Protecting Retiree Benefits in Bankruptcy

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Executive Summary

Tens of millions of American retirees on fixed incomes rely on earned benefits from their former employers for retirement income, critical medical treatment, and essential benefits for their survivors. During their decades of work, retirees were promised these benefits as part of their "total compensation package." Workers and retirees plan their retirement security around the continuation of these benefits. Unfortunately, a growing number of retirees and older workers are finding that these benefits are the first things lost when their former employer files for bankruptcy. Even though pension, health care, disability and life insurance benefits are critical for basic health and well-being, bankruptcy courts too often treat them as expendable.

Since bankruptcy courts view their priority under Chapter 11 as facilitating the company's survival and emergence from bankruptcy, judges are inclined to agree to management's request to terminate or reduce the "legacy" costs of promised pension, health and welfare benefits. Unlike certain other creditors, retirees are not seen as necessary for the business going forward. And unlike suppliers, lenders, investors and even active employees – who can diversify their risk or recoup a portion of their losses out of future dealings with the restructured company – retirees typically suffer a permanent loss of those benefits. Living on a fixed income and long-promised retiree benefits, they have no alternative to relying on their three- or four-decade investment in their employers' fortunes.

In addition to the health, disability and survivor benefits that can be canceled outright, there is also a growing gap in the legal protections for retiree pension benefits when plans are terminated in bankruptcy. When an under-funded plan terminates, many retirees and other plan participants suffer a *permanent loss of income* despite the partial guarantees provided by the Pension Benefit Guaranty Corporation (PBGC). Workers and retirees learn only after plan termination that a number of PBGC policies can leave them with benefits that are permanently reduced by 30% or more.

For example, in 2010 Delphi retirees were shocked to discover they had lost all of their healthcare benefits and 30% or more of company pension benefits when a federal government Task Force overstepped. The Task Force, PBGC and the court threw defenseless retirees under the bus in striking a deal that protected the high risk/high reward assets of creditors and the resurrection of the company, but neglected entirely the interests of retirees in apparent disregard of the intent of ERISA.

A more recent example is Avaya, which filed for bankruptcy protection in January 2017. The company's original reorganization plan proposed to maintain both of the company's pension plans after emergence from bankruptcy. But the secured creditors ultimately convinced the court that the plan for salaried employees, which was only 58% funded, needed to be terminated and taken over by the PBGC. As a result, according to the PBGC, a substantial portion of the plan's 8,000 participants will lose vested benefits not guaranteed by the agency.

By adding Bankruptcy Code Section 1114, Congress recognized the need to protect critical health and welfare benefits in a bankruptcy process that would otherwise result in retirees bearing an unfair share of the cuts – and losing everything before others give up anything. Unfortunately, large bankruptcy cases in recent years have highlighted (or even created) tragic shortcomings or loopholes in those protections, demonstrating the urgent need for legislative reform. Because of current gaps in (and misinterpretations of) existing statutes, retirees often receive little or limited protection of their benefits.

Additional reforms are needed to level the playing field and protect the reliance of millions of retirees on vested benefits earned over a lifetime of work. In this white paper (and a companion fact sheet) the National Retiree Legislative Network (NRLN) recommends a number of specific legislative amendments that can restore Congressional intent and further extend protections for retirees:

- The statute should be amended to require prompt appointment of a Section 1114 committee to represent retirees in large bankruptcy cases within 60 days after the bankruptcy petition is filed and to ensure that at least the largest of the established retiree organizations representing a substantial number of the non-union-represented retirees is appointed to the Committee.

- Congress should further revise Section 1114 of the Bankruptcy Code to clarify that the protections of retiree health and welfare benefits do indeed extend to "any plan, fund, or program" providing those benefits (as Congress intended, but some courts have ignored), not only those benefits a debtor failed to reserve the right to modify outside bankruptcy.

- In addition, Congress should amend Section 1114 to give bankruptcy court judges the discretion to expand the power of a retiree committee to negotiate over claims for termination of non-qualified pension benefits in appropriate cases.

- Congress should provide that if a plan sponsor in bankruptcy is permitted to terminate its qualified pension plan, then the Department of Labor or the PBGC can make a *priority claim* on behalf of plan participants and beneficiaries to recover the vested but unfunded benefits that will *not* be guaranteed by the PBGC (after distribution of assets in the plan as of the termination date). This would add a category to the list of unsecured claims that receive priority payment pursuant to Bankruptcy Code Section 507(a)(4).

- Congress should generally require the continued minimum funding of defined benefit pension plans during a bankruptcy and explicitly provide that if those minimum contributions are not made, that claims by the pension trust or by the government on its behalf shall receive priority as an administrative expense under Bankruptcy Code Section 503(b).

- Parallel to the protections for small business creditors that Congress has already added in Bankruptcy Code Section 1102(a)(4), to ensure a representative creditors committee, Congress should give bankruptcy courts the flexibility to allow a retiree representative on the creditors committee, in addition to any PBGC representation, particularly where unions have specifically declined to represent their retirees in negotiating over benefits.

Proposed Legislative Amendments with specific statutory changes corresponding to these proposed reforms is available from the NRLN on request at contact@nrln.org.

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Table of Contents

Executive Summary	**Page 1**
Introduction	**Page 4**
The Impact of Bankruptcy on Retiree Benefits	**Page 5**
In Their Own Words: *Delphi Retirees*	**Page 6**
In Their Own Words: *GM Retirees*	**Page 7**
Review of Current Law: The Judicial Evisceration of Section 1114	**Page 8**
Bankruptcy Judges Speak: *Adlai S. Hardin*	**Page 9**
Specific Legislative Proposals Needed for Reform	**Page 10**
Bankruptcy Judges Speak: *Robert Drain*	**Page 12**
Conclusion	**Page 20**

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Introduction

Millions of American retirees on fixed incomes rely on earned benefits from their former employers for retirement income, critical medical treatment and essential benefits for their survivors. During their decades of work, retirees were promised these benefits as part of their "total compensation package" and have typically planned their retirement security on the continuation of these benefits. Unfortunately, a growing number of retirees are finding that these critical benefits are the first things lost when their former employer files for bankruptcy. Even though pension, health care, prescription drugs, disability and life insurance benefits are critical for basic health and well-being, bankruptcy courts too often treat them as expendable. Unlike the other creditor constituencies of suppliers, secured creditors and active employees, retirees are not seen as necessary for the business going forward.

The recent deep recession has dramatically increased the impact of these devastating cuts. Companies providing retiree medical care and other essential benefits to retirees are disproportionately concentrated in cyclical industries—steel, automotive, manufacturing, airlines—which are especially hard hit in a recession. These are the same U.S. industries that have downsized repeatedly in the last decade, forcing millions of their workers into premature early retirement, before age 65, when they are not yet eligible for Medicare.

When retirees lose critical benefits in a bankruptcy they don't ever get them back, even when the economy or the company's fortunes improve. The buyers of assets out of bankruptcy—the ultimate shareholders of successor companies such as "New Chrysler" and "New GM"—have little loyalty to the former workers of a predecessor company that just happened to have the same name. And unlike suppliers, lenders, and active employees, who can diversify their risk or make an adjustment as a company descends into bankruptcy – or who can recoup a portion of their losses out of future dealings with the restructured company – retirees typically suffer a permanent loss of those benefits.

In addition to the health, disability and survivor benefits that can be canceled outright, there is also a growing gap in the legal protections for retiree pension benefits when plans are terminated in bankruptcy. Over the past decade the number of employers terminating underfunded plans after seeking protection under Chapter 11 of the Bankruptcy Code has increased dramatically.

The most recent example is Avaya, which filed for bankruptcy protection in January 2017. The company's original reorganization plan proposed to maintain both its pension plans ongoing upon emergence from bankruptcy. But the secured creditors ultimately convinced the court that the plan for salaried employees, which was only 58% funded, needed to be terminated and taken over by the PBGC. As a result, according to the PBGC, a substantial portion of the plan's 8.000 participants will lose vested benefits not guaranteed by the agency.[1]

In 2008, financial journalist Fran Hawthorne published *Pension Dumping*, a book that chronicled how an increasing number of companies over the past decade have used bankruptcy – and the unsecured status of pension and other retiree benefit liabilities – to transfer tens of billions of dollars in legacy liabilities onto the books of the government's Pension Benefit Guaranty Corporation (PBGC), while simultaneously causing many of their retired and older workers to permanently lose billions in benefits not insured by the PBGC. She notes that pension defaults were uncommon prior to 2000. At that time,

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[1] *See* Pension Benefit Guaranty Corp., "Statement by PBGC on Avaya's Pension Plans and the Company's New Plan to Emerge from Bankruptcy" (Aug. 7, 2017), available at https://www.pbgc.gov/news/press/releases/pr17-05.

defined benefit pension plans were over-funded by 20% on average, with $1.2 trillion in assets to cover $1 trillion in benefit obligations.[2] But after 9/11 and the recession that followed, a parade of companies in the airline, steel, auto parts and textile industries fell into bankruptcy. She writes:

> And pension promises tumbled with them. . . . Companies were throwing their pension plans overboard as fast as they could bail – Bethlehem Steel, LTV, Kemper Insurance, US Airways, United Airlines, Kaiser Aluminum, Polaroid . . . When Steven A. Kendarian became [PBGC] executive director in December 2001, the agency had a surplus of $10 billion . . . by the time he left two years later, it had a [projected actuarial] deficit of about $11 billion, having taken on all those abandoned pension plans.[3]

Since bankruptcy courts view their priority under Chapter 11 as engineering a company's survival and emergence from bankruptcy, judges are inclined to agree to a company's request to terminate or reduce the "legacy" costs of promised pension, health and welfare benefits.[4] This white paper recommends a number of specific legislative amendments that can restore Congressional intent and further extend protections for retirees.

The Impact of Bankruptcy on Retiree Health Benefits

In 1988, the LTV Steel Company, on its very first day in bankruptcy, attempted to cancel the long-promised retiree health and life insurance benefits of its more than 70,000 retirees. In reaction, Congress passed the Retiree Benefits Protection Act of 1988.[5] The Act added Section 1114 to the Bankruptcy Code to create limited protections for "***any*** plan, fund or program" that provides retiree medical, health, prescription drug, disability, or death benefits (emphasis added). The law's Section 1114 added procedural safeguards to the Bankruptcy Code that are similar to those pertaining to collective bargaining agreements under section 1113.

Section 1114 requires the employer to engage in a bargaining process before seeking court approval for cancellation or modification of "retiree benefits," which are defined very broadly to describe virtually any medical, disability or death benefit offered to retired workers at the time of the bankruptcy filing.[6] The purpose was to give retirees a chance to negotiate a resolution – and to prevent management from acting unilaterally without a hearing and an informed decision by the bankruptcy court that the reduction in benefits is lawful, necessary and equitable under the circumstances.

Unfortunately, in part because judges have ignored the plain language and intent of the statute, the 1988 Act has not provided adequate protection for retirees who have suffered devastating financial losses in several recent bankruptcy cases. The fate of the Delphi retirees is an example. Tens of thousands of salaried retirees for Delphi Corporation started out working for General Motors (GM),

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[2] Fran Hawthorne, *Pension Dumping: The Reasons, The Wreckage, The Stakes for Wall Street*, Bloomberg Press (New York, 2008), at xvi.
[3] *Id*, at xvii.
[4] *See generally* Fran Hawthorne, *Pension Dumping*, *supra note* 2.
[5] *See In re Chateaugay Corp.*, 64 B. R. 990, 992 (S.D.N.Y. 1986); 133 Cong. Rec. H8558 (Daily ed. Oct. 13, 1987) ("the triggering event for [enacting § 1114] was [the] bankruptcy of LTV Steel[.]").
[6] 11 U.S.C. § 1114(a). Retiree benefits are defined as "payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, **for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise)** maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under this title." (Emphasis added.)

but were later spun off along with GM's auto parts division when it became a separate company. Immediately after its bankruptcy filing, Delphi successfully opposed the appointment of a Bankruptcy Code Section 1114 retiree committee on the grounds that the company had no plans to cut retiree medical benefits. Three and a half years later, on less than a month's notice, Delphi terminated all company-paid retiree health care and insurance benefits. The bankruptcy court ruled that Delphi did not have to comply with Section 1114 before terminating the benefits, although the court did appoint a retiree committee to settle the appeal of that ruling. A few months later Delphi terminated its pension plans as well.[7]

In their Own Words: Delphi Retirees Lose Health Benefits

Here is a sampling of retiree reactions to the Bankruptcy Court's ruling that Delphi did not need to comply with Section 1114 and could unilaterally terminate its long-promised health and survivorship benefits:

"I was one of the employees…in Flint, Michigan where our plant closed and some of us were basically forced to retire….I am now 60 years old…not old enough for…Medicare… My total [income] each month is a little over $1,800 [which] is less than Delphi's health insurance payment each month for my daughter and me (she is 22 years old and in college.) I am a diabetic…with no other means of getting my medication or having the routine 3-month check-up. I won't be able to receive diabetic supplies any longer. For me it really does mean getting health insurance or eating. Either way I will lose the battle of life. Michigan has the highest unemployment rate at this time so getting another job will be nearly impossible."
--Brenda T., Delphi (involuntary) retiree

"I am one of the 'desperate' retirees who will have no health coverage. I was forced into retirement at age 52 with the closure of the Kettering (Ohio) Operations. My wife, a nurse, works full time but her company does not offer health care benefits. We have both been pursuing employment opportunities, but the Dayton, OH market is stagnant. I have even interviewed in Minnesota, Georgia, Pennsylvania, as well as Ohio, but still no offers…. I sought quotes for personal coverage, but was denied because I have diabetes and high cholesterol. My plan is to drop health care but keep life insurance."
--Christopher L., Delphi (involuntary) retiree

"Jeanne and I are/were what is commonly described as a family living from paycheck to paycheck…. Then I became disabled (four heart attacks destroying one third of my heart, Adult Respiratory Distress Syndrome partially destroying one of the lobes in my lungs, and then came P.T.S.D.)…. We were scraping by when Jeanne was diagnosed with cancer (she has had 4 operations so far). We thought things were returning to normal, then Delphi threw us a curve. …. I had to cancel having my defibrillator/pacemaker checked and/or adjusted for the past year, nor have I seen my cardiologist for the same period. I have stopped taking two of my medications, and am taking the most critical one every other day…. This has literally placed Jeanne and I before a firing squad. The execution will take place on April 1st this year. That is when our medical care ends, or we stop eating or we move into a car (a GM Cobalt, no less.)
-- the MacKenzie family, Delphi retirees

[7] Shortly after the PBGC took over the Delphi plans, General Motors filed its own bankruptcy and announced that it was cutting its retirees' life insurance benefits to a maximum of $10,000 for its over 123,000 salaried retirees. The bankruptcy court allowed this reduction and refused to apply the statute to limit General Motors additional announcement that there would be a two thirds reduction of remaining retiree health care benefits.

In their Own Words: GM Retirees Lose Health and Life Insurance Benefits

Here are some GM retiree reactions to the company slashing retiree health care and life insurance benefits that had been promised and in place for decades:

"The combination of the cuts in health care and life insurance will force me to spend over half of my gross pension income on health insurance and life insurance. Or looking at it from a net pension income (after taxes) perspective, these two expenses will take at least 70% of my net pension. These are expenses that I did not plan for during my working years because GM always told us that they would cover these expenses. The other 30% of my net pension income will have to cover all my other expenses (food, shelter, transportation, etc.)."
– Terry M. (GM)

"I am a GM Salaried Retiree who worked for Buick for 41 years in management capacities… I also served 2 1/2 years in the US Navy starting in March 1944 and served as an officer on an LST in the Pacific…Reducing my total insurance …to $10,000, virtual burial insurance, is a devastating blow. Upon my death, my wife will also receive a reduced pension and will have a lower standard of living. At my age, purchasing insurance will be unaffordable. The insurance has been part of my estate financial planning for years. I also suffered a considerable loss in GM stock, much of it purchased through the stock savings plan but that was my risk. It does not seem that unrepresented employees and retirees should bear these large losses without reconsidering the impact and hardship that is being placed on GM family members."
--Raymond J. (GM)

"Due to the many job transfers I have accepted with GMAC during my tenure of 31 years, my wife has not been able to really secure a long-time career of any type and has solely relied on the benefits GM has provided to us - we really need affordable continued coverage. At a time in our lives where insurance coverage is needed the most - during retirement - it is not good to take this away from us at the late stages in life. Had we begun our career later in GM's lifespan where pension plans were not afforded and insurance premiums were higher we would have been prepared more for this - but during my tenure and time - we always counted on the pension plan of GM and put all we could into it while raising 6 kids - we can't lose it now - it would kill us both." –
Tim and Pam C. (GM)

"With the cost of food, utilities all going up you have to choose between eating, paying bills, or your meds." ***– Rita S. (GM)***

In other recent bankruptcies – from manufacturing (Kodak), to airlines (American), to telecommunications (Nortel Networks), to materials (Lyondell Chemicals), to retail (Circuit City), to financial firms and to practically every other kind of business – millions of retirees either have or likely will lose all or most of their earned benefits.

Review of Current Law: The Judicial Evisceration of Section 1114

The language of the Section 1114 is straightforward. Section 1114 provides generally that a Chapter 11 debtor "shall timely pay and shall not modify any retiree benefits" unless it first complies with the procedures required under the 1988 Act and the court approves a modification.[8] The "retiree benefits" protected under Section 1114 clearly include all health and welfare benefits provided under "any plan, fund, or program (through the purchase of insurance or otherwise) . . .."

The statute defines "retiree benefits" as:

> payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents, **for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise)** maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under this title.[9]

The definition of "retiree benefits" therefore includes retiree health and life insurance premiums. Section 1114 doesn't prohibit termination or modification of retiree health, life insurance, disability or other welfare benefits during bankruptcy, but it does require a process and some limited fact finding before a court can conclude that the circumstances justify the cuts proposed by the company. Section 1114 is modeled on the heightened standards for revoking a collective bargaining agreement under Bankruptcy Code Section 1113 and requires nearly identical procedures.

Section 1114(f) requires the debtor to make a proposal for change to the retiree representatives, along with relevant information to evaluate the proposal. Before "any" retiree plan benefits are terminated or modified, the bankruptcy debtor must negotiate with an "authorized representative" of the affected retirees—either a union or a committee of retirees appointed by the court. If the proposal is rejected by the retiree representatives, Section 1114(k) requires the court to hold a prompt hearing on the proposal and sets forth certain standards by which the court must assess the proposed modification. The debtor may ultimately be permitted to reduce or cancel the benefits, but only if the court is persuaded that the modification "is necessary to permit the reorganization of the debtor and assures that all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and is clearly favored by the balance of the equities."[10]

Congress also extended the protection of any surviving retiree benefits beyond confirmation of the debtor's Chapter 11 reorganization plan.[11] Congress extended these protections further in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. To close a potential loophole, the

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[8] 11 U.S.C. § 1114(e)(1). Section 1114 provides administrative expense priority for unpaid retiree benefits, regardless of when they are earned, until such time as the court approves a modification.
[9] 11 U.S.C. § 1114(a) (emphasis added).
[10] Section 1114 only protects benefits for the duration of the bankruptcy, not after confirmation of a bankruptcy plan, unless the debtor agrees to protect the benefits for a time after confirmation, as provided in §1129(a)(13).
[11] Section 1129(a)(13) of the Bankruptcy Code provides that "[t]he court shall confirm a plan only if … (13) [t]he plan provides for the continuation after its effective date of payment of all retiree benefits…at the level established pursuant to [sections 1114(e)(1)(B) or 1114(g)], at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits."

In His Own Words: Bankruptcy Court Judge Adlai S. Hardin

‘When Retiree Section 1114 Committees are Authorized, the Process Works’

Hon. Adlai S. Hardin, Bankruptcy Judge for the Southern District of New York, approving the agreements struck separately by Delta Air Lines with the separate retiree committee representing its retired pilots, involving over half a dozen different groups with separate benefits and the retiree committee representing its retired non-pilots (both union and non-union) including those with retirement packages under several different early retirement programs, some contractual and some amendable. The negotiated changes saved Delta many tens of millions of dollars a year, but preserved some subsidies for essential retiree benefits:

I have seen so clearly in this Delta case how important and how wise Congress was in the provisions written into Sections 1113 and 1114. . . . One of the protections built in, which I'm sure that every judge that's ever had to administer this kind of issue is deeply grateful for, is the provision requiring the appointment of committees that have to be paid for by the debtor, out of the debtor's estate, to represent constituencies of debtor employees who have differing interests, and everything that we've heard today underscores the importance of the 1114 committee. I had no idea what a good thing I was doing in granting the motion for an 1114 committee. I thought it was right at the time, but I didn't have the slightest idea how important that decision was.

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So, we have here a situation where two committees, for different segments of retired employees, have been appointed... And there were conflicting interests amongst the various constituents .... What Congress did was [to] authorize [the court] to appoint a committee with the fiduciary responsibility of the individuals on that committee and the professionals, to look out for all of the different constituencies within their particular groups.

* * *

I am confident, based upon what I have seen and heard, that they have done so in as fair and equitable manner as would be possible, and it is always preferable for parties to reach an agreement which they, in their own respective adversarial and competing interests, have concluded is best for their respective clients. It's better to have it done that way than to litigate and have a Court have to master all of the issues and basically force a result.

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I hope self-evident by now, the only way to resolve these complex social issues involving many, many people, with disparate interests, is, as Congress has done, to require to appointment of committees to represent a reasonably allied or similarly situated personnel, and have the committee be charged with the professional responsibility of representing the interest, as best they can see them, of all of those people. That was done here. The process has worked.

Transcript of Hearing, In re Delta Air Lines, case No. 17923, U.S. Bankruptcy Court S.D.N.Y., 10:30 a.m. October 19, 2006, 2:30 p.m. pages 73-79.

2005 Act added Bankruptcy Code Section 1114(l), which also gives the bankruptcy court the right to reinstate benefits that were modified or terminated within the 180 days before a bankruptcy filing, if the debtor was insolvent at the time of the benefit modification. That prevents a debtor from making cuts on the eve of a bankruptcy filing to avoid the protections of Bankruptcy Code Section 1114, which until then only protected retirees against benefit cuts made during the bankruptcy case.

Congress provided further relief in 2009 as part of the American Recovery and Reinvestment Act, which broadened the definition of "qualifying coverage" for the Health Coverage Tax Credit (HCTC) to include benefits sponsored by a Voluntary Employee Benefit Association (VEBA) set up either by a Section 1114 retiree committee or by order of a bankruptcy judge in a bankruptcy case. The HCTC is a federal tax credit that pays 72.5% of the health insurance premium costs of eligible retirees age 55 through 64 whose pensions have been taken over by the Pension Benefit Guaranty Corporation.[12]

Specific Legislative Proposals Needed for Reform

The combination of the Retiree Benefits Protection Act of 1988, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, and the American Recovery and Reinvestment Act of 2009 should have provided protection for retirees, but important loopholes have created dangerous gaps in the protections that Congress sought to provide. Several urgent changes are needed to protect these crucial benefits and fine-tune the existing statutory protections:

1. **Bankruptcy Code Section 1114 should be revised to provide prompt appointment of retiree committees within 60 days after the bankruptcy petition is filed and to ensure that at least the largest of the established retiree organizations representing a substantial number of the non-union-represented retirees is appointed to the Committee.**

Bankruptcy debtors and trustees routinely delay the appointment of a Section 1114 committee to represent retirees until it's too late to have a meaningful dialogue over benefit changes, or to conduct a fact-finding for the required judicial hearing, and then use the short time available as an additional justification to avoid appointment of a committee to represent retirees. Congress should add language to Bankruptcy Code Section 1114 that ensures the court makes a decision about the need to appoint retiree representatives early in the proceeding. Section 1114 should also clarify a preference for retiree representation by established retiree organizations familiar with the company and benefit programs.

First, NRLN recommends that if the debtor provides retiree benefits to 2,000 or more plan participants and beneficiaries, Congress should require that the court authorize a Section 1114 retiree committee under Section 1114(d) during the first 60 days after the bankruptcy filing. The only exceptions should be if the debtor agrees to continue current retiree benefits through the duration of the bankruptcy, or otherwise establishes extraordinary cause for not doing so (for example, if thee bankruptcy court finds that a liquidation or Chapter 11 confirmation is highly likely within 60 days).

In addition, Congress should seek to ensure that Section 1114 committees are truly representative of salaried and other non-union-represented retirees when their benefits are at risk. At the urging of management, too many bankruptcy trustees and judges treat the Section 1114 process as a bothersome administrative duty – and select representatives from a list supplied by management and/or the unions

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[12] The HCTC was extended and increased to a 72.5% credit when Congress enacted the Trade Adjustment Assistance Extension Act in October 2011. It can be claimed for qualified coverage through 2019. Background and updates on the HCTC are available from the IRS at https://www.irs.gov/credits-deductions/individuals/hctc.

(when they elect to represent their retired members at all, which is optional). Although management cannot hope to exclude unions, they often maneuver to exclude legitimate representatives of the non-union retirees, who are often a very substantial share of retired plan participants with benefits at stake.

A fair reading of Section 1114 of the Bankruptcy Code suggests that Congress intended for both union and non-union retirees to be fairly represented on the Committee. Section 1114(d) states:

> **(d)** The court, upon a motion by any party in interest, and after notice and a hearing, **shall order the appointment of a committee of retired employees** if the debtor seeks to modify or not pay the retiree benefits . . . **to serve as the authorized representative, under this section, of those persons receiving any retiree benefits not covered by a collective bargaining agreement**. The United States trustee shall appoint any such committee.[13]

Despite this very clear Congressional intent to include "retired employees" as representatives of retirees "*not* covered by a collective bargaining agreement" as members of the Section 1114 Committee, some courts appoint at best a proxy representative while excluding authorized representatives of established retiree associations that represent thousands of plan participants and beneficiaries.

An example is the 2012 Chapter 11 proceeding involving American Airlines. In that case, although two associations of American Airlines retirees sought appointment to the Section 1114 Committee, the bankruptcy trustee followed the recommendation of management and excluded both organizations. Although a committee of seven representatives would have been typical considering the enormous size and diversity of the airline's retiree population, the court approved the appointment of four union representatives and one corporate lawyer with no connection to American Airlines retirees to represent all other "persons receiving retiree benefits not covered by a collective bargaining agreement." One of the two retiree associations, the American Airlines Retirees Committee, is a well-established association of dues-paying American Airlines retirees and an affiliate of the National Retirees Legislative Network. It was actively educating and communicating with all of the company's retirees. AMRRC's president, Paul Mazzara, clearly had the background and credibility to represent salaried and rank-and-file management retirees not represented by the four unions.

It would therefore be consistent with the purpose of Section 1114 for Congress to **revise Section 1114(d) to require that the court must appoint at least one representative of retirees in non-collectively bargained benefit plans including, if practical, the largest retiree organization that can credibly represents the interests of a substantial share of the non-union-represented retirees.** Including retiree organizations on the Section 1114 Committee can also ensure there is representation for retired union members concerning modification of their collectively-bargained benefits when their union elects not to represent them on those issues (see recommendation five just below).

[13] 11 U.S.C. § 1114(d), emphasis added.

In His Own Words: Bankruptcy Court Judge Robert Drain

Hon. Robert Drain, U.S. Bankruptcy Court, S.D.N.Y., made the following remarks in court during the Delphi Corporation bankruptcy case, where he appointed a Section 1114 committee only after approving termination of all salaried retiree health and welfare benefits. He later authorized the committee to negotiate a settlement of the appeal of his order. Within weeks, the retiree committee resolved and settled the appeal and obtained $8.5 million in seed money to set up a hardship program and a Voluntary Employee Benefit Association (VEBA), which has since rolled out a benefit to all the retirees ages 55-65 that is eligible for an 80% federal Health Coverage Tax Credit subsidy, giving the otherwise devastated retirees potentially hundreds of millions of dollars in critical medical subsidies:

The settlement is clearly reasonable from the debtors' perspective in that it brings finality to this issue to the debtors. Normally, that's the only consideration that I would make under the Second Circuit case law. But given the concern Congress expressed for retirees over their benefits, I also want to note that I believe that the settlement reflects the very sophisticated participation by the retirees' committee and its counsel. And so, while normally I would never do this in connection with the settlement, again, since it's not my function to approve the fairness of the settlement to the other side, it appears to me, under all the circumstances, to be fair to both sides in light of all the issues and the debtors' condition and the issues raised by the retirees.

Transcript of Hearing, In re Delphi Corp., case No. 17923, U.S. Bankruptcy Court S.D.N.Y., 11:00 a.m. April 2, 2009.

Section 1114 also should be amended to require that within 30 days after any proposal is made to modify or reduce retiree benefits, the debtor should be required provide the names, last known addresses and contact information for all retirees to any retiree committee appointed under Section 1114, or—if no such committee is yet appointed—to the organization(s) representative of retirees seeking to represent their interests in the bankruptcy case. It is critical that the representatives of retirees potentially impacted by reductions in health and welfare benefits be informed and consulted throughout the course of the proceeding.

Finally, the bankruptcy process should do more to inform and assist retirees in securing their rights. If a class of retirees will be required to file claims, or respond to claim objections, bankruptcy courts should have the explicit authority (if not an obligation) to appoint an ombudsman that can assist them in navigating the process. For example, during Kodak's Chapter 11 proceeding in 2012, in addition to losing all retiree health benefits, as well as a joint and survivor benefit, many retirees lost non-qualified, unfunded pension benefits. These retirees were required to file a claim. The claims process was conducted twice, because the original claim form did not list the dollar amount of the claim Kodak had calculated. The form also included legal language that many/most didn't understand. This caused 450 of the 1192 claimants at Kodak to file invalid claims. If there had been an ombudsman appointed to assist retirees and to coordinate with the Eastman Kodak Retirees Association (EKRA), the process would have been considerably more smooth, expedited and fair.

2. **Bankruptcy Code Section 1114 should be clarified to protect *all* the retiree health and welfare plan benefits (medical, dental, life insurance, disability and survivorship benefits) during the bankruptcy case, not only those the company did not reserve the right to amend.**

The problem for Congress now is that a number of court decisions have effectively rewritten Section 1114 so that it applies only to health and welfare benefits that a Bankruptcy Court judge finds are contractually guaranteed and not subject to the company's discretion, pre-bankruptcy, to reduce or cancel under a "reservation of rights" clause or for other good reason. As noted above, Congress intended Bankruptcy Code Section 1114(a) to apply to the modification of "*any* plan, fund, or program" that provides the retiree medical, disability, life insurance or other welfare benefits.

In addition, the statute expressly applies, through Bankruptcy Code Section 1114(*l*), to programs the debtor modified under ERISA or any other non-bankruptcy law during the 180 days prior to the bankruptcy filing (pre-petition). Unfortunately, many bankruptcy courts have rejected the plain meaning and intent of the statute, and have refused to grant retirees the procedural protections of Section 1114 in cases where the employer included boilerplate language in plan documents that reserve rights to amend, modify, or terminate retiree benefits under applicable non-bankruptcy law (as almost all employers have now done with "reservation of rights" clauses).

In a series of high profile cases, including the Delphi and General Motors bankruptcies, bankruptcy courts have ruled that the statute does not apply to any retiree benefit program that the debtor reserved a right to modify outside of bankruptcy. This strained interpretation is now being applied in the "majority" of published decisions on the issue, as the Delphi court concluded. Even though bankruptcy courts are authorized to determine that modifying a retiree benefit is necessary as part of a reorganization plan, retirees are being denied the basic due process required under Section 1114.

The most straightforward approach would be to create a legal presumption that promised retiree health care benefits vest at retirement and cannot be reduced after an employee retires. This is exactly what Sens. Elizabeth Warren and Jay Rockefeller proposed in their Bankruptcy Fairness and Employee Benefits Protection Act of 2014, as well as a requirement that companies emerging from bankruptcy must continue to pay for retiree health care benefits for a minimum of two years following the company's restructuring.[14]

Legislative clarification that Section 1114 applies to *all* retiree health and welfare plan benefits is crucial because judicial misinterpretation of the current statute effectively eviscerates Section 1114 and leads to absurd results. First, although Congress modeled Section 1114 to mirror the protections of Section 1113, which protects all health and welfare benefits covered under a collective bargaining agreement, a judicial carve out for all benefits that the employer arguably could have modified pre-petition recreates the same disparity of treatment between former union members and other retirees that Congress sought to remedy. Second, this judicial interpretation means that in most cases where a benefit modified by the debtor during the 180 days before bankruptcy must be reinstated under Section

[14] Bankruptcy Fairness and Employee Benefits Protection Act of 2014, S.2418, 113th Congress (June 3, 2014), available https://www.congress.gov/bill/113th-congress/senate-bill/2418/text?r=28&s=1; Sen. Elizabeth Warren, "Rockefeller, Warren Introduce Legislation to Protect Employees and Retirees from Unfair Benefit Cuts," Press Release (June 3, 2014), available at https://tinyurl.com/2dyxsxma.

1114(*l*), it could then be immediately eliminated by the debtor during bankruptcy if the court agrees that a debtor's right to amend benefits outside bankruptcy preempts Section 1114.

A clarification that Section 1114 applies to "any plan, fund, or program" would not create permanent vesting of retiree benefits either during or after bankruptcy – but it would guarantee retirees the representation and procedural protections that Congress intended. Under current Bankruptcy Code Section 1129(a)(13), a debtor is not required to maintain benefits protected by Section 1114 after confirmation of a bankruptcy plan, unless the debtor has committed to maintain those benefits for a specific amount of time. What this proposal does do is ensure short term and limited protections for these critical benefits during the bankruptcy case, imposing a process so that retirees have a voice in the bankruptcy that will drastically affect their benefits, with a chance to negotiate for slightly less devastating changes—as Congress intended in 1988 and again in passing 2005 amendments.

Without this clarification, other provisions of the Bankruptcy Code and the dynamics of the Chapter 11 process will force even debtors who don't want to cut retiree benefits to do so. Secured creditors have special rights to approve or oppose how cash is spent in a bankruptcy case (it is their "cash collateral" under Bankruptcy Code Section 363(c)), and if amendable retiree benefits can be cut without having to go through a process or meet a standard, these lenders will insist that those benefits be eliminated as a condition to the debtor's authorization to use cash for other operating expenses. As Congress recognized in passing the Retiree Benefits Protection Act of 1988 originally, retirees are otherwise vulnerable to losing everything before any other group has to lose anything: Having already made their contribution to the company, sometimes decades ago, "there is nothing that retirees have that the company needs."[15] As a result, their benefits are seen as the first cost that can be cut without endangering the debtor's ongoing business.

3. **Congress should provide that if a plan sponsor in bankruptcy is permitted to terminate its qualified pension plan, then the Pension Benefit Guaranty Corporation can make a priority claim on behalf of plan participants and beneficiaries to recover the vested but unfunded benefits that will *not* be guaranteed by the PBGC (after allocation of assets in the plan as of the termination date). This would add a category to the list of unsecured claims that receive priority payment pursuant to Bankruptcy Code Section 507(a)(4)**.

For retirees and older workers, the costs imposed by a distress termination can be severe. When an under-funded plan terminates, many retirees and other plan participants suffer a *permanent loss of income* despite the partial guarantees provided by the PBGC. The permanent loss of vested but *non-guaranteed* pension benefits, due to various PBGC limitations, can be devastating to the individuals affected, as the NRLN documents in a companion white paper entitled *Pension Guarantees that Work for Retirees.*[16] Workers and retirees learn only after plan termination that a number of PBGC policies can leave them with benefits that are permanently reduced by 30% or more. The share of vested benefits permanently lost has tripled in recent years to 28% on average per participant, among those with non-guaranteed benefits, according to PBGC data.[17]

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[15] *Retiree Benefits Security Act of 1987: Hearings on S.548 Before the Subcommittee on Courts and Administrative Practice of the Senate Comm. on the Judiciary*, 100th Cong., 1st Sess. 16 (statement of Senator Heinz).

[16] National Retirees Legislative Network, "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms," White Paper Series (*updated* September 2017).

[17] "PBGC's Guarantee Limits: An Update," Pension Benefit Guarantee Corporation, September 2008, available at http://www.pbgc.gov/docs/guaranteelimits.pdf. The PBGC has not publicly released updated data to our knowledge.

The permanent loss of non-guaranteed benefits occurs most commonly among younger and more highly-paid retirees and older workers. For example, a 2009 study by the Government Accountability Office (GAO) identified five plan terminations that *each* resulted in more than $500 million in permanently lost benefits due to PBGC coverage limitations.[18] The largest losses occurred among the pilots and certain other airline employees at United, Delta Air Lines and U.S. Airways. At Delta, plan participants lost $2.96 billion in unfunded benefits (34.7% of their total vested but non-guaranteed benefits). At U.S. Airways, plan participants lost $9 billion of their vested but non-guaranteed benefits (20% of their total non-guaranteed benefits).

Much of this is due to pension under-funding, since typically the assets of a plan terminated in bankruptcy is not sufficient to pay all or most of the vested benefits greater than the PBGC's maximum guarantee limit (which varies by age). However, additional benefits can be lost due to the retroactive 5-year phase-in of guarantees on benefit increases and the arbitrary 3-year lookback limit on individuals who have been retired (or eligible to retire) less than 3 years.[19]

Although these non-guaranteed benefits should have been "secured" by a fully-funded pension trust, when a bankrupt firm terminates its pension plan, a growing share of retirees and older workers can end up with claims that are both unsecured and uninsured by PBGC. Only the PBGC is authorized to recover unfunded pension benefit claims from a bankrupt company.[20] **Courts have decided that only the PBGC has standing to recover unfunded pension liabilities in bankruptcy even with respect to vested pension benefits that are not guaranteed by the PBGC**, such as amounts exceeding the PBGC's annual guarantee limit and benefit increases during the 5 years preceding plan termination.[21] However, the PBGC lien against the company's remaining assets cannot arise until *after* plan termination; as a result, plan termination after a Chapter 11 bankruptcy filing prevents the perfection of the PBGC's lien.[22]

Financial journalist Fran Hawthorne described this double-bind in her book *Pension Dumping*: "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 created under ERISA."[23] If there ultimately is any recovery by the PBGC, the proceeds are split between the agency and participants (to reduce their permanent losses) under a statutory formula.[24] The PBGC becomes just another unsecured creditor, typically one of the very largest; and negotiates with the debtor and the creditors' committee to recover as large a share of the remaining non-pension assets as possible.

PBGC has in the past argued to bankruptcy courts – with merit but without success – that its claims for pension underfunding should be treated like other federal tax claims under Bankruptcy Code Section 507(a)(8) and have priority over other unsecured claims. In addition to the lack of clear statutory

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[18] General Accountability Office, "Pension Benefit Guarantee Corporation: More Strategic Approach Needed for Processing Complex Plans Prone to Delays and Overpayments," August 2009, Appendix VI, at p. 69.

[19] The impact of these PBGC insurance limitations are described in detail, along with proposals for reform, in the NRLN white paper "Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms" (*updated* January, 2013).

[20] *See* ERISA §4062(b), 29 U.S.C. §1362(b) and ERISA §4022(c)(2), 29 U.S.C. §1301(a)(18).

[21] *See, e.g., United Steelworkers of America v. United Engineering Inc.,* 52 F.3d 1386, 1394 (6th Circuit, 1995), holding that a union could not directly sue the employer to recover benefits not guaranteed by the PBGC.

[22] *Id.*, at p. 1606-1610. Once the debtor is in bankruptcy, the PBGC will file contingent claims for underfunding and for contributions and premiums, and as a result, may play an important role on the creditors' committee.

[23] Fran Hawthorne, *Pension Dumping: The Reasons, the Wreckage, the Stakes for Wall Street*, Bloomberg Press (New York, 2008).

[24] *See* ERISA §4022(c)(2), 29 U.S.C. §1301(a)(18).

support for this argument, Bankruptcy Courts have been predisposed against giving priority to claims for pension underfunding since historically the court's priority under Chapter 11 is engineering a solution that allows the company to emerge from bankruptcy and continue operating. From the court's perspective, retirees and other plan participants have "insurance" for the benefits lost due to plan termination. And even if a particular plan termination adds to the PBGC's projected long-term deficit, the agency has the resources (from recovered assets, investment income and premiums) to make good on most of the unfunded benefits.

The problem, as noted above, is that **many individual retirees and older workers permanently lose vested benefits that are not guaranteed by the PBGC**. Unlike most unsecured claims in bankruptcy, these benefits should have been "secured" by assets deposited in the company's legally-separate pension trust. Although the NRLN agrees that Congress should give *all* unfunded pension liabilities priority status in bankruptcy, at a minimum Congress should amend the Bankruptcy Code to allow the PBGC to make a priority claim on behalf of plan participants and beneficiaries to recover the **vested but unfunded benefits that will *not* be guaranteed by the PBGC** (that is, the vested pension benefits that will not be funded by the allocation of assets in the pension plan as of the termination date). **The non-guaranteed pension benefits of retirees and other plan participants should be added explicitly to the list of unsecured claims that receive priority payment pursuant to Bankruptcy Code Section 507(a)(4).**

In 2020, senior Democrats acknowledged this problem in the Protecting Employees and Retirees in Business Bankruptcies Act of 2020, which was reported out of the House Judiciary Committee in September 2020.[25] Section 204 of that bill, introduced by current Chairman Jerrold Nadler, proposed to amend Section 502 of Bankruptcy Code to "allow a claim by an active or retired participant . . . for any shortfall in pension benefits accrued . . . as a result of the termination of the plan and limitations upon the payment of benefits imposed pursuant to section 4022" of ERISA, which puts limits on vested benefits guaranteed by PBGC. The NRLN believes this does not go far enough, since vested but unpaid pension benefits not insured by the PBGC should be a *priority claim* under Section 507(a)(4).

4. **Congress should amend the Bankruptcy Code to require payment of minimum funding contributions and vested pension benefits during Chapter 11 bankruptcy cases and give administrative priority status (under §503) to any claim by the pension plan trustee, or by the government, that arise due to the debtor's failure to timely pay the minimum funding contributions or retiree benefits that accrue prior to court approval of plan termination.**

Qualified defined-benefit pension plans often become increasingly underfunded as bankruptcy cases drag on and the employers use the protection of bankruptcy law to stop making otherwise required minimum contributions during the case. Moreover, leading up to bankruptcy an increasing number of troubled firms further diminish plan assets by using them to make large lump-sum severance payments to certain groups of workers as they downsize, as the NRLN documents in a separate white paper entitled *Back Door Reversions*.[26] The combined result is a heightened risk that pension plan sponsors

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[25] Protecting Employees and Retirees in Business Bankruptcies Act of 2020, H.R. 7370, 116th Cong. § 204 (2020). An equivalent companion bill was introduced by Senator Dick Durbin (S. 4089) on June 25, 2020 (full text here).

[26] National Retirees Legislative Network, "Back Door Reversions: Limiting the Use of Pension Assets for Severance and Encouraging Plan Contributions Will Strengthen Defined Benefit Retirement Security," White Paper Series, *updated* January 2017. For example, during 2008 General Motors, as it teetered on the verge of bankruptcy, used $2.9 billion in pension assets to make lump sum severance payments – and ended the year with a projected $12.4 billion deficit in its pension plans ($20 billion by PBGC calculations). Tim Higgins, "Questions Arise from GM's Use of Pension for Buyouts, VEBA Trust," *Detroit Free Press*, March 1, 2009.

or the PBGC will seek termination of pension plans and that retirees will suffer greater losses of pension benefits.

Congress should require the continued minimum funding of defined benefit pension plans during the bankruptcy and explicitly provide that if those minimum contributions are not made, that claims by the pension trust or by the government on its behalf shall receive priority as an administrative expense under Bankruptcy Code Section 503(b)(1).[27]

Accordingly, the NRLN strongly supports the proposal in Section 103 of the Protecting Employees and Retirees in Business Bankruptcies Act of 2020, introduced by the current chairmen of the House and Senate Judiciary Committees.[28] The bill would amend Section 503(b) to require that unpaid contributions due under an employee benefit plan are prioritized for payment to the plan as an administrative expense. Sen. Elizabeth Warren similarly included this protection in her Bankruptcy Fairness and Employee Benefits Protection Act of 2014, requiring companies to continue making payments to pension plans while bankruptcy proceedings are ongoing.[29]

In addition, the NRLN similarly supports the provision in Sen. Joe Manchin's Prioritizing Our Workers Act of 2019 (S. 1486) that would add vested but unfunded benefits to the list of allowed administrative expenses that must be paid under Section 503(b), adding it as Section 503(b)(10).[30] As Sen. Manchin stated when introducing the bill: "I firmly believe that no one should be denied their pension because their employer goes bankrupt. . . . Companies offering pension plans made promises to their workers and need to live up to those promises, no matter what else happens to that company financially."[31]

5. **<u>The Bankruptcy Code should be revised to provide, similar to the provision facilitating representation for small business creditors, that a retiree representative may be included as a member of the unsecured creditors committee.</u>**

In bankruptcy cases, retirees often lose as much or more than other unsecured creditors. In fact, the aggregate value of benefits owed to them is often the debtor's largest liability. Yet retirees rarely are provided *any* representation on unsecured creditors' committees that play a key role throughout the proceeding. The lack of representation of retirees is a result of the initial selection of creditors from among those with the largest *individual* claims. Although retirees, as a group, often have the largest *aggregate* claim in the bankruptcy, it is divided among thousands of individual retirees, none of whom is individually one of the company's largest creditors. And although the PBGC is typically appointed to the creditors' committee with respect to the company's qualified pension plan liabilities, retirees almost always have additional and very substantial claims for earned benefits that are *not* represented by the PBGC.

Recognizing that a similar problem led to the systematic exclusion of small business creditors from creditors committees (particularly since small vendors can be devastated by a large customer

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[27] *See* 11 U.S.C. §§ 503(b)(1), 507(a)(1).

[28] Protecting Employees and Retirees in Business Bankruptcies Act of 2020, H.R. 7370, 116th Cong. § 103 (2020). An equivalent companion bill was introduced by Senator Dick Durbin (S. 4089) on June 25, 2020 (full text here).

[29] Bankruptcy Fairness and Employee Benefits Protection Act of 2014, S. 2418, 113th Congress (June 3, 2014), available https://www.congress.gov/bill/113th-congress/senate-bill/2418/text?r=28&s=1.

[30] Prioritizing Our Workers Act of 2019, S. 1486, 116th Congress (May 15, 2019), available https://tinyurl.com/wsh5xtta.

[31] Office of Sen. Joe Manchin, "Manchin Introduces Bill to Change Bankruptcy Code to Protect Workers' Pensions," Press Release (May 15, 2019), available at https://umwa.org/video/Prioritizing+Our+Workers+Act.

bankruptcy), Congress added Bankruptcy Code Section 1102(a)(4), which provides a means for adding a small business creditor to the creditors' committee in cases where small businesses as a group (but not individually) represent a large portion of the debt.

The need for the protection of retirees is even more compelling. Most creditors – even small businesses and local banks – commonly spread their financial risk among many different business customers (or in the case of bondholders, they hold a portfolio of risk-based bonds that are often acquired at a deep discount). In contrast, retirees commonly have their retirement security eggs in one basket: as workers they spend decades, and sometimes their entire careers, at a single company. The loss of retiree benefits normally has a disproportionate impact on retirees when compared to the losses of other creditors. Consistent with the provision that small businesses receive special consideration for appointment to the unsecured creditors committee under Section 1102(a)(4), the appointment of a retiree representative to the unsecured creditors committee would ensure more equitable representation of the interests of retirees.

The NRLN proposes that Congress add a subclause at the end of Section 1102(a)(4), that effectively provides: "The court may also order the U.S. Trustee to increase the number of members of a committee to include a creditor that is a retiree, or an authorized representative of retirees, if the court determines that such persons hold claims (including health and welfare and pension benefits not guaranteed by the Pension Benefit Guaranty Corporation) the aggregate amount of which are comparable to or greater in value than the claims of other creditors that are members of the committee."

6. **Bankruptcy Code Section 1114 should be revised to provide flexibility for including the determination of claims for loss of retiree's non-qualified pension benefits.**

Section 1114 of the Bankruptcy Code applies only to retiree medical, disability, survivorship and other health and welfare benefits. *Pension* benefits currently do not fall under the protections of Section 1114. But while the PBGC is authorized to represent retirees with respect to *qualified* pension plan benefits that are insured by the agency, often obtaining a seat on the creditors' committee, recent bankruptcy cases have highlighted the need for the protection of certain *non-qualified* pension benefits that have been earned by non-executive workers and managers.

When a debtor proposes the distress termination of a *qualified* defined benefit plan, the PBGC is involved in negotiations and arguments before the court if it opposes termination. Similarly, where a pension plan is subject to a collective bargaining agreement, the union also may participate in negotiations relating to the proposed termination. Left unrepresented, however, are many non-executive workers and retirees who have accrued non-qualified pension benefits that are not pursuant to a collective bargaining agreement. No one is authorized to represent the interests of retirees or workers with respect to non-qualified pension benefits – not the PBGC, not any union, and not the Section 1114 retiree committee, which is limited to dealing with non-pension benefits.

This gap in the Bankruptcy Code's procedural protections for retiree benefits can result in serious abuses, particularly in relation to allowing and determining individual claims for the loss of non-qualified pension benefits. The calculation of the net present value of future pension payments is complex and can vary significantly depending upon actuarial assumptions relating to longevity and discount rates. A Section 1114 retiree committee is the logical body to negotiate and recommend the most appropriate determination of those claims.

Congress can remedy this gap in the protections provided by Section 1114 by adding "**non-qualified pension plan payments or accruals not insured by the Pension Benefit Guaranty Corporation**" to the list of retiree benefits specified in Section 1114(a). Alternatively, language could be added at the end of Section 1114(d) providing that if the court determines it is appropriate, the court may authorize a committee appointed under this section, or Section 1114(c)(2) above, to represent the interests of retirees with respect to non-qualified pension plan, or any other benefits other than a qualified pension plan (where payments are guaranteed by the Pension Benefit Guaranty Corporation), including with respect to the determination of any claims of retirees arising from modifications to those benefits.

Adding non-qualified pension benefits to the scope of the Section 1114 committee would not lessen the court's authority to approve the termination or reduction of non-qualified pension plan benefits, but it would give bankruptcy courts additional flexibility in providing representation for retirees on critical issues, as well as a more accountable and efficient way of resolving group claims for loss of non-qualified pension benefits.

Congress might appropriately be concerned about whether such a provision would be misused to protect the special benefits granted to a few top executives. That is not the case, however, because Bankruptcy Code Section 1114(m) already includes an income limitation, providing that the provisions of Section 1114 do not apply to retirees who earned over $250,000 in the twelve months before the bankruptcy filing (except in unusual cases where replacement insurance is unavailable). There are many higher-wage professionals, such as the engineers who lost non-qualified retirement savings during the Kodak bankruptcy, who are neither executives nor "insiders," and yet in many cases they can potentially lose decades of hard-earned savings without even representation under current law.

7. **Congress should amend Section 1408 of the Bankruptcy Code to require corporations to file Chapter 11 reorganization cases in the judicial district where they have their principal place of business, or principal assets, rather than in a distant district where they have few employees, retirees, assets or connections to the community.**

Another tactic some bankrupt companies use to exclude effective employee, retiree and small business participation in a Chapter 11 proceeding is to file for bankruptcy in management-friendly courts in New York City and Delaware, often thousands of miles from the corporation's principal place of business. Fortunately, there is growing bipartisan consensus that this loophole in the Bankruptcy Code should be patched. In 2019 members of the House Judiciary Committee, led by Rep. Zoe Lofgren (D-CA) introduced the *Bankruptcy Venue Reform Act of 2019* (H.R. 4421). The bill would require corporations to file reorganization cases in the judicial district where they have their principal place of business, or principal assets, rather than in a distant, management-friendly district where they have no employees, assets or connection to the community. In 2020 more than 40 state attorneys general sent a letter to Congress backing bankruptcy venue reform.[32]

Similar venue reform bills have been introduced by senior members of the Judiciary Committee since at least 2011, when a bipartisan bill was introduced by then-Chairman Lamar Smith (R-TX) and ranking Democrat John Conyers (D-MI). "Venue shopping for sympathetic courts has become an all-too-common practice for large companies filing for bankruptcy," Chairman Smith stated when he introduced the bill. "Unfortunately, it significantly disadvantages displaced employees, creditors and

[32] Jonathan Randles, "Dozens of States Back Bankruptcy Venue Reform," *The Wall Street Journal* (Feb. 21, 2020).

shareholders who should be able to participate in the reorganization negotiations." Smith recounted his firsthand experience with Enron, which filed for bankruptcy in New York "rather than face the music in Texas" where most of its employee and retiree victims resided. Similarly, Rep. Conyers noted that General Motors used the same tactic, filing its bankruptcy in New York rather than in Michigan, close to the ordinary employees, retirees and creditors who were most harmed by its mismanagement.

8. Congress should amend the Bankruptcy Code to require that the termination of non-qualified senior executive pension and deferred compensation plans are a precondition to the termination of any qualified pension plan maintained for a broader class of employees.

The termination of a qualified, rank-and-file pension plan should be the remedy of last resort during a bankruptcy case – one necessary for the debtor's reorganization and survival – and not the first cost to cut. Unfortunately, current law gives debtors too much discretion over which obligations to jettison and which to carry forward. The top executives making those decisions typically have a conflict of interest because the largest share of their own retirement benefits, including accrued benefits in supplemental (non-qualified) retirement compensation plans, are generally treated as unsecured claims in bankruptcy.[33]

Congress cited this moral hazard as a primary rationale when it enacted provisions in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 that restrict the ability of Bankruptcy Court judges to approve lucrative retention and severance payments for insiders.[34] The 2005 Act needs to be extended to explicitly constrain top executives from using Chapter 11 to dump their qualified pension plan liabilities while maintaining liabilities for supplemental (non-qualified) pension and deferred saving plans for senior executives.

The NRLN strongly supports the proposal in Section 304 of the Protecting Employees and Retirees in Business Bankruptcies Act of 2020, introduced by the current chairmen of the House and Senate Judiciary Committees.[35] The bill proposed to amend Section 365 of the Bankruptcy Code to require that "[n]o deferred compensation arrangement for the benefit of . . . a senior executive officer of the debtor, or any of the 20 highest compensated employees of the debtor who are not insiders or senior executive officers, shall be assumed if a defined benefit plan for employees of the debtor has been terminated" under ERISA Sections 4041 or 4042.[36]

Under current law, the debtor may request bankruptcy court approval for payment of pre-petition non-qualified plan benefits to senior executives, typically arguing that the loss would create a "morale problem" among the senior executives critical to emerging from bankruptcy. However, as one bankruptcy court determined, it is blatantly inequitable for the executives of bankrupt firms to propose the termination of employee pension plans to facilitate a reorganization, while maintaining the

[33] *In re Bethlehem Steel Corp.,* 479 F.3d 167 (2d Circuit, 2007) (treating vested, prepetition accruals in nonqualified plans as unsecured claims on the estate). Senior Executive Retirement Plan (SERPs) and other non-qualified pension and saving plans for executives, typically are provided in addition to participation in the company's qualified plan to provide benefits that exceed qualified benefit plan limits under IRC section 401(a)(17) (limit on compensation that may be taken into account under a qualified plan) or IRC section 415 (limit on annual benefits payable to a retiree).
[34] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).
[35] Protecting Employees and Retirees in Business Bankruptcies Act of 2020, H.R. 7370, 116th Cong. § 304 (2020). An equivalent companion bill was introduced by Senator Dick Durbin (S. 4089) on June 25, 2020 (full text here).
[36] *Ibid*.

company's liability for their own supplemental pension and deferred compensation plans.[37] In that 2006 case, involving the bankruptcy of Dana Corp., the court approved payment of a non-qualified pension benefit to the CEO as an administrative priority claim (with respect to 60 percent of his pre-petition benefit) and to three other senior management employees (with respect to their entire accrued benefit) on the condition that all pre-petition accruals would revert to unsecured claims in the event of a termination of the debtor's defined benefit plan for other employees.

The New York court's decision – tying payment of the qualified and non-qualified benefit plans inextricably together – should be the norm. As a matter of equity and to ensure that the termination of any pension plan is absolutely essential to emerging from bankruptcy, **termination of any non-qualified pension or deferred executive compensation plan, as well as unsecured claim status with respect to any pre-petition accruals, should be a prerequisite to Bankruptcy Court or PBGC approval of a distress termination with respect to current and recently former senior executive officers** (including named executive officers who left the company within the 12 months prior to the bankruptcy petition).

Conclusion

There are few happy faces in bankruptcy court. It is a devastating process for every stakeholder. But the other key constituencies in a bankruptcy case – employees, management, lenders, suppliers – can typically live to fight another day and regain some losses as the reorganized company emerges and succeeds in the future. The retirees cannot. Once their benefits are lost, those benefits are lost forever. Five years in the future, the new shareholders of the reorganized company are not going to authorize reinstatement a benefit earned by workers who retired years before the reorganization. Those other key constituencies also have a choice—they can choose to deal with a troubled company, or not, as bankruptcy looms. Most unsecured claims are by lenders, investors and suppliers with diversified holdings. But for retirees living on a fixed income, who are many years beyond working age, that choice is unavailable, and nothing they or Congress or the courts can do can give them back their three or four decades of service for a company.

Bankruptcy is supposed to be a level playing field where the results are fair. Unfortunately, for retirees, recent experience has made it look more like a game of three-card Monte: Difficult to understand, but completely predictable: They lose every time. The modest changes to existing law recommended will restore a large measure of procedural fairness, level the playing field, and mitigate the loss of critical retiree benefits that millions of retirees worked decades to earn.

Appendix: Proposed Statutory Amendments

Updated June 2021

[37] *See In re Dana Corp.,* 358 B.R. 567 (Bankruptcy Court, S.D.N.Y. 2006).