employees would probably demand more security with the investment of their retirement income.

Furthermore, most plan sponsors, unions, and employees never feared that these pension promises would not be fulfilled: "[d]uring the [1990s] especially, when it seemed that every pension promise could be fulfilled by a rising stock market, employers either recklessly overpromised or recklessly underprovided—or both—for the commitments they made."⁶²

As has been shown by the recent bankruptcy filings, the full realization of an employee's promised pension benefits is far from guaranteed. For instance, in the 1990s and 2000s, United increased its pension promises, thinking it could pay for these promises later.⁶³ In exchange for these added pension promises, United sought to reduce current wages and health insurance benefits liabilities. It is this belief that a corporation can save now, by reducing wages and health insurance benefits, and pay later, when pension promises came due, that underscores the moral hazard problem inherent in pension insurance.

The plan sponsor's senior management has the most control over the risk involved in increasing its pension obligations. These corporate executives may find it easier to pay off the corporation's employees with future pension promises rather than with wages that are presently due.⁶⁴ The PBGC plays an important role in this scenario by allowing plan sponsors to underfund their plans and providing plan sponsors with minimum funding waivers for a given year.⁶⁵ Furthermore, for many corporations, these future pension promises will never come due because the plan will be terminated. The inability to pay pension benefits when they come due does not

60. Keating, *supra* note 41, at 71.

61. Chason, *supra* note 58, at 530.

62. Lowenstein, *supra* note 52, at 58.

63. Much of this optimism was based on the successful stock market. United, and many other similarly-situated corporations, failed to predict the downturn of the stock market at the turn of the century. See *The Future of Your Retirement*, *supra* note 48, at 8.

64. Lowenstein, *supra* note 52, at 58.

65. The plan sponsor "retains a tremendous amount of discretion as to the level of funding that each plan will have." Keating, *supra* note 41, at 73. Note that 26 U.S.C. § 412(c)(3)(A) requires actuarial assumptions to be "reasonable," but there is a generous range given to plan sponsors so they can fund plans according to their own preferences. "[T]he minimum funding standards themselves recognize and specifically allow for the existence of significant underfunding based on past-service liability that has been accrued at the time a plan has begun. Employers are required merely to reduce that type of underfunding over a number of years." *Id.* at 74.

worry many plan sponsors because they know these promises are insured by the PBGC.

Frequently, plan sponsors threaten employees with the initiation of bankruptcy proceedings, which often leads to pension plan terminations, if their employees do not agree to wage concessions. For instance, airline officials told their employees that bankruptcy protection may be a useful tool.⁶⁶ Likewise, companies' stock valuations rise when they rid themselves of the burden of traditional pension plans, which furthers the incentive to trim pension liabilities. If a company can discharge these liabilities, it can attract greater third-party investment and therefore become more profitable.⁶⁷

Nevertheless, union leaders, who negotiate most pension agreements, often seek pension promises that even they know are excessive, in large part because the PBGC insures these promises.⁶⁸ In addition, unions and their constituents rarely ensure that their pensions are fully funded: "As a result of federal pension insurance, employees lack the proper incentives to monitor their employers' funding levels because the employees will not bear the full costs of their inattention."⁶⁹ In an effort to resolve this tension, the PBGC does not insure any and all pension promises, instead limiting yearly payouts to beneficiaries.⁷⁰ Ironically, the PBGC does this to give employees incentives to make sure their employer funds their plans adequately.⁷¹ Nevertheless, many pension promises are not as insured as most employees would believe.

This moral hazard problem can be more dangerous than other insurance-based moral hazards, such as federally-insured banks or products liability insurance, because the PBGC insurance function affects three parties, not two.⁷² As noted above, employers, employees, *and* the PBGC play a part in this moral hazard. "Typically, the party with a moral hazard will be the party who both benefits from the insurance coverage and has control over the reactive risk that is being covered."⁷³

In the pension situation, both the plan sponsor and its covered employees benefit from the PBGC's insurance function. Therefore, this insurance encourages plan sponsors and their employees to raise pension

66. See Evan Perez, *Delta May File for Bankruptcy in Coming Week*, WALL ST. J., Sept. 12, 2005, at A3.

67. Cummins & Nikolai, *supra* note 53, at 585.

68. Lowenstein, *supra* note 52, at 58.

69. Keating, *supra* note 41, at 75.

70. *Id.*

71. *Id.* Keating calls this the "co-insurance feature."

72. *Id.* at 71.

73. *Id.* at 71-72.

benefits because they know these benefits are insured by the government.⁷⁴ When a plan terminates, employees with unpaid pension promises are paid directly by the PBGC. While plan sponsors do not receive direct payments from the PBGC, they too become PBGC beneficiaries when the PBGC insures and eventually pays out pension benefits.⁷⁵ The PBGC's insurance function allows plan sponsors to focus less on current wages, which are very current liabilities, and, instead, on making promises for future liabilities, or pension plans.⁷⁶

When testifying about the problems facing the PBGC, Belt testified in a Senate hearing that ERISA's "[b]yzantine and often ineffectual set of funding rules" has promulgated a "poorly designed system that can be gamed."⁷⁷ In United's case, its "promises of hefty increases in pension benefits throughout the 1990s and into 2000, when it seemed money was growing on trees, laid the groundwork for the [moral hazard] problem."⁷⁸

B. *The United Bankruptcy and Its Pension Terminations*

The story of the United bankruptcy was well-publicized not only because of its length, but also because of its employees' lost pension benefits. On December 9, 2002, UAL, Corp., United's parent corporation,⁷⁹ and twenty-seven related corporations, including United, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in the Northern District of Illinois.⁸⁰ Some of the significant factors that led to United's business failings included a poor post-September 11, 2001 economy, strong competition by low-cost carriers, such as Southwest Airlines, and rising fuel costs.⁸¹ Nevertheless, it seemed clear from the very beginning of the bankruptcy that the only way United could emerge from Chapter 11 as a viable airline would be to rid itself of its pension liabilities. United entered bankruptcy with \$8.3 billion in unpaid pension promises, including \$4.445 billion in pension liabilities due by the end of 2009.⁸²

At the time it filed its bankruptcy petition, United sponsored four major pension plans, which were all underfunded: (1) a pilots' plan; (2) a

74. Lowenstein, *supra* note 52, at 58.

75. Keating, *supra* note 41, at 72.

76. *Id.* (noting that companies with insured pension plans often attract employees who are willing to take lower wages).

77. See *The Future of Your Retirement*, *supra* note 48, at 8.

78. *Id.*

79. Hereinafter United and UAL will be used interchangeably.

80. UAL Corp. Notice of Bankruptcy, *supra* note 49.

81. Editorial, *Airlines: Cut Costs or Perish*, CHI. TRIB., Dec. 10, 2002, § 1, at 28.

82. *In re UAL Corp.*, 428 F.3d 677, 680 (7th Cir. 2005); Brief of Appellee United Airlines, Inc. at 5, *In re UAL Corp.*, 468 F.3d 444 (7th Cir. 2006) (No. 06-1222), 2006 WL 2300671.

flight attendants' plan; (3) a machinists' plan; and (4) a mechanics' plan.⁸³ United itself blamed the underfunding on "the combination of the lowest interest rates in forty-five years and volatile stock market returns."⁸⁴ Furthermore, statutory funding requirements required United to pay a special surcharge called a "deficit reduction contribution," which would have required United to make accelerated contributions to the plans, had it not shed this obligation in bankruptcy.⁸⁵

Initially, United claimed that it did not want to terminate these pension plans. Instead, the airline sought a loan guarantee application—a bail out—from the United States Air Transportation Stabilization Board (ATSB) that would have allowed United to exit bankruptcy without terminating its plans.⁸⁶ In order to push for this bailout, the airline made efforts to cut costs to become more competitive. For instance, it eliminated approximately \$6.4 billion in labor costs, \$200 million in retiree medical benefit costs, and \$1.2 billion in pension costs.⁸⁷ Nevertheless, the ATSB refused to bail out United, which forced the airline to look for other ways to obtain sufficient exit financing—specifically, terminating its pension plans—to exit bankruptcy as an entity that could eventually become profitable.⁸⁸

In 2004, in the wake of the ATSB decision, United first stated that it would seek to terminate its four underfunded pension plans and replace them with defined-contribution plans.⁸⁹ Concurrently, it announced that it was halting pension contributions altogether.⁹⁰ By the end of 2004, these missed pension payments had amounted to \$994 million.⁹¹ A United spokesperson maintained that bankruptcy protection provided the airline an opportunity to refrain from funding its plans: "Our decision not to make these contributions was based on our good-faith business judgment concerning our use of cash and need to preserve liquidity during this phase of our restructuring. . . . [i]t is the prudent exercise of our discretion under the bankruptcy code."⁹² The profitable low-cost carriers do not offer traditional pension plans. Therefore, in order to become a competitive airline, United believed that it had to shed this burden.

83. *Id.* at 4.

84. *Id.* at 4–5.

85. *Id.* at 5.

86. *Id.* at 5–6.

87. *Id.* at 6.

88. *Id.* at 6.

89. See *The Future of Your Retirement*, *supra* note 48, at 8.

90. *Trustee Seeks Pension Funds Owed by United*, CHI. TRIB., Dec. 1, 2004, § 3, at 3.

91. *Id.*

92. *Id.*

Not only was United failing to pay pension obligations and threatening to terminate its four pension plans, but it was also seeking pay cuts from its unions through the § 1113 process. Section 1113 requires that a corporation under Chapter 11 protection negotiate with its unions before changing collective bargaining agreements.⁹³ United insisted that these pay cuts were necessary for the company to successfully emerge from bankruptcy.

The unions were left with no choice but to accept these cuts in part because of “the subtle preferences afforded to airlines by bankruptcy judges.”⁹⁴ For instance, United and its machinists’ union (United’s largest union, representing more than 20,000 reservations agents, customer service agents, and baggage handlers) ratified a new five-year contract in 2005, which cut the machinists’ pay by an average of 3.9%.⁹⁵ The only other option for the unions would have been to go on strike, which probably would have been a debilitating blow to the airline and which probably would have cost the union members their jobs.⁹⁶ Judge Eugene Wedoff, the bankruptcy judge overseeing United’s bankruptcy proceedings, observed that “[t]he least bad of the available choices here has got to be the one that keeps an airline functioning, that keeps employees being paid.”⁹⁷

Nevertheless, United’s unions did their best to vigorously contest the termination of their pension plans.⁹⁸ United’s pilots had the most to lose. During the time of these bankruptcy proceedings, the PBGC’s maximum payout was \$44,386.00 per year, which did not start until the covered employee reached the age of sixty-five. For pilots, the federally mandated retirement age is sixty, so United’s pilots faced the problem of having a five year gap before receiving any PBGC pension insurance pay-out. Furthermore, United and the Air Line Pilot Association (ALPA), the pilots’ union, had negotiated far higher pension benefit promises than the maximum payout from the PBGC. According to the Seventh Circuit, “[w]hat the PBGC can pay is limited by 29 U.S.C. § 1322(b)(3), so vested benefits of well-paid retirees such as airline pilots [will not be] fully insured.”⁹⁹ ALPA and its members had negotiated far higher retirement benefits that were federally insured—precisely the inherent moral hazard that is present in this federally-insured pension structure.

93. 11 U.S.C. § 1113; *see also* Dowdell, *supra* note 47, at 675.

94. Dowdell, *supra* note 47, at 675–76.

95. Editorial, *A Good Day for United*, CHI. TRIB., June 1, 2005, § 1, at 22.

96. *Id.*

97. *Id.*

98. *See, e.g.*, Brief and Required Short Appendix of Appellant Air Line Pilots Ass’n, Int’l at 4, *In re UAL Corp.*, 468 F.3d 456 (7th Cir. 2006) (No. 06-2714), 2006 WL 2617971.

99. *In re UAL Corp.*, 468 F.3d 444, 447 (7th Cir. 2006).

Once United terminated the plans, neither the airline nor its pilots could ensure that the pilots received more than the maximum statutory payouts by the PBGC. To ensure that plan sponsors do not take advantage of the PBGC's payout limits, the Supreme Court has held that bankrupt plan sponsors may not offer "follow-on" plans. "Follow-on" plans seek to make up for the difference between the original pension promise and the PBGC maximum guaranty.¹⁰⁰ For example, if the pilots were promised \$90,000 per year from their pension plan, United could not terminate that plan, thereby forcing the PBGC to pay out the maximum, and then initiate a new plan for the pilots that would promise them an additional \$45,614 per year upon retirement (the difference between the original plan's promise and the PBGC maximum payout).

United claimed to be seeking to reach "consensual modifications" with ALPA by making modifications to the pilots' plan and to the pilots' wages.¹⁰¹ On December 16, 2004, United and ALPA reached a tentative agreement to terminate the pilots' plan at the end of June 2005. This agreement called for ALPA to acquiesce to United's proposed distress termination of the pilots' plan in exchange for \$550 million in convertible notes in the reorganized United and a new defined-contribution pension plan.¹⁰²

The PBGC believed this agreement was unfair. Therefore, before it was approved by the bankruptcy court, the PBGC sought to initiate an involuntary termination of the pilots' plan on December 30, 2004. Significantly, the PBGC sought to put a "hard freeze" on the pilots' plan as of December 31, 2004, thereby forgoing the additional \$84 million in liability that the PBGC would have attained had the plans been allowed to continue into 2005.¹⁰³ When a traditional pension plan undergoes a "hard freeze," no accrued benefits are lost, but employees no longer accrue benefits after the date the plan is frozen.¹⁰⁴ The additional liability would have been incurred because the pilots were to earn additional work credits and an annual cost-of-living increase had the plan rolled over into 2005.¹⁰⁵ Specifically, the PBGC knew the airline would almost certainly fail to make these required contributions to the already underfunded plan.¹⁰⁶

100. Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 642 (1990).

101. Brief of Appellee United Airlines, *supra* note 82, at 7.

102. *In re UAL Corp.*, 468 F.3d at 447.

103. *Id.* at 447–48.

104. Stephanie Armour, *IBM to Freeze Pension Program: Company Considered Pacesetter on Benefits*, USA TODAY, Jan. 6, 2006, at 1A.

105. *In re UAL Corp.*, 468 F.3d at 447.

106. *Id.*

During the United-ALPA negotiations, the airline began its own negotiations with the PBGC. The PBGC agreed to accept about \$1.5 billion in stock in the newly reorganized United upon plan confirmation in exchange for agreeing to continue three pension plans (namely, all plans except the pilots' plan) through June 30, 2005. The PBGC reserved its right to seek an earlier termination of the pilots' plan under 29 U.S.C. § 1342(a)(4). This right conflicted directly with the recent United-ALPA agreement, whereby United promised not to end the pilots' plan prior to the terminations of the other three plans. Despite ALPA's complaints, the Seventh Circuit upheld the PBGC's decision to terminate the pilots' plan at the end of 2004, holding that the district court is statutorily permitted to set the termination date of a pension plan.¹⁰⁷ The United-ALPA agreement had no bearing on the termination date of the plan, once it was initiated by the PBGC, because both the court and the PBGC were "strangers to the bargain."¹⁰⁸

Despite its effort to reduce its eventual liability, once all the plans were terminated, the PBGC was saddled with an additional \$6.6 billion in pension obligations.¹⁰⁹ The terminations cost United employees and retirees approximately \$3.2 billion in lost benefits.¹¹⁰

C. The Termination of United's Pension Plans Epitomizes the Inherent Moral Hazard in Federally-Insured Defined-Benefit Pension Plans

The story of United's building pension debt and eventual terminations is a prime example of how the PBGC's insurance of defined-benefit pension plans leads to a moral hazard. Judge Easterbrook of the Seventh Circuit noted that United's labor negotiations with its unions throughout the 1990s exemplified the moral hazard inherent in pension insurance: "Insured parties alter[ed] their behavior to take advantage of the third-party payor; insurers must respond by making such maneuvers more difficult."¹¹¹ Shockingly, after not funding any of its four pension plans from 2000–2002, United granted a 40% increase in pension benefits to 23,000 of its mechanics in 2002, just months after the September 11th tragedy.¹¹² It seems hard to imagine that airline executives actually believed it would be able to make these payments.

107. *Id.* at 455.

108. *Id.* at 452.

109. Dowdell, *supra* note 47, at 678.

110. *Id.*

111. *In re UAL Corp.*, 468 F.3d 444, 452 (7th Cir. 2006).

112. Lowenstein, *supra* note 52, at 62.

The PBGC made sure that pension promises were halted when it forced the termination of the pilots' plan before the start of 2005. It had no choice but to object to the United-ALPA agreement, since United was promising six more months of accrued benefits while openly acknowledging that it would not fund any of these promises. Instead, both the airline and the pilots would rely on the PBGC.

After United's plan of reorganization was confirmed in January 2006, the PBGC (which, after the pension terminations, had become United's largest unsecured creditor) became the single largest shareholder of new United stock.¹¹³ Through negotiations with its unions and the PBGC, United was able to shift \$10.2 billion in unfunded pension liabilities to the PBGC during its reorganization.¹¹⁴

Meanwhile, United's management received what some parties called excessive incentive plans that were included in United's plan of reorganization.¹¹⁵ UAL's top 400 managers were awarded 8% of the 125 million shares of UAL stock that were issued after UAL came out of bankruptcy. Judge Wedoff noted that, "It may be we have a culture in this country that overcompensates management, but United is just one enterprise that operates in that general environment . . . [t]he marketplace indicates this is a reasonable plan."¹¹⁶ Therefore, tangible punishments for managers promising unrealistic pension benefits do not seem to exist.

Surprisingly, after emerging from bankruptcy, United posted profits.¹¹⁷ In the second quarter of 2006, United posted a profit of \$119 million, its first profit since 2000.¹¹⁸ In the third quarter of 2006, United boasted a \$190 million profit, as compared with a loss of \$1.77 billion during the same quarter in 2005.¹¹⁹ The company suggested these profits were attributable to fuller flights and higher ticket prices,¹²⁰ but one can also assume that its exit from bankruptcy, spurred greatly by reducing pension liabilities, was also a major, if not the most significant, contributor.

113. Michael Schroeder & Susan Carey, *Pension Board To Trim UAL Stake But Still To Pay Most Legacy Costs*, WALL ST. J., Feb. 1, 2006, at A2.

114. *Id.*

115. Susan Carey, *Judge Approves UAL's Managers Incentive Plan*, WALL ST. J., Jan. 19, 2006, at A2 (writing that Judge Wedoff overruled United's unions' and retirees' objections to the equity incentive plan).

116. *Id.*

117. Julie Johnsson, *United Aims to Trim Debt: Airline Reports \$190 Million Profit for 3rd Quarter*, CHI. TRIB., Nov. 1, 2006, § 3, at 1.

118. Susan Carey, *UAL Expects Earnings Above Wall Street Views*, WALL ST. J., July 25, 2006, at A2.

119. Johnsson, *supra* note 117, at 1.

120. *Id.*

D. Others in the Airline Industry

The United bankruptcy, which followed the US Airways bankruptcy filing,¹²¹ was only the start of the major airline bankruptcies. Delta Airlines¹²² and Northwest Airlines¹²³ filed for protection in 2005. United's success story—coming out of bankruptcy and posting immediate profits—poses the following question: should Congress be satisfied with the business model that United used over the past decade? United's situation epitomizes the moral hazard problem that federally funded pension insurance poses. In the years leading up to its bankruptcy, United made more and more pension promises to its unions in exchange for wage cuts.¹²⁴ During its bankruptcy, the company extracted even more wage cuts from its unions and shed its pension obligations by effectively forcing the PBGC terminate its plans.¹²⁵ Now the company is making profits in a very competitive industry while the PBGC, backed by the federal taxpayers, has been left footing the bill for billions of dollars of unpaid pension promises.¹²⁶

One of United's chief competitors, American Airlines ("American"), chose not to enter Chapter 11 in 2003 despite unsuccessful labor negotiations and the resignation of its CEO.¹²⁷ Current American CEO Gerard Arpey sought to avoid bankruptcy so the airline could control its own destiny: "Bankruptcy, by definition, really puts the problem in the hands of somebody else."¹²⁸ While this seems like a logical stand, American has seen its competitors enter bankruptcy and succeed in terminating pensions and lowering employees' wages.¹²⁹ Airlines like United and US Airways can now offer stiffer competition to American because of these cuts.¹³⁰ Arpey has sought to slash costs by taking such drastic actions as removing pillows from planes, halting some unprofitable routes, adding more seats, and even charging for soft drinks.¹³¹ All of these unwanted actions were forced directly upon the consumer because the airline chose not to enter

121. US Airways Notice of Bankruptcy, *supra* note 49.

122. Delta Airlines Notice of Bankruptcy, *supra* note 49.

123. Northwest Airlines Notice of Bankruptcy, *supra* note 49.

124. *See supra* text accompanying notes 63–64, 112.

125. *See supra* text accompanying notes 87, 89–92, 95–97, 101–102.

126. *See supra* text accompanying notes 117–118.

127. Melanie Trottman, *Airline CEO's Novel Strategy: No Bankruptcy*, WALL ST. J., Apr. 17, 2006, at B1.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

bankruptcy. Additionally, because American decided against bankruptcy protection, it must still fund its pension plans.¹³²

By staying out of bankruptcy court, American sought better employee relations,¹³³ but these improved relations came at a steep cost. "Airlines in bankruptcy . . . have a free ride on expensive assets, while competitors continue to grapple with rising expenses (such as fuel) and on-going interest payment obligations."¹³⁴ Therefore, many experts believe that some airlines have filed for Chapter 11 protection despite having any real reason to take such drastic measures other than eliminating pension liabilities.¹³⁵ For example, at the time of its bankruptcy filing,¹³⁶ Northwest Airlines had \$1 billion in available cash and credit.¹³⁷ In fact, its finances were in such good shape that five Wall Street firms had "buy" recommendations for Northwest stock as late as the day that the airline filed its bankruptcy documents.¹³⁸ "Rather than cut costs by eliminating layers of management or streamlining operations, these carriers 'hide out' in bankruptcy court."¹³⁹

III. THE PENSION PROTECTION ACT OF 2006

When pension programs are underfunded by their sponsors, they create a ripple effect on the economy of the entire country. Because of the burden on the PBGC, it will eventually be unable to insure the pension plans of retirees. Therefore, the expectations of tens of millions of plan beneficiaries may be frustrated. This undermines consumer confidence, which impedes economic growth. These pension terminations force the retirees who are dependent, or plan to depend, on their pensions to be more dependent on other public programs, such as Social Security and even the federal welfare system. These programs are not intended to fully support retirees, which, in turn, cause many families to struggle to meet their basic needs.¹⁴⁰ The Pension Protection Act was intended to reverse this trend by forcing plan sponsors to adequately fund their pension plans, which would put an end to the drastic cycle set forth above.

132. *Id.*

133. *Id.*

134. Dowdell, *supra* note 47, at 684–85.

135. *See id.* at 684–89.

136. *See* Northwest Airlines Notice of Bankruptcy, *supra* note 49.

137. Jerry Knight, *Airlines Hide Out in Bankruptcy Court*, WASH. POST, Sept. 19, 2005, at D9.

138. *Id.*

139. Dowdell, *supra* note 47, at 670.

140. Cummins & Nikolai, *supra* note 53, at 571–72; *see also* Donald L. Bartlett & James B. Steele, *The Broken Promise*, TIME, Oct. 31, 2005, at 32.

The highly-publicized United pension terminations and other corporate pension terminations spurred Congress into action in 2005. Congress passed the Pension Protection Act of 2006 (PPA)¹⁴¹ to “provide economic security for all Americans”¹⁴² and to prevent what Senator John McCain has called a “looming train wreck for American taxpayers.”¹⁴³ While the PPA purported to protect workers’ current pension plans, it seemed clear that the statute really sought to rid the country of traditional pension plans. Now, employees must fend for themselves as the PPA encouraged defined-contribution pension plans, which put more of the onus on employees to save for their own retirements.

Because of the many plan sponsors under bankruptcy protection who had recently terminated their pension, some view the entire PPA as bankruptcy legislation.¹⁴⁴ While Title IV of the Act¹⁴⁵ purports to make certain that the PBGC can insure America’s workforce a lifetime of pension security, it may have the opposite effect.¹⁴⁶ The Act seems to create more difficulties for corporations seeking to shore up their defined-benefit pension plans. According to Ed Slott, a certified public accountant and retirement tax law expert, “There are so many new rules, hurdles, reporting and funding requirements that many companies might just say ‘the heck with this’ and discontinue those plans.”¹⁴⁷

A. *The Creation of the Pension Protection Act*

President George W. Bush and his Republican allies in Congress claimed to have long hoped to eliminate many of the loopholes and deficiencies inherent in the pension insurance system run by the PBGC.¹⁴⁸ These loopholes had created a PBGC deficit of approximately \$30 billion in 2005,¹⁴⁹ more than twice its deficit in 2003.¹⁵⁰ The Congressional Budget Office (CBO) estimated that this deficit will skyrocket to \$100 billion by 2025.¹⁵¹

141. Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (codified as amended in scattered sections of 26 U.S.C. and 29 U.S.C.).

142. *Id.*

143. See *The Future of Your Retirement*, *supra* note 48, at 8.

144. *Legislative Highlights: Pension Reform Changes Airline and Credit Counseling Requirements*, AM. BANKR. INST. J., Sept. 2006, at 8.

145. Pension Protection Act of 2006 §§ 401–412.

146. Humberto Cruz, *Retirement Plan More Important than Ever*, CHI. TRIB., Sept. 10, 2006, § 5, at 8.

147. *Id.*

148. Lowenstein, *supra* note 52, at 59.

149. Cummins & Nikolai, *supra* note 53, at 568.

150. See *The Future of Your Retirement*, *supra* note 48, at 8.

151. Cummins & Nikolai, *supra* note 53, at 568.

In formulating the legislation that he would eventually sponsor, former House majority leader John Boehner (R-Ohio) sought to change the pension industry and protect the PBGC from further losses. He stated that “[i]f the PBGC is forced to assume the airline industry’s nearly \$30 billion in pension liabilities, workers and retirees will be left with reduced benefits and taxpayers could be left with a huge bill.”¹⁵² Furthermore, he referenced the possibility that the moral hazard inherent in federal pension insurance would continue: “I’m concerned about the possibility of a company using the PBGC as a pension dumping ground to boost their economic prospects and get a leg up on the competition.”¹⁵³ As noted earlier, this “leg up” was exactly what United accomplished when its pensions were terminated and what many more bankrupt corporations may currently be seeking.

Boehner set forth six principal reforms that the PPA purported to make.¹⁵⁴ First, the PPA sought to provide a permanent interest rate that would accurately calculate employers’ promised pension funding requirements.¹⁵⁵ Second, the PPA purported to give incentives to employers to better fund their pension plans during good economic times.¹⁵⁶ Third, the PPA intended to reduce the funding volatility in pension plans by ensuring that employers make adequate and consistent pension contributions.¹⁵⁷ Fourth, the PPA sought to prevent the moral hazard in the system evidenced by employers and unions making promises to employees that both parties know cannot be kept.¹⁵⁸ Fifth, the Act sought to give more accurate and meaningful disclosure to employees about the status of their pension plans.¹⁵⁹ Finally, the Act intended to resolve the legal uncertainty to ensure other pension plans, such as cash balance pension plans, remained a viable part of the defined-benefit system.¹⁶⁰ Therefore, those who pushed for the PPA sought to alleviate many of the inherent flaws in the modern pension system.

152. See *The Future of Your Retirement*, *supra* note 48, at 8.

153. *Id.*

154. H. COMM. ON EDUC. & THE WORKPLACE, 109TH CONG., THE PENSION PROTECTION ACT: STRENGTHENING RETIREMENT SECURITY, PROTECTING TAXPAYERS BY FIXING OUTDATED WORKER PENSION LAWS 1 (2005), available at http://www.thepensioncoalition.org/news/PensionProtectionAct_summary.pdf. For a thorough discussion of the PPA’s legislative history, see Daniel B. Klaff, Recent Development, *The Pension Protection Act of 2006: Reforming the Defined Benefit System*, 44 HARV. J. ON LEGIS. 553 (2007).

155. H. COMM. ON EDUC. & THE WORKPLACE, *supra* note 154, at 1.

156. *Id.*

157. *Id.* at 2.

158. *Id.*

159. *Id.*

160. *Id.*

The PPA also made some significant changes to the defined-benefit pension system. For instance, beginning in 2008, the PPA phased in a new requirement that plan sponsors discount their pension obligations using a higher grade of corporate bonds than the currently required thirty-year Treasury bond. Furthermore, it required that plan sponsors of poorly funded plans make additional contributions, or “catch-up” payments, and limits some of the benefits that these plans can provide.¹⁶¹ Also, the PPA required the variable-rate premiums paid to the PBGC to be based on 100% of the plan’s underfunding—a plan sponsor must pay the PBGC \$9 per \$1,000 of underfunding.¹⁶²

In an effort to protect the PBGC, the PPA also made the following changes to the pension funding rules for defined-benefit plans: (1) it limited the ability of plans with less than an 80% funding ratio to make lump-sum payments or increase benefits; (2) it required plans with funding ratios less than 60% to freeze normal benefit increases; and (3) it prohibited plans from paying benefits for unpredictable contingent events, such as shutdown benefits to employees of facilities that are closed down.¹⁶³

The CBO estimated that the PPA would reduce federal spending by \$5 billion from 2007 through 2016, but the CBO also expressed the belief that the PPA would decrease federal revenues for the same period by \$72.9 billion. Furthermore, during the same 2007–2016 period, the CBO noted that the PBGC’s premium receipts should increase by \$5.8 billion, while its net benefit payments should increase by only \$0.3 billion.¹⁶⁴

As noted earlier, Congress intended to end the age of large corporations supporting the retirements of their employees through traditional pension plans. The PPA encourages employees to contribute to employer-sponsored defined-contribution plans such as a 401(k).¹⁶⁵ These defined-contribution plans differ from defined-benefit plans because employees do not earn pension promises from their employers based on length of employment and salary. Instead, plans such as 401(k)s are financed in full or in part by the employees themselves. One of the significant problems with defined-contribution pension plans is that most Americans do not invest properly when they are put in charge of their own retirement savings.¹⁶⁶ Perhaps for this reason, the PPA encourages employers to automatically

161. See Terrien & Swett, *supra* note 45, at 22.

162. CONG. BUDGET OFFICE, COST ESTIMATE FOR H.R. 4: PENSION PROTECTION ACT OF 2006, at 4–5 (2006), available at <http://www.cbo.gov/ftpdocs/74xx/doc7493/hr4pgo.pdf>.

163. *Id.* at 8.

164. *Id.* at 1.

165. Stabile, *supra* note 1, at 318; see also Cruz, *supra* note 146, at 8.

166. Cruz, *supra* note 146, at 8.

enroll their employees in defined-contribution plans, unless an employee opted out of the plan.¹⁶⁷ This change was expected to increase participation in defined-contribution plans by 66% to 92%.¹⁶⁸

Furthermore, the PPA allows employers to automatically increase contribution rates into defined-contribution plans if an employee receives a raise. Likewise, it allows the employer to automatically invest its employees' retirement funds in a diversified portfolio. Finally, it makes it easier for employees to sell their stock in their own company, in order to have a more diversified portfolio.¹⁶⁹

The PPA's preference for 401(k)s seemed to be recognition of the fact that traditional pension plans are no longer viable options for corporations. A worker's retirement security is now up to the employee and 401(k)s put the burden on the employee to save.¹⁷⁰ To assist in educating employees about their retirement choices, the PPA encourages employers to make independent financial advisers available to their employees. Hence, workers would control their individual retirement savings, instead of having the insurance of a federally-insured defined-benefit pension plan maintained by their employer. This would benefit the PBGC and taxpayers who subsidize the federal corporation.

B. Title IV of the PPA and Its Exceptions for the Airline Industry

With the introduction of the PPA, the Bush Administration claimed to get rid of the inherent moral hazard that surrounded the PBGC.¹⁷¹ The PPA seeks to prevent companies with poor credit ratings from increasing pension benefits, or from providing further unfunded pension benefits to union leaders who agree to plant shutdowns.¹⁷² Nevertheless, the PPA does not provide for the meaningful change it promised when it comes to the airline industry.

Title IV of the PPA gives concessions to the very industry that many credit with causing the need for the PPA in the first place.¹⁷³ Title IV allows those employers that are either a commercial passenger airline or a company whose primary business is providing catering services for com-

167. The PPA also allows employers to automatically increase contribution rates when their employees receive a raise. See CONG. BUDGET OFFICE, *supra* note 162, at 12.

168. Elaine L. Chao, U.S. Sec'y of Labor, Speech Before the National Association of Steel Pipe Distributors in Washington D.C. (June 22, 2007).

169. Cruz, *supra* note 146, at 8.

170. *Id.*

171. Lowenstein, *supra* note 52, at 63.

172. *Id.*

173. CONG. BUDGET OFFICE, *supra* note 162, at 3.

mercial passenger airlines to choose one of two pension plan funding alternatives.¹⁷⁴ These employers may either choose a seventeen-year amortization of the pension plan's unfunded liability or, for plans that do not meet certain benefit accrual and benefit increase restrictions, the employer may choose a ten-year amortization period for the first taxable year beginning in 2008.¹⁷⁵ In exchange for this funding relief, plan sponsors who terminate their plans within the first five years after the PPA passed would be subject to a \$2,500.00 per participant surcharge for three years.¹⁷⁶

The preferential treatment does not end there. The PPA gives airlines that opt for a "hard freeze" of their plans an additional ten years to meet their funding contributions.¹⁷⁷ In addition, airlines that opt for a "soft freeze" now have an additional three years to meet their funding obligations.¹⁷⁸ In contrast to a "hard freeze,"¹⁷⁹ a "soft freeze" allows employees who are already covered by the pension plan to continue to accrue benefits, but restricts the plan to those employees—neither future employees, nor current employees not yet eligible for the plan, may participate. In essence, these rules allow airlines to freeze their traditional pension plans with little or no repercussions.

John Penn, an American Bankruptcy Institute past President, saw the inherent flaw of giving the airline industry a break. As Penn stated, "Allowing those with frozen plans substantially better terms than those honoring their financial obligations appears to be politically, rather than economically, motivated."¹⁸⁰ Penn pointed to the fact that the senators from Texas and Ohio, the respective home states of American Airlines and Continental Airlines (the two major airlines that had not yet filed for bankruptcy at the time the PPA was debated), refused to support the PPA because they believed it gave Delta and Northwest more time to pay off their pension liabilities, which would negatively alter American and Continen-

174. Pension Protection Act of 2006, *supra* note 141, § 402(a). The idea of giving preferential treatment to the airline industry was one of the most controversial parts of the PPA. *Legislative Highlights: Pension Reform Changes Airline and Credit Counseling Requirements*, *supra* note 144, at 8.

175. See Pension Protection Act of 2006, Pub. L. No. 109-280, § 402, 120 Stat. 780 (2006); see also STAFF OF J. COMM. ON TAXATION, 109th CONG., TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," tit. IV (Comm. Print 2006).

176. CONG. BUDGET OFFICE, *supra* note 162, at 7 ("This requirement, however, may be waived by the Secretary of Labor if the Secretary determines that the termination resulted from extraordinary circumstances such as terrorist attacks or other similar events.").

177. *Legislative Highlights: Pension Reform Changes Airline and Credit Counseling Requirements*, *supra* note 144, at 8.

178. *Id.*

179. See Armour, *supra* note 104, at 1A.

180. *Legislative Highlights: Pension Reform Changes Airline and Credit Counseling Requirements*, *supra* note 144, at 8.

tal's competitive landscapes.¹⁸¹ Penn went on to state, "If the goal was to keep companies from freezing or terminating their defined benefit plan, benefiting those that froze their plans seems counterproductive."¹⁸² Nevertheless, Delta and Northwest said that the PPA allowed them to save all of their pension plans other than their pilot plans, which both the airlines and their unions admit are unsalvageable.¹⁸³

For example, prior to approval of the PPA, Delta sent a letter to Congress urging it to pass the PPA because it would give Delta more time to catch up on its payments to some of its pension plans.¹⁸⁴ While there was no doubt that Delta's pilots' plan would have to be terminated, Delta claimed to be seeking to save a larger pension plan benefiting 91,000 employees and retirees.

Therefore, other than the increased pension termination surcharge, airline sponsors need not conform to many of the new rules established by the PPA.¹⁸⁵ Ironically, the industry that decimated the PBGC and frustrated the expected retirement security of many of its employees received a free pass from Congress.

Nevertheless, this may have been Congress's only option. Had the PPA not exempted the airline industry from many of these funding requirements, the airlines still saddled with huge pension liabilities would have had no choice but to seek immediate termination of their plans, which would have severely affected the PBGC and those retirees covered by the potentially terminated plans. The more liability the PBGC inherits, the greater the chances are that the government will have to bail out the PBGC, which would affect all American taxpayers.

IV. FURTHER REFORM IS STILL NECESSARY FOR THE PPA TO ACCOMPLISH ITS PURPORTED GOALS

Despite the PPA, Congress must do more to ensure the survival of the PBGC and to guarantee the retirement security of millions of American retirees and future retirees. In effect, the PPA may encourage more companies to freeze their plans or leave the pension system outright, precisely the result Belt claimed he did not want. This fear is exemplified by what some

181. *Id.*

182. *Id.*

183. The plans are unsalvageable because Delta said that 1,946 pilots would be eligible for retirement October 1, 2006, which would enable more than half of them to take lump-sum payouts of \$500,000 or more. See Evan Perez, *Delta Files to End Pilot Pension*, WALL ST. J., Aug. 7, 2006, at A2.

184. *Id.*

185. See Cummins & Nikolai, *supra* note 53, at 594–95 (discussing legislation introduced in Congress that eventually became the PPA).

call the “pacesetter” in employee benefits: IBM, which froze its pension plans in early 2006.¹⁸⁶ IBM said it would “beef up” 401(k) contributions to its more than 125,000 U.S. employees.¹⁸⁷ IBM froze their plans not because of the cost of traditional pension plans, but because of “the unpredictability of the plans”¹⁸⁸ and because the plans were “captive to the volatility of the capital markets.”¹⁸⁹ In fact, there are half as many defined-benefit plans in the United States than there were ten years ago.¹⁹⁰ The logical inference is that most corporations with traditional plans will either freeze or terminate them in the near future, if they have not already. Congress must ensure that the PBGC is ready and able to handle this. Furthermore, U.S. workers must understand that any pension promises they were given are not guaranteed. Workers must rely on themselves to ensure a steady and stable retirement income.

A. Since Congress Made Exceptions for the Airline Industry, It Should Now Make Similar Exceptions for Other Problem Industries

General Motors (GM) strongly opposed the Bush Administration’s proposal that eventually became the PPA.¹⁹¹ GM believed that Bush’s plan would force many old-economy corporations, such as itself, to put more money into their defined-benefit pension plans just when their businesses were hurting the most.¹⁹² GM, which is facing enormous financial difficulty,¹⁹³ might be underfunding its pension plans because of a lack of assets. In effect, GM must choose between investing in the future of its business and funding its archaic pension plans. Forcing GM to fully fund its plans, as the PPA does, could eventually push the automaker into bankruptcy. Like many of the corporations discussed above, GM would probably then be forced to terminate its pension plans during bankruptcy. Therefore, by forcing GM to fund its plans, the PPA could, in effect, cause the eventual termination of the plans—transferring the added burden of GM’s enormous pension obligations to the PBGC.¹⁹⁴ This seems to be the exact reason why Congress enacted the airline exceptions in the PPA—so why not the automobile industry?

186. Armour, *supra* note 104, at 1A.

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.* (noting that there were 58,000 plans in 1994, as compared to 29,000 plans in 2004).

191. Lowenstein, *supra* note 52, at 63.

192. *Id.*

193. *Id.*

194. *Id.*

The answer seems simple: Congress favors the airline industry unlike any other industry.¹⁹⁵ For instance, § 1110 of the Bankruptcy Code¹⁹⁶ provides protections to financiers of aircraft not given to financiers in other “capital-intensive” industries such as the automotive or steel industries.¹⁹⁷ Section 1110 requires airlines to assume or reject lease or purchase obligations for its aircraft within the first sixty days of filing for Chapter 11.¹⁹⁸ The automatic stay provision of the Bankruptcy Code does not apply in instances when a bankrupt airline rejects a lease or a purchase agreement because the financiers are able to immediately assert their interests and take possession of the aircrafts.¹⁹⁹ Therefore, § 1110 helps airlines obtain financing for their aircraft; it provides the aircraft financiers with extra protection by enabling them to get around the automatic stay.²⁰⁰ These benefits have never been applied to other industries, including the automotive and steel industries.²⁰¹

Similarly, Congress has supported the airline industry with other legislation since the industry was deregulated in 1978.²⁰² For instance, the Senate introduced the Employee Pension Preservation Act of 2005, which allowed airlines to restructure their unfunded pension plan liabilities over a twenty-five-year period.²⁰³ Many considered it a “slap in the face” to other industries, such as the automotive industry.²⁰⁴ GM had recently borrowed billions of dollars so that it could fund its underfunded pensions, while Congress gave the airlines a free pass on many of their pension obligations.²⁰⁵

Therefore, after seeing the airline industry place heavy burdens on the PBGC, Congress and the Bush Administration, seem to be drawing the line at the automobile industry.²⁰⁶ Belt has stated that there is “[n]o question our single largest source of exposure is the auto sector”²⁰⁷ but “[t]he last

195. Dowdell, *supra* note 47, at 676; see generally Gregory P. Ripple, Note, *Special Protection in the Air[line Industry]: The Historical Development of Section 1110 of the Bankruptcy Code*, 78 Notre Dame L. Rev. 281 (2002).

196. 11 U.S.C. § 1110 (2000).

197. Dowdell, *supra* note 47, at 676. Very few airlines actually own their own fleet because of the high costs of aircraft. *Id.* at 676 n.49.

198. 11 U.S.C. § 1110(a)(2)(A).

199. *Id.* § 1110(a)(1).

200. Dowdell, *supra* note 47, at 676.

201. *Id.*

202. *Id.* at 676–79.

203. S. 861, 109th Cong. § (o)(4)(D)(ii) (2005).

204. Dowdell, *supra* note 47, at 678.

205. *Id.*

206. Lowenstein, *supra* note 52, at 63.

207. *Id.* at 63.

thing we want to do is chase people out of the system.”²⁰⁸ Nevertheless, the PPA could chase many plan sponsors out of the traditional pension system, either by forcing untimely terminations or by forcing plan freezes. Therefore, Congress must look beyond the airline industry and take a fresh look at the implications of forcing large corporations to fully fund their traditional pension plans.

B. Plan Sponsors Must Not Be Forced To Fund Their Plans When Their Businesses Are in Financial Trouble

Although it may seem counterintuitive, plan sponsors such as GM, whose plans are not meeting funding requirements, should not necessarily be forced to increase the funding of their plans, or even fund their plans at all.²⁰⁹ The PPA has eliminated many of the pension funding loopholes, which, on its face, seems like a good idea. Nevertheless, forced funding could “lead to more companies freezing their plans or leaving the [pension] system outright.”²¹⁰ Generally, plans are underfunded because the plan’s sponsor is in the midst of financial trouble. These companies must choose between following the federal rules by funding their traditional pension plans and filing for bankruptcy, with the hope of shedding their pension obligations in much the same way United did: either make a deal with the unions to terminate the plans or wait for the PBGC to step in and file an involuntary termination. Regardless, once a plan is terminated, it puts the strain on the PBGC to initiate its insurance function.

Instead, the federal rules should prevent plan sponsors from increasing their pension promises unless the sponsor’s pension is already fully funded. As noted earlier, United continued to increase its pension obligations despite the fact that it was already underfunding its plans. United continued to promise benefits even when it was clear to the airline, its union leaders, and the government that the company was in dire financial trouble and would probably never be able to live up to its promises.²¹¹

In order to ease the strain on plan sponsors, Congress should allow sponsors to stretch out contributions to their pension plans as long as they pledge not to make further promises to employees for future pension benefits. Congress should also actively force underperforming plan sponsors to put a “hard freeze” on their traditional pension plans. These changes will make painfully clear to employees that they must reassess their belief that

208. *Id.* at 59.

209. *Id.* at 58.

210. *Id.* at 59.

211. *See The Future of Your Retirement, supra* note 48, at 8.

they can rely on their pension for most of their retirement income. This is the difficult reality of the current pension situation. Many workers will lose money and the government's insurer, the PBGC, does not have the assets to guarantee each and every traditional pension plan.

Nevertheless, forcing some sponsors to freeze their plans would stop the vicious cycle of sponsors making promises to their employees that cannot be fulfilled. The sooner American workers realize that it is unlikely their employer will make any significant contribution to their retirements, the sooner workers will take on the challenge of finding other ways to ensure a retirement free from worrying about basic necessities.

C. *Changes May Also Be Needed to the PBGC's Priority Within the Bankruptcy Code*

As noted earlier, the PBGC usually becomes a general unsecured creditor when a terminated plan's sponsor enters bankruptcy.²¹² Therefore, the PBGC gets paid after secured creditors and some unsecured creditors.²¹³ General unsecured creditors receive only a pro-rata share of the debtor's remaining assets, which usually means receiving only cents on the dollar. Belt believes that the government should make it more difficult for plan sponsors to discard their pension obligations during bankruptcy proceedings. This would be ideal, but it is unclear whether the government is ready to implement this plan. Nevertheless, the growing problem of underfunded pensions has increased the assertiveness of the PBGC, which wants to maximize its recoveries and contain its losses in the Chapter 11 process.²¹⁴ The senior liens of a debtor's many secured lenders may now be primed if the PBGC has the ability to assert more powerful lien rights.²¹⁵ The PPA and the Financial Accounting Standards Board's (FASB) recent statement regarding the standards for accounting for pension plans magnify this risk to other secured lenders.²¹⁶

While the threat of losing some priority status may pose dangers for senior secured lenders, it may also *benefit* the overall funding of the tradi-

212. See Schroeder & Carey, *supra* note 113, at A8 (discussing PBGC becoming United's largest unsecured creditor).

213. For the full set of priority rules in bankruptcy, see 11 U.S.C. § 507 (2000).

214. See Terrien & Swett, *supra* note 45, at 22.

215. *Id.* Note, however, that 26 U.S.C. § 412 and 29 U.S.C. § 1368 are generally construed to "grant a grace period to secured lenders." *Id.* at 73. This grace period ends forty-five days after the PBGC's filing of its lien or after the date of "actual notice or knowledge" of the filing of this lien. Furthermore, "actual notice or knowledge" is ambiguous enough to potentially include information in financial statements. *Id.* Therefore, the PBGC may be able to argue that a lender had "actual notice or knowledge" long before the forty-five-day period would have begun. *Id.*

216. *Id.* at 22.

tional pension plan and thereby aid employees and retirees of companies with such plans. For instance, in order to ensure that they are repaid by their borrowers, lenders may formalize and enforce new monitoring procedures over their borrowers who maintain defined-benefit plans.²¹⁷ These monitoring procedures could be pushed forward by the federal government. For instance, plan sponsors are now finally forced to include overfunding and underfunding on their balance sheets.²¹⁸ This may not go far enough. Plan sponsors should be required “to timely provide schedules of required plan contributions and prompt proof that required contributions are made” as well as up-to-date information about the funding levels of their traditional pension plans.²¹⁹ If lenders see that a plan is being underfunded, they will be motivated to pressure the borrower to fund its plan because the PBGC may end up having greater lien priority over these lenders should the borrower enter bankruptcy.

D. The PPA’s Preference for Defined-Contribution Plans Will Eventually Force American Workers To Depend on No One But Themselves for Retirement Support

Defined-contribution pension plans, such as 401(k)s, do not promise anything to an employee.²²⁰ While these plans allow workers to defer taxes, employers are not required to contribute anything to their employees’ retirements.²²¹ “These disadvantages were, in the 1990s, somehow perceived (with the help of exuberant marketing pitches by mutual-fund firms) to be advantages: 401(k)s let workers manage their own assets; they were a roadmap to economic freedom.”²²² Significantly, traditional pension plans provide retirement benefits for as long as the retiree lives. In contrast, defined-contribution plans have set balances that could run out if the retiree lives too long: “The [traditional] pension plan can afford to support people who live to ninety, because some of its members will expire at sixty-six. It subsidizes its more robust members from the resources of those who die young.”²²³ Therefore, defined-contribution pension plans are not a true substitute for the traditional pension.²²⁴

217. *Id.*

218. *Id.* at 73.

219. *Id.*

220. Lowenstein, *supra* note 52, at 59.

221. *Id.*

222. *Id.*

223. *Id.* at 60.

224. *Id.*

The PPA encouraged 401(k)s and similar defined-contribution plans, but these 401(k)s depend on the individual to save and “Americans are rotten at saving.”²²⁵ The percentage of post-tax income saved by American workers has declined steadily for the past three decades; currently, one-third of American households have no financial assets.²²⁶ Unfortunately, the quick demise of the traditional pension system has led many older workers into very precarious situations. These older workers are in serious peril—their standard of living will probably not be the standard they envisioned for themselves when they entered the workforce more than thirty years ago.

Furthermore, the decrease in the popularity of traditional plans actually negatively affects the PBGC. While there are fewer defined-benefit plan sponsors to insure, there are also fewer sponsors paying premiums to the PBGC, which reduces the PBGC's assets. Therefore, those who phase out or completely terminate traditional plans and replace them with 401(k)s, which the PPA prefers, actually reduce the pool of sponsors paying PBGC premiums, which affects the overall fiscal viability of the PBGC.²²⁷

Finally, while the PPA attempts to save traditional pension plans, in reality, the private sector has already recognized that these plans will soon be extinct. Delphi's Executive Chairman, Robert S. Miller, stated that “[a] pension plan makes no sense in today's world. It's not wise for a company to make financial promises forty or fifty years down the road.”²²⁸ Therefore, it is imperative that young workers today realize that they must start saving for retirement because it is unlikely that their employer or the federal government will be there with a safety net to protect their retirement security.

CONCLUSION

The downfall of traditional pension plans will eventually affect all Americans. The effects might be seen on older workers who find out that their employers' pension promises are no longer being kept, or they might be seen on younger workers who no longer expect their retirements to be paid for by their employer. It will affect all taxpayers because they will eventually have to support a PBGC that cannot pay out on all the traditional

225. Jackie Calmes, *New Programs Spur Working Poor To Begin Saving*, WALL ST. J., Jan. 11, 2006, at A1.

226. *Id.* at A11.

227. *See supra* text accompanying notes 14–19 (discussing sources of PBGC's funding).

228. Lowenstein, *supra* note 52, at 90.

pension promises made to workers over the past fifty years. The PPA should be viewed as a stop-gap measure to temporarily fix a system that is badly broken, not a full-scale congressional solution to the myriad of problems inherent in the traditional pension system. In the coming years, more and more American workers will become retirees who have inadequate retirement benefits. Therefore, Congress must soon act to save those defined-benefit pension programs that are still active.