



The Bankrupt's Guide to Employee Benefits: Terminating Retirement Plans in Bankruptcy

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In this article, Matt Cristy examines which retirement plans a company may terminate before or during a Chapter 11 bankruptcy, the process of terminating retirement plans, the requirements the company must fulfill, and the possible timing.

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Chapter 11 bankruptcy protection offers a temporary safe harbor to foundering companies, giving them a chance to reorganize their operations in an attempt to remain in business. However, to keep the company afloat and set it back on course, management must decide during the Chapter 11 process how to cut the costs and debts weighing the company down. Retirement plans represent some of the largest ballast on the company's books, so management needs to know which plans it can cut free and how to do it.

Bankruptcy law permits a company in Chapter 11 protection to free itself from burdensome contracts and leases, to settle many debts for a fraction of their original value, and to discharge a host of debts for nothing. Management often wants to use these powers to terminate all the retirement plans, discharge all the plan-related debts in the bankruptcy, and start fresh with the newly reorganized company. However, judges and lawmakers understood this threat to the retirement futures of U.S. workers and erected special protections for certain types of retirement plans—traditional, defined-benefit pension plans, in particular—and also for benefits promised in agreements with organized labor groups.

This article explains which retirement plans a company may terminate before or during bankruptcy, the process of terminating retirement plans, the requirements the company must fulfill, and the possible timing. The discussion will focus on efforts to terminate traditional defined-benefit pension plans (**Pension Plans**) because these are the most costly plans to maintain and the most difficult to terminate. We will also survey the major issues related to terminating defined contribution plans and nonqualified deferred compensation plans. This article also focuses on the rules applicable to corporations and other for-profit business entities (other than sole proprietorships) that file for Chapter 11 bankruptcy protection with the intent of reorganizing and emerging from bankruptcy as a going concern. We will only address terminations of retirement plans sponsored by a single company or a single family of companies—referred to as single-employer plans. (We will not cover Taft-Hartley plans sponsored by multiple unrelated employers—called multi-employer plans—that usually arise through collective bargaining agreements with a common union or other labor organization and that have their own special rules and issues.)

Basic Bankruptcy Concepts

A company seeking protection under federal bankruptcy law (**Company**) secures that protection by filing a petition with the bankruptcy court (**Court**). That date (**Petition Date**) creates an important financial watershed, and all the Company's debts, obligations, and liabilities will be categorized with reference to that date, i.e., those arising before the Petition Date (pre-petition) and those occurring on or after the Petition Date (post-petition). Many pre-petition debts can be paid off for a fraction of the amount the Company owes, and many will be entirely discharged by the time the Company emerges from bankruptcy protection with a new reorganization plan. However, generally, debts arising post-petition must be paid in full, including taxes, penalties imposed by taxing and regulatory agencies, and damages for financial and other types of losses caused to other entities and individuals.

The Company's management team will continue to direct the operations of the Company, unless a creditor can show cause for the replacement of management with a court-appointed trustee, such as fraud, dishonesty, incompetence, or gross mismanagement (disregarding the assets and liabilities of the Company). In bankruptcy parlance, the Company is the "debtor," and when management continues to operate the Company, management is referred to as "the debtor in possession." All the property, assets, and interests held by the Company on the Petition Date compose the "debtor's estate," and the management team serves as the "trustee" of the debtor's estate (**Bankruptcy Trustee**). The Company's management, in its role as the Bankruptcy Trustee, acts as a steward of the Company's assets on behalf of the interests of the Company, its owners, and the Company's creditors.

The Court not only has the power to discharge the Company's debts to lenders but also to wipe clean many obligations and liabilities the Company had to other parties as of the Petition Date, including obligations to:

- Pay or provide services to business partners,
- Pay past debts to suppliers,
- Make future orders or purchases from suppliers,
- Sell or deliver products to customers,
- Perform services for customers,
- Honor employment agreements and promises of benefits to employees,
- Pay past due salaries and already accrued benefits,

- Pay taxes, fines, and penalties to federal, state, and local taxing authorities and regulators,
- Pay interest and penalties on debts, contractual obligations, and taxable amounts,
- Pay individuals injured by Company products, by employees or on Company property,
- Pay individuals and other parties for damage to property by Company employees or agents, and
- Pay other parties for financial and other types of damages caused by a failure to fulfill or comply with contractual duties.

All the parties holding such interests against the Company are "creditors." Generally, the Court will require creditors who want to receive compensation for their interest against the Company to file a "claim" with the Court, and creditors who fail to timely file their claim may lose the ability to ever recover anything from the Company.

The Company's creditors will be divided into two major categories based on whether they secured the debt the Company owed to them by taking all the steps necessary under applicable state law to obtain a lien on an item of the Company's property (a process called "perfecting a lien"). Creditors holding a perfected lien on some Company asset are "secured creditors." All other creditors are "unsecured creditors." A creditor that perfected a lien for one debt but not another will be a secured creditor for the purposes of the debt upon which the lien is based and will be an unsecured creditor for purposes of the other debt. In general, creditors prefer to be secured creditors, who have a right either to recover the asset or item of property on which they hold a lien or to payment equal to the value of the lien on the asset or property.

Finally, it is important to recognize the difference between the three types of "trustee" referred to in the bankruptcy and retirement plan arenas: the Plan Trustee, the Bankruptcy Trustee, and the U.S. Trustee. The **Plan Trustee** is an entity, individual, or individuals that agree to hold and protect the funds held in the plan trust for the benefit of participants. The Company cannot be the Plan Trustee, but officers and employees can accept the role. The **Bankruptcy Trustee** is an entity or individual assigned by the Court to protect the assets of the bankruptcy estate for the benefit of creditors. If the Company's management is removed as the Bankruptcy Trustee, the Court may appoint a professional bankruptcy trustee. The **U.S. Trustee** is an individual who acts as the agent

of the U.S. Department of Justice and performs many administrative functions for the Court.

Protections of Bankruptcy

What Is Protected?—The Bankruptcy Estate

The Court protects the Company's assets from creditors. Without this protection, creditors of insolvent companies would swoop in and strip away the assets the Company needs to operate its business and harass management with collection efforts when managers need to focus on successful operations and strategy. However, this protection is temporary. The Court protects the assets for the benefit of the creditors until the Court approves the reorganization plan. The reorganization plan must provide each creditor with at least the value it would have received for its claim outside of bankruptcy, although this value may be nil for many unsecured creditors.

Special Protections for Creditors

Priority Claims

The Bankruptcy Code provides special protections for the interests of certain creditors by giving them higher preference when the assets of the bankruptcy estate are distributed. These assets may be ownership interests in the reorganized Company, new Company debt obligations, property, or cash. The Bankruptcy Code gives preference to ten ranked categories of claims, called "statutory priority claims," running the gamut from retail consumer's claims for undelivered goods to government claims for taxes and customs. Although several of these priority claims have no bearing on retirement plans, three (the first, fourth, and fifth categories) are very important in relation to plans.

The first category of priority claims against a business in Chapter 11 bankruptcy is composed of expenses, usually incurred after the Petition Date, approved by the Court to continue operating the business and to protect the bankruptcy estate. These expenses, called "administrative expenses," can be paid immediately, and when they are not, they receive preference for payment before any pre-petition claims. These expenses include post-petition purchases of goods and services in the ordinary course of business; post-petition wages and salaries; court costs and fees for Bankruptcy Trustees, attorneys, and accountants; and pre- and post-petition claims for personal injury or death to individuals [Bankruptcy Code §§ 364(a), 503, 507].

The fourth category of priority claims is for unsecured claims for wages, salaries, and commissions

earned in the 180 days before the Petition Date for amounts up to \$10,950 per individual [Bankruptcy Code § 507(a)(4)]. This category also includes vacation, severance, and sick leave pay earned by the individual.

The fifth category is for unsecured claims for contributions to an employee benefit plan for services rendered in the 180 days before the Petition Date [Bankruptcy Code § 507(a)(5)]. The total priority claim permitted to each employee benefit plan is equal to \$10,950 multiplied by the number of employees covered under the plan. The plan may claim the \$10,950 for each covered employee whether or not any individual employee has earned \$10,950 in contributions during such period or whether or not any contribution is owed to the plan on behalf of that employee. Thus, if the Company sponsors a Pension Plan covering ten (10) employees, a highly paid executive and nine rank-and-file employees, the Pension Plan could potentially receive a priority claim for \$109,500 in past due contributions (\$10,950 x 10 covered employees). Thus, if the Company owed contributions to the Pension Plan relating to employee services for the six months prior to the Petition Date worth \$100,000 for one executive and worth \$100 for each of the nine rank-and-file employees for a total claim of \$100,900, the Pension Plan could receive a priority claim for the entire \$100,900.

However, the Bankruptcy Code limits an employee benefit plan's claims that receive priority status with offsets for any claims paid under the fourth priority for wages, salaries, etc., and for any amounts paid under the fifth priority to any other employee benefits plans. Thus, the potential \$10,950 that can be claimed for each employee will be used first for any wage claims for that employee and the remainder spread among the employee benefit plans that cover that employee, including retirement plans, health and welfare plans, and potentially other fringe benefit plans. (It is unclear whether a claim for benefits under a nonqualified plan could receive fifth priority status. However, the issue may be moot in most cases because management may choose to continue these plans (which primarily benefit executives) rather than seek to discharge them in bankruptcy, because the \$10,950 per employee limit will be fully absorbed by benefits in tax-favored plans and health plans that the participants in the Nonqualified Plans would prefer to have protected over immediately taxable funds in the nonqualified plan, and because only a very small amount of the nonqualified plan benefits would

receive priority status between the dollar limit and the 180-day service window to which the benefits must be tied.)

Claims by Secured Creditors

After the statutory priority claims, claims by secured creditors—those who obtained a lien against a Company asset before the Petition Date—receive the next level of priority. Secured creditors generally have the right to recover the value of the property up to the amount of the lien, and any excess amount owed to them becomes an unsecured claim.

Other Claims

Claims by unsecured creditors receive the next level of priority. Finally, stockholders' claims receive last priority. Commonly, unsecured creditors and stockholders receive nothing from a debtor's bankruptcy estate.

Protection of Retirement Funds

The Bankruptcy Code directly protects the interests of a retirement plan as a claimant for amounts due as of the Petition Date and for funding obligations that accrue post-petition. Retirement plans continued by the Company after the Petition Date generally will receive priority as administrative claims. Qualified plans, as discussed above, receive a special priority for claims for pre-petition funding obligations. A Pension Plan may also be a secured creditor with a lien on the Company's property, in which case the Court will help protect the plan's interests in the Company's property from unsecured creditors. In helping the Company continue as a going concern, presumably the protection the Court provides to the Company helps the Company's assets retain their value. A Pension Plan obtains an automatic lien on the assets of the Company and on any member of the Company's controlled group if the Pension Plan is underfunded, the Company fails to make one of the required quarterly installment payments, and the aggregate value of all the unpaid installments exceeds \$1 million. [*See* Code § 412(n).]

The Bankruptcy Code does not directly protect money in a retirement plan's trust fund and preserve it for the benefit of employees. Generally, if the Company owns the retirement plan's funds (as it generally does for nonqualified plans), those funds belong to the bankruptcy estate and will be used to satisfy creditor's claims or to pay Company expenses. On the other hand, funds held by qualified plans—plans that

receive special tax treatment because they meet the requirements of IRC § 401(a) (Qualified Plans)—do not belong to the Company, are not part of the bankruptcy estate, and cannot be used to pay creditors or Company expenses. The ownership interests of retirement plans funds are generally determined by state law, although ERISA and the Bankruptcy Code provide some special determinations for qualified plans and similar tax-protected plans.

Qualified Plan Funds

To obtain their special tax-qualified status, qualified plans are required to hold their assets in a trust fund separate from the assets of the Company and not subject to the claims of the Company's creditors. The money, investments, and property held by the qualified Plan Trustee—whether in the general pooled fund of a Pension Plan or in the individual accounts of employees, former employees, and their beneficiaries in individual account plans (such as 401(k) plans)—are not part of the bankruptcy estate, cannot be used to satisfy the claims of the Company's creditors, and are not subject to the Court's powers. Thus, qualified plan funds may be paid out to participants and beneficiaries as benefits become due under the plan's terms and may be used to pay plan expenses. The plan's fiduciaries may also continue to hire and retain service providers such as administrators, bookkeepers, actuaries, plan auditors, legal counsel, investment consultants, investment managers, and investment fund providers.

Qualified plans include profit sharing plans (including 401(k) plans), Pension Plans, stock bonus plans, and Employee Stock Ownership Plans (ESOPs). SIMPLE IRAs and SEP IRAs are also not part of the bankruptcy estate.

Contributions in the Company's Possession.

If the Company withholds amounts from employee wages for payment as contributions to a retirement benefit plan covered by the Employee Retirement Income Security Act (ERISA) of 1974, those amounts in the Company's possession do not become part of the bankruptcy estate [Bankruptcy Code § 541(b)(7)]. Similarly, if an employee pays to the Company any amount for payment as a contribution to a retirement benefit plan under ERISA, the amounts in the Company's possession do not become part of the bankruptcy estate. [*Id.*] Any qualified plan sponsored by a Company will be a retirement benefit plan under ERISA.

Because a Pension Plan or other qualified retirement plan is not a debtor in bankruptcy and the plan's funds

are not part of a bankruptcy estate, the funds are not protected from the claims of the plan's own creditors. Thus, plan fiduciaries should continue to timely pay all the plan's debts and expenses.

Nonqualified Plans

Most retirement benefits not provided through a qualified plan will be part of the bankruptcy estate and can be used to satisfy the claims of other creditors in bankruptcy. Most nonqualified plans are created for executives and other highly paid, highly valued employees (and nonemployees such as members of the board of directors). These plans are designed to delay taxation of income earned in the current year until actually paid in some future year, when the executive expects to have a use for the money or expects to have a lower income tax rate. These plans are most commonly called nonqualified deferred compensation plans or NQDC plans (**Nonqualified Plans**).

If the deferred funds are set aside for the employee and the employee has the right or ability to access or otherwise use those funds, he will be taxed on those funds when they are set aside, just as if his employer paid those funds to him, because the IRS will treat him as having "constructive receipt" of the money. To avoid this outcome, most employers do not set aside any money to pay the benefits under the plan and pay the benefits out of the employer's general assets when they become due. Alternatively, if the employee or the employer is concerned that the employer will not have the funds available to pay the executive when they become due under the plan's terms, the employer may earmark certain amounts in its general assets for the plan or establish a bank account or other investment to provide funding for the benefit. However, all funds still in the Company's general assets, held in bank accounts owned by the Company, or held in investments owned by the Company will be part of the bankruptcy estate.

Some executives not only want their benefits under a Nonqualified Plan to actually be funded, but they also want assurance that those funds will not be revoked by the employer if the employer has a change of heart or undergoes a change in control. In 1980, the IRS approved a new structure, called a rabbi trust, in which the employer could fund an irrevocable trust that would be paid out to the employee (or his beneficiary) upon his termination of employment, retirement, death, or disability [Priv. Ltr. Rul. 8113107] (The structure is called a rabbi trust because the private ruling request to the IRS was made on

behalf of an employee who was a rabbi and the congregation that employed him.). The employer could not amend or revoke the terms of the trust, and the trust's assets were subject to the claims of the employer's creditors as if the funds were part of the employer's general assets. The IRS ruled that the funds placed in the trust were not taxable income to the employee until paid out from the trust fund and the employee did not have constructive receipt of the funds because they were still subject to the claims of the employer's creditors. Thus, in the bankruptcy setting, if a Company sets aside funds for an executive in a rabbi trust, even though those funds are segregated from the employer's general assets and are not within the control of the Company, the funds will still be part of the bankruptcy estate. To ensure that funds in a rabbi trust are not taxable to the employee, the assets in the trust fund must be expressly subject to the claims of creditors, at least when the Company is insolvent or in bankruptcy.

Finally, some executives may request that their deferred compensation be set aside in an irrevocable trust that is expressly *not* subject to the claims of the employer's creditors. (Because these trusts are counter to the religious-sounding "rabbi trust," such trusts are referred to as secular trusts.) Secular trusts are not too common because the employee is taxed on the employer's contributions to the trust in the year the contributions are made, but the employee does not have access to or control over the funds. However, if the secular trust is properly created under state law so that the employer has neither legal nor equitable title to the funds in the trust, then the trust should not become part of the bankruptcy estate if the employer enters bankruptcy. [See Bankruptcy Code § 541.]

Contributions in the Company's Possession. Nonqualified Plans that provide for the employee to contribute part of his own compensation to the plan and that only permit distributions to the employee upon retirement, termination of employment, death, or disability may qualify as plans covered by ERISA. [See ERISA § 4.] Employee contributions to such a plan and salary withheld for contribution to such a plan will not become part of the bankruptcy estate just because the Company was holding such funds for a short period before placing those funds in the plan trust. [See Bankruptcy Code § 541(b)(7).] However, for the funds in the SERP to be protected from creditors, the funds would need to be held in an irrevocable trust not accessible to the Company or its creditors (a Secular Trust). Although this treatment would protect

the funds from creditors, it would also make the funds taxable to the employee in the year the Company made the contribution, defeating the purpose of deferring the compensation.

Funding a Nonqualified Plan. If the Company or its affiliates sponsor a qualified Pension Plan and if the Pension Plan or the Company suffers financial trouble, any funding the Company sets aside for the Nonqualified Plan benefits will become taxable to the participants when set aside. The restrictions on funding apply in any of the following circumstances:

1. When the Company is under bankruptcy protection,
2. When the Pension Plan terminates without sufficient funds to cover all liabilities (which should be either a distress termination or involuntary termination [see discussion of distress and involuntary terminations under the section titled “Terminating a Pension Plan Under ERISA” below], in which case the restriction applies during the 12-month period starting six months before the termination); or
3. When the Pension Plan is in “at risk” status. The Pension Plan is “at risk” if the plan’s assets for the prior year were less than 80% of the plan’s required funding target and less than 70% of the required funding target after applying the actuarial assumptions under the special “at risk” rules. [See Code § 430(i).] The “at risk” rules do not apply to employers with fewer than 500 employees who participate in any of the Pension Plans sponsored by the employer’s controlled group. [See Code § 409A(b)(3)(B).]

These restrictions apply to any funds set aside, reserved in a trust, or transferred to a trust for the purpose of paying benefits under a Nonqualified Plan and to any restriction on the Company’s assets limiting the use of such assets for the provision of benefits under a Nonqualified Plan. Funds actually set aside before any of the above circumstances occur receive an exemption from these restrictions. If the Company or its affiliates set aside or earmark funds for a Nonqualified Plan during a restricted period, then the funded benefits provided for certain key executives will be taxable to those executives in the year funded. If the Company tries to pay any federal, state, or local income taxes the executive would owe on the funded amounts (or “grosses up” the benefit), the IRS will impose on the executive

a 20% penalty tax plus interest (at an enhanced underpayment rate) on the additional amount provided by the Company. The Company also will not be able to deduct the additional or gross-up amount. [See Code § 409A(b)(3)(C).]

The key executives subject to these penalties are the following individuals within *each member* of the Company’s controlled group:

- The chief executive officer
- The four highest-paid employees, and
- Any of the following individuals subject to the reporting requirements of section 16(a) of the Securities Exchange of 1934:
 - A director,
 - An officer, and
 - A principal stockholder (an owner of more than 10% of any class of any equity security).
 [See Code § 409A(b).]

Protecting Nonqualified Plan Benefits. As the discussion above shows, a Company will find it difficult to design a Nonqualified Plan that will protect employees from immediate taxation on deferred compensation *and* protect that compensation from creditors if the employer becomes insolvent or enters bankruptcy protection. The only way to ensure a Nonqualified Plan will be able to pay the promised benefits is to establish a pool of funds set aside for those benefits. However, if the Company places those funds in a trust, either the funds must be subject to the claims of creditors (rabbi trust) or else the creation of the trust will cause the employees to be taxed in the year the funds are placed in the trust (secular trust). If the Company did not earmark or set aside funds expressly for the Nonqualified Plan when it was created but the Company expressly reserves funds to pay the Nonqualified Plan benefits because of a change in the Company’s financial health, the employees entitled to such benefits will be taxed as if the Company had paid those funded benefits. In addition, the Code imposes an additional 20% penalty tax on those benefits and imposes an enhanced interest rate (the income tax underpayment rate plus one percentage point) on the benefits running from the year those amounts were originally earned. This treatment applies whether the Company places the reserved funds in a trust, merely earmarks the funds for the Nonqualified Plan, or writes the set aside into the Nonqualified Plan’s terms. [See Code § 409A(b)(2), (4), (5).]

Once a Company begins suffering financial difficulties, it is probably too late to protect Nonqualified Plan benefits. Paying out those benefits before allowed under the Nonqualified Plan's terms will subject the employees to immediate taxation, the 20% penalty tax, and the enhanced interest on the amounts paid out, and it may also subject them to the same treatment for benefits already earned, vested or paid out under that plan and certain other Nonqualified Plans that are aggregated under Code Section 409A with the plan paying the benefits. Even if the employees are willing to accept the income tax and penalties, a payment, reservation, or set aside of Nonqualified Plans that occurs while the Company is insolvent or within the 90-day period prior to the Petition Date can be voided by the Court and the funds returned to the Company's possession for the use of the bankruptcy estate. [See Bankruptcy Code § 547.] If the participant in the Nonqualified Plan is director, officer, a person in control of the Company, or a relative of any of such individuals, then the Court can void a payment, reservation, or set aside made up to a year before the Petition Date, and if the transfer to such an individual was made to hinder, delay, or defraud payment of any other creditor, then the Court can undo any such transfer made up to two years prior to the Petition Date. [See Bankruptcy Codes §§ 547 and 548.] If the Court uses this "avoidance" power, this leads to the worst possible situation for employees, who become subject to exorbitant taxes and penalties on income they likely will never be paid or recover. Thus, Companies should be very careful when attempting to protect employees' Nonqualified Plan benefits from creditors because the cost of botched protection measures may far exceed the potential loss of the benefits.

The best method of protecting the benefits under a Nonqualified Plan may be for the Company to assume the plan, i.e., for the Company to ask the Court's permission to continue to operate the plan according to its terms, so that the executives entitled to benefits under the Nonqualified Plan can be paid by the reorganized company on the plan's original schedule. If management truly believes the Company will emerge intact from bankruptcy protection, this approach will better serve executives who remain loyal to the Company because they will receive their promised benefits instead of receiving little or nothing as unsecured creditors of the bankruptcy estate. However, this approach will not work for equity-based compensation if the Company replaces its stock in the reorganization.

How Is the Bankruptcy Estate Protected?— The Automatic Stay

Once the Company files the Petition, creditors are prohibited from taking any action outside the Court to collect any amount owed to them as of the Petition Date. Creditors may not file suits against the Company or try to obtain possession of property held by the Company. Creditors may not take further steps to secure their interests in any amounts owed by the Company as of the Petition Date, including making demands for security for amounts owed or creating, perfecting, or enforcing a lien on Company property. Courts and practitioners refer to this prohibition as the "Automatic Stay" because it automatically applies upon the filing of the Petition without any required additional action by the Company or the Court. The Automatic Stay prevents secured creditors from foreclosing on the Company's property on which they hold liens and prevents unsecured creditors from starting a race to demand security and file liens on the Company's remaining property. This serves the Court's mission to protect the value of the Company as a going concern, to obtain the maximum compensation for creditor's claims, and to handle the competing claims and interests of the many stakeholders—including owners, employees, and creditors—in an equitable and just manner.

Because the Automatic Stay prevents creditors taking any further steps to obtain security for debts owed to them, it freezes the status of a creditor as either a secured creditor or an unsecured creditor on the Petition Date. For this reason, the Petition Date is also a watershed for creditors' interests.

Retirement Plans As Creditors

The Automatic Stay also applies to any retirement plan to the extent the plan is a creditor of the Company. If a Pension Plan is not fully funded on the Petition Date or any time while the Company is in bankruptcy, then the plan has a claim against the Company and is a creditor. Even if a Qualified Plan is not a Pension Plan required to maintain certain funding levels, if the Company has failed to make any contribution due under the terms of the plan, then the plan has a claim and is a creditor. As a creditor, a qualified plan is subject to the Automatic Stay and the plan's fiduciaries must pursue the payment of any contribution amounts as claims through the Court. Unless the Company files such claims with the Court on the plan's behalf, plan fiduciaries need to file claims with the bankruptcy court for any

pre-petition amounts owed by the Company to the plan and for any funding obligations that arise while the Company remains under bankruptcy protection. The Court will discharge any claims that are not filed with it, and the plan and its participants can sue plan fiduciaries for breaching their duties by failing to pursue such claims. Management should pay careful attention to these duties. The plan documents often designate the Company as the Plan Administrator and executives often assume duties as a Plan Trustee, and Plan Administrators and Plan Trustees are plan fiduciaries. According to one federal circuit court, Plan Trustees have the fiduciary duty to collect delinquent contributions from the employer, even if the trust or plan documents expressly limit the Plan Trustees' responsibilities. [*Best v. Cyrus*, 310 F.3d 932 (6th Cir. 2002).]

Most Nonqualified Plans will not have a Plan Trustee, Plan Administrator or any other fiduciary to watch out for the interests of the employees entitled to benefits under these plans. If these employees are owners of the Company or C-suite executives, then they will probably ensure that the Company files claims for these benefits. Otherwise, employees with such benefits should be bringing their claims to the Company's attention and making sure their claims are timely filed with the Court to prevent their claims from being discharged without payment. Rabbi and secular trusts will have a Plan Trustee, which may assist the plan participants, but most likely the trust agreement will excuse the Plan Trustee from any responsibility to pursue claims against the Company for unpaid funding obligations.

Terminating Retirement Plans

Power of the Bankruptcy Trustee to Reject Contracts

One purpose of the Automatic Stay is to give the Company time to review its contracts and leases to determine which are of greatest benefit to the continued operation of the business. The Bankruptcy Code gives the Bankruptcy Trustee the right, with the Court's approval, to assume contracts that will be of use or benefit to the Company and to reject those contracts that the Company cannot fulfill or that would be too expensive or burdensome for the benefit the Company would receive. [*See* Bankruptcy Code § 365.] (The Company generally cannot reject the contract unless *both* the Company and the other contracting party still owe some obligation to the

other under the contract.) When a Company (acting as Bankruptcy Trustee) rejects a contract, it breaches the contract, and the other contracting parties obtain a claim against the Company for such breach. Usually, the claim will be treated as an unsecured, pre-petition claim, and the contracting parties will receive pennies on the dollar, if anything.

Rejecting a Pension Plan

Naturally, some companies in bankruptcy have attempted to use this rejection power to reject their agreements to provide pension benefits to employees and to avoid fulfilling any obligations under the Pension Plan documents. Courts have held, however, that the Company may not use the power to reject contracts to reject a Pension Plan. Further, such courts have held that a Company can only end its ongoing obligations to fund a Pension Plan through the termination procedures provided for under ERISA. [*See, e.g., In re Philip Servs. Corp.*, 310 B.R. 802, 809 (Bankr. S.D. Tex. 2004).]

Several reasons motivate a Company's desire to simply "reject" a Pension Plan, rather than terminate it under ERISA as required. First, if it could reject the plan, the Company could discharge its debts to the Pension Plan in the bankruptcy, the Company would have no obligation to fully fund the unfunded benefits employees had earned under the plan, and the plan would have no choice but to settle for whatever partial payment (if any) it could receive from the bankruptcy estate as an unsecured creditor. Second, the Company could possibly skirt around the ERISA termination rules that prohibit a termination of a plan that is required to be provided to employees under a collective bargaining agreement. Third, under the ERISA requirements, the Company cannot quickly freeze the accrual of plan benefits, and terminating the plan takes even longer and involves significant costs. If it were allowed, bypassing all these requirements and obligations by rejecting the Plan would be an easy "out" for the Company.

Terminating Nondefined Benefit Retirement Plans

Qualified and Other Tax-Preferred Plans Other Than Defined Benefit Plans

Defined contribution plans, such as profit-sharing plans and 401(k) plans, can usually be terminated entirely at the Company's discretion. If management knows it wants to terminate the plan, it will probably adopt an amendment or resolution setting a

termination date sometime before the Petition Date. Although it may take some time for all the plan assets to be distributed to the participants, the participant's rights to benefits (and their potential claims in the bankruptcy) will be fixed as of the termination date. If the Company still owes any mandatory contributions, such as money purchase pension contributions, matching contributions, or nondiscretionary profit-sharing contributions, and the participants have already accrued the rights to those benefits under the plan's terms, then claims for those amounts would obtain Fifth Priority for payment in the bankruptcy. If the Company does not terminate the plan before the Petition Date, it may need the Court's approval to terminate the plan, and employer-provided benefits that accrued post-petition may be entitled to administrative claim status and immediate payment during the bankruptcy period.

Nonqualified Plans

Nonqualified Plans come in numerous types and forms, and the methods of permissible termination will vary from plan to plan. Some plans will permit unilateral termination by the Company, and some may permit termination upon certain business exigencies, such as insolvency or bankruptcy. However, many will require written consent of the participating employee before termination may occur. Whatever the method of termination, most plans will provide some sort of protection of the benefits already earned by the employees, such as accelerated vesting. They may also include protection for some or all of the payments not yet earned or provide for alternative compensation if the plan is terminated early, and, if not, an employee protected by a consent requirement may demand some alternative compensation for future earnings in return for his consent to early termination.

If an employee has not earned all the potential benefits under the plan, the Company may request the Court's permission to reject the Nonqualified Plan with respect to that employee. However, some Nonqualified Plans are embodied in employment contracts, and the entire employment contract would need to be rejected to eliminate the Nonqualified Plan. In the case of an indispensable or highly valued employee that the Company wants to retain during and after the bankruptcy reorganization, this rejection may not be an option unless the Company can offer the employee a new employment contract with equally enticing terms.

Companies should consult with competent employee benefits counsel before modifying, replacing,

or substituting payments or benefits for Nonqualified Plans. These plans are subject to the provisions of Code § 409A, which prohibit the early payment of amounts promised to be paid in future years and any substitution for other benefits that would accomplish similar results.

Rejecting a Plan Covered by a Collective Bargaining Agreement

If contributions to either a Pension Plan or a defined contribution plan are required under the terms of a collective bargaining agreement (CBA), the Company will not be able to terminate the plan prior to bankruptcy without the collective bargaining unit's (Union) consent, unless the Agreement expires and any period during which the Company has post-expiration obligations also ends. Even after the Company files for bankruptcy, the Bankruptcy Trustee cannot simply reject the CBA or terminate a retirement plan that provides benefits mandated under the CBA. Instead, the Company must propose modifications of the CBA to the Union and engage in good-faith negotiations with the Union over modification of the CBA. If the Company and the Union cannot reach agreement, the Company can file an application with the Court to reject the entire CBA.

Unless the terms of the CBA or the obligations under the retirement plan place the Company in immediate danger of dissolution, this process is not likely to be speedy. In that situation, the Company could conceivably file the rejection application the same day that it provides the proposal to the Union, and the Court could schedule the hearing within days and issue a quick ruling. However, the Court can set the hearing as far out as 21 days from the date the rejection application is filed and wait another 30 days to issue its ruling. Also, it will probably take the Company a substantial amount of time to prepare its modification proposal for the Union, to engage in adequate negotiations with the Union to satisfy the Court, and to prepare supporting documentation and arguments to support its rejection application to the Court. In negotiations, the Company will need to address all the modifications it needs in the CBA, not just the provisions requiring retirement benefits. If the Company and the Union cannot agree on all the modifications the Company needs, the Company's only other option to accepting the current CBA is rejecting the entire CBA. Thus, to support its rejection application, the Company will need to be able to explain to the Court the entire cost of the CBA, demonstrate its

affect on the creditors and other interested parties, and justify the elimination of all the benefits and protections afforded by the CBA.

If a CBA mandates the Company provide Pension Plan benefits, the Company must jump two hurdles to terminate the Pension Plan: (1) modification of the CBA to eliminate the Pension Plan benefits (or rejection of the CBA) and (2) satisfaction of the ERISA termination requirements.

Terminating a Pension Plan Under ERISA

Standard Termination

A Company contemplating bankruptcy may not be able to terminate a Pension Plan using the Standard Termination procedures. A Standard Termination requires the plan to have enough assets to pay for all liabilities under the plan as of the termination date, so either the plan must be fully funded or else a company sponsoring the plan (or an affiliate) must contribute sufficient funds to the plan trust to fund all the benefits employees have accrued under the plan. In 2008 and 2009, even well-funded Pension Plans suffered significant investment losses. In testimony before Congress on October 1, a principal at Mercer reported that funding levels of pension plans fell from 110% on January 1, 2008, to 93% on January 1, 2009, and 39% of plans will have 2009 adjusted funding target attainment percentages of less than 80%, which would put them in “at risk” status. The results were based upon Mercer’s internal survey of 874 pension plans, reported in Mercer’s report, “2009 Required Contributions and Credit Balances,” and Mercer estimated the 2009 funding levels based on the elections employers had in place in April 2009 [*Defined Benefit Pension Plan Funding Levels and Investment Advice Rules: Hearing Before the House Committee on Ways and Means*, 111th Cong. 1-2 (2009) (statement of Craig P. Rosenthal, Principal, Mercer)].

Employers contemplating bankruptcy do not have extra funds available to contribute to a Pension Plan to make up for recent investment losses, and employers with chronically underfunded Pension Plans probably lacked such extra funds for years. (Some funding alternatives will also be discussed below in the “Funding Obligations” section.) However, we will provide a quick overview of the Standard Termination process to explain the fundamental rules of a plan termination under ERISA and for purposes of comparison with the other types of termination procedures.

Notices

An employer must provide a notice to all participants in the plan, and certain other parties, at least sixty (60) days in advance of the proposed termination date. The other parties entitled to the notice include beneficiaries of deceased participants, former spouses, and children of participants entitled to plan benefits under a domestic relations order, and unions that represent participants. Gathering the names and addresses of all the relevant parties, especially for participants who have not been employees for long periods of time, may take significant time in itself and must be completed before the 60-day notice period can start.

If the plan has not already been frozen, the employer should also issue a notice to freeze accruals under the plan as soon as possible to all employees eligible to accrue benefits. This notice must be provided at least forty-five (45) days before a plan amendment freezing all benefit accruals can be effective. An employer in decent financial shape may set the same effective date for the freeze and the termination. However, a Company contemplating bankruptcy or already in bankruptcy should be curbing every cost and limiting every liability and should freeze benefits accruals as soon as possible (45 days after the notices are mailed), which is at least fifteen (15) days earlier than the plan termination. Even employers in decent financial shape should formally amend the plan and send the freeze notice so that, even if the actual termination must be postponed for some reason, accruals will be frozen as of the originally intended date and the employer will not be running up that additional benefits cost.

Funding Obligations

A plan cannot be terminated in a Standard Termination unless the plan has sufficient assets to cover the all the accrued benefit liabilities under the plan as of the termination date [ERISA § 4041(b)]. In practice, the plan will need sufficient funds to cover the cost of all other current liabilities and those that will arise before all the funds have been distributed, such as PBGC premiums, which must be paid through the end of the year in which the termination occurs [PBGC Reg. § 4007.11(d)].

This rule is a Catch-22 for some financially troubled employers. If they are already having trouble providing sufficient funding to the plan to provide the benefits promised and already accrued by current and former employees, they would like to terminate

the plan and cut their losses before they get worse. Such employers would like to end the ongoing administrative obligations (and costs) of maintaining the plan, end the punitive taxes that can accrue when a plan remains underfunded, and eliminate the risk that they will have to make up further funding deficits if the plan's assets—such as investments in stocks and bonds—decline in value. Employers cannot fudge on whether they can meet this standard, either. As part of the Standard Termination notice to the PBGC, the employer must verify that it can meet this funding standard and must provide certification of the same by an enrolled actuary [ERISA § 4041(b)(2)(A)]. In cases of fraud, the PBGC can undo the plan termination. [See ERISA § 4047.]

Some funding alternatives available may make it possible for the employer to terminate the plan even if he does not currently have the assets available to fully fund the plan. First, another party can always provide or loan sufficient funds to the employer to put into the plan to provide adequate levels of funding. The sponsoring employer(s), or any member of such employer's controlled group, can also make a written commitment to the plan, which must be signed by the party making the commitment, to contribute any additional sums necessary to enable the plan to satisfy the funding requirements for termination. A commitment meeting these requirements will satisfy the funding requirement, enabling the sponsoring employer to terminate the plan. The written commitment can even be provided by a party in a bankruptcy if either (i) the Court approves the written commitment or (ii) a party not in bankruptcy unconditionally guarantees to meet the commitment no later than the date the plan assets are required to be distributed [PBGC Reg. § 4041.21(b)(1)]. The funding requirements can also be eliminated by a majority owner (i.e., someone who owns at least 50%) of the sponsoring employer who is a participant in the plan and agrees to forego receipt of his plan benefits to the extent necessary to enable the plan to meet all other plan benefits [PBGC Reg. § 4041.21(b)(2)]. Employers with a primary owner and few employees often can rely on this alternative to meet the funding requirement because the owner's benefits under the plan often account for a significant amount, and sometimes a majority of, the plan's liabilities. This alternative may also work for larger employers with a majority owner if the owner's plan benefits are significant and the funding shortfall is less than the value of those benefits.

Collective Bargaining Agreements

The PBGC cannot permit a Standard Termination of a Pension Plan that would violate the terms of a CBA [ERISA § 4041(a)(3)]. Thus, if the Company has a CBA with a union (or other collective bargaining unit) that requires the Company to provide pension benefits to employees, the Company will not be able to terminate the plan providing those benefits until it can reform the CBA. Depending on the terms of the CBA and of management's relationship with the union, the Company may not be able to reform the CBA without the assistance of the Court. In that case, the plan cannot be terminated before filing its petition with the Court.

If the Company cannot terminate a Pension Plan prior to the Petition Date and must terminate the plan during the bankruptcy, it may not be able to discharge as many plan-related costs, especially the termination expenses, and the termination expenses likely will receive administrative claim status, taking priority above other claims. If the Company terminates a Pension Plan in a distress termination or if the PBGC terminates the plan in an involuntary termination (discussed further in the Sections B and C below), the Company and its affiliates will be liable for an additional premium to the PBGC for the next three (3) years following the termination (Termination Premium). The Termination Premium is \$1,250 each year for each participant in the plan at the time of the termination. The Termination Premium can haunt other members of the Company's controlled group, especially if the Company eventually fails and cannot bear any of the cost itself. If the distress termination occurs during the bankruptcy, the Termination Premium cannot be discharged in the reorganization. [See *Pension Benefit Guar. Corp. v. Oneida, Ltd.*, 562 F.3d 154 (2d Cir. 2009).]

Distress Termination

When the PBGC determines that the requirements for a Distress Termination have been met, a Company may terminate a Pension Plan, even if the plan does not have sufficient assets to cover all the plan's liabilities.

Requirements

Distress Criteria Test

A plan only qualifies for a Distress Termination if the PBGC determines that all of the employers sponsoring the plan (and all members of sponsors'

control group(s)) meet one of the following conditions:

Reorganization in Bankruptcy. As of the proposed Termination Date, the plan sponsor has filed a petition with the Court seeking reorganization and the case has not been dismissed as of the proposed Termination Date. This condition is also satisfied by either of the following: (a) a bankruptcy filing under Chapter 11 for a reorganization that has been converted to a case in which liquidation is sought and (b) a case in which a third party files a petition for the involuntary bankruptcy of a plan sponsor. In the bankruptcy case, the Court must approve the termination and must also determine that the termination of the Pension Plan is necessary for the sponsor to be able to pay all its debts under the reorganization plan and to be able to continue in business outside the Court's protection [ERISA § 4041(c)(2)(B)(ii)].

Liquidation. As of the proposed Termination Date, the plan sponsor has filed a petition with the Court seeking liquidation and the case has not been dismissed as of the proposed Termination Date. This condition is also satisfied by either of the following: (a) a bankruptcy filing under Chapter 11 for a reorganization that has been converted to a case in which liquidation is sought and (b) a case in which a third party files a petition for the involuntary bankruptcy of a plan sponsor [ERISA § 4041(c)(2)(B)(i)].

Necessary to Pay Debts. The sponsor can demonstrate to the PBGC's satisfaction that a Distress Termination is necessary for the sponsor to pay its debts when due and to be able to continue in business [(Inability to Continue in Business Criterion) ERISA § 4041(c)(2)(B)(iii)].

Unreasonably Burdensome Costs. The costs of all the sponsor's Pension Plans have become unreasonably burdensome because of the decline in the amount of the workforce covered by those plans [ERISA § 4041(c)(2)(B)(iii)].

If a Company is a stand-alone corporation without affiliates, it may not be too difficult for the Pension Plan to meet one of these conditions, especially if the Company has already filed for bankruptcy protection. If the Company is part of a family of corporations in which all the corporations are insolvent or seeking bankruptcy protection, the Pension Plan may be able to meet the required conditions. However, it may be difficult for a Pension Plan sponsored by one or more members of an extended corporate family to qualify for a Distress

Termination because every member of each sponsor's controlled group must meet one of the above conditions.

Court-Granted Distress Terminations

Congress expressly reserved to the Court the decision as to whether a plan sponsor (or a member of its controlled group) meets the first condition listed above for companies under bankruptcy protection, which the Courts refer to as the "Reorganization Test." If a Company requests that the Court make a determination under the Reorganization Test, whether for itself or a member of its controlled group, the Company must concurrently provide the PBGC with copies of the motion and any supporting documents filed with the Court. The PBGC will request the Court to determine whether the sponsor (or controlled group member) will be unable to pay its debts when due and continue in business unless the Distress Termination occurs and will provide the Court with all germane information. The PBGC will be bound by a final and nonappealable order of the Court, but it may argue in the bankruptcy court, the federal district court (on first appeal), and in the circuit court (on second appeal) that the Reorganization Test has not been met. [See PBGC Reg. § 4041.41(c).]

The PBGC finds a Court's determination under the Reorganization Test is duplicative of the PBGC's own determination under the Inability to Continue in Business Criterion. [See PBGC Reg. § 4041.41(d).] If the sponsor has asked the Court to make a determination under the Reorganization Test, the PBGC will defer any decision on the same entity under the Inability to Continue in Business Criterion. If the Court (or final appellate court) finds the entity meets the Reorganization Test, the PBGC's determination is moot. If the Court finds the entity does not meet the Reorganization Test, it is possible the PBGC could still find the entity meets the Inability to Continue in Business Criterion and the Pension Plan can be terminated in a Distress Termination. If the PBGC determines that the entity does not meet the Inability to Continue in Business Criterion and the sponsor subsequently asks the Court for a determination on the same entity under the Reorganization Test, the PBGC will advise the Court of the PBGC's determination. It is to be presumed that the PBGC would also go before the Court and dispute the entity's ability to meet the Reorganization Test if warranted by the amount of PBGC guaranteed benefits provided under the plan.

Procedures for Distress Termination

The Company must provide a notice to all the same parties as in a Standard Termination and must provide the notice on the same timeline as in a Standard Termination, at least sixty (60) days in advance of the proposed termination date. The notice must notify the Pension Plan participants and other interested parties that the Company expects to terminate the plan in a distress termination and must include a statement of whether plan assets are sufficient to pay all the accrued benefits and all the benefits guaranteed by the PBGC and the implications [PBGC Reg. § 4041.43]. As soon as possible after sending the notice to participants, the Company must file a PBGC Form 600, which is an application seeking the PBGC's approval to terminate the plan in a Distress Termination. In the application, the Company provides information supporting the need for a distress termination and extensive plan documents. The Company must also provide narrative explanations why each plan sponsor and each member of the sponsors' controlled group meet one of the distress conditions. For any entity that is not under reorganizing or liquidating under federal bankruptcy protection (or similar state proceedings), the Company will need to provide extensive financial documentation, including audited financial statements for the last five (5) fiscal years. Because of the amount of time and effort involved in preparing the materials about the entities meeting a distress condition, the PBGC allows applicants to file the Form 600 first and then provide these materials up to 60 days later. However, the PBGC states that its ability to determine that a plan meets the requirements for a Distress Termination is limited until these additional materials have been provided [Pension Benefit Guar. Corp., Distress Termination Filing Instructions 14 (2009)].

By the proposed Distress Termination date, the PBGC will make a tentative determination as to whether the plan qualifies and the Company may proceed with the Distress Termination. The PBGC will make its determination based upon whether each of the relevant companies meets one of the distress conditions and whether the notice requirements were met. If PBGC determines that the plan does *not* qualify for a Distress Termination, then the termination is void and the plan must continue as an ongoing plan. The Plan Administrator must notify the affected parties, including anyone who received the initial notice of intent to terminate, in writing that the plan is not terminating [PBGC Reg. § 4041.46(e)].

Within 120 days after the termination, the Company must file PBGC Form 601 and Schedule EA-D (enrolled actuary certification). The actuary must certify as to whether plan assets are sufficient to provide for all benefit liabilities under the plan and, if not, then for the lesser amount guaranteed by the PBGC. If the plan is sufficient to provide for one of these levels, and if the PBGC agrees, the PBGC will notify the Company to start the final distribution process. The Company must notify the affected parties within sixty (60) days of the actual termination date and other required information about their benefits. Within fifteen (15) days of issuing such notices, the Company must certify that the notice requirements were met. The Company must verify that the plan can provide for the level of benefits to which the PBGC concurred, and then distribute the assets of the plan within 180 days after sending the distribution notice. Typically, for participants who do not yet qualify for a distribution of their Pension Plan benefits, the Company will purchase an annuity contract from an insurance company to provide the participant's benefits at normal retirement age. Finally, the Company must file PBGC Form 501, certifying the distribution of the assets, within 30 days of the distributions.

If at any point in the process, the Company determines that the plan assets will not meet the coverage level confirmed by the PBGC (either all benefits liabilities or PBGC guaranteed levels), the Company must notify the PBGC. As long as the assets can cover PBGC guaranteed benefits, the Company must continue with the distribution. If the PBGC determines that the assets will not cover guaranteed benefits, then the distribution must stop and the PBGC will proceed with an involuntary termination.

Involuntary Termination

The PBGC must begin proceedings to terminate a Pension Plan that does not have sufficient assets to pay the benefits that are currently due [ERISA § 4042(a)]. The PBGC may also take action to terminate a Pension Plan if the plan has not met the minimum funding standards, a distribution of \$10,000 or more has been made to someone with a substantial ownership interest in the company sponsoring the plan (i.e., a sole-proprietor, a 10% shareholder, or a partner with a 10% interest) and afterwards all the vested benefits are not funded, or if the PBGC's expected long-run losses for guaranteeing the plan are expected to increase unreasonably.

Generally, a Company's management cannot plan for an involuntary termination because the Company

cannot initiate such a termination or file an application for such a termination. By the time a plan becomes so underfunded that it cannot meet the current benefits as they become due, the Company usually will have been required to provide various notices to the PBGC that would alert the agency to the plan's dire funding status. In that case, the PBGC usually would contact the Company and demand the Company and its affiliates provide financial protections such as funding or guarantees to keep the plan from becoming a liability for the PBGC.

When the PBGC determines an involuntary termination is necessary, the PBGC and the Company can agree to appointment of a trustee and termination of the plan. In that case, the trustee will take possession of the plan assets, administer the plan so as not to increase the PBGC's potential liability, and institute termination proceedings as soon as possible. If the Company does not consent, the PBGC will apply to a U.S. district court for the appointment of a trustee and for a decree that the plan must be terminated. The PBGC may request that it be designated as the trustee. The PBGC can institute these proceedings regardless of the protection of the Company under the bankruptcy court.

No Free Ride

Distress and involuntary terminations do not give the plan sponsor or its affiliates a free ride. ERISA imposes special liabilities on any company sponsoring the plan and the members of such a company's controlled group. All those parties are jointly and severally liable for the following amounts:

1. To the PBGC, the total amount of the unfunded liabilities to all the Pension Plan's participants and beneficiaries as of the termination date and interest from the termination date until paid, and
2. To the Plan Trustee, the sum of the shortfall amortization charge for the plan year in which the termination occurred, the shortfall amortization installments for the seven-year period starting with the plan year in which the termination occurred, the waiver amortization charge for the plan year in which the termination occurred, and the waiver amortization installments for the succeeding five years.

Once the PBGC demands payment of the amount listed in the first item above, a lien automatically attaches to all the property of the parties that the PBGC can enforce in federal district court. The lien

can attach to property of the parties up to 30% of their collective net worth. While there is a six-year statute of limitations from the date of the termination on collection of the liability to the PBGC, the statute of limitations for any of the parties is suspended while the party is in bankruptcy or under state court insolvency protection. However, if the PBGC does not make its demand before the Petition Date, the lien cannot attach to the Company under the Court's protection because of the Automatic Stay, the PBGC will be an unsecured creditor, and the Company can discharge its liability for the amounts at a fraction of the amount owed. [*See In re Tenn-Ero Corp.*, 14 B.R. 884 (Bankr. Mass. 1981).] Any affiliates in the Company's controlled group that are not also under bankruptcy protection will not have those protections.

Conclusion

The Bankruptcy Code and the bankruptcy courts will provide protection for the Company from its creditors, at least long enough for the Company and the court to determine whether the Company has the assets and the other necessary elements to continue business operations and to provide a better return for the creditors than an outright liquidation of the Company's assets. However, to successfully obtain approval of a plan of reorganization and to successfully operate the Company after emerging from bankruptcy protection, the Company's management must plan ahead. Merely freezing benefit accruals in retirement plans to stop the Company from hemorrhaging cash takes time, and successfully terminating a plan takes even longer. Also, it may not be possible to terminate a Pension Plan, especially an underfunded plan or one dictated under a collective bargaining agreement. Therefore, the Company needs to determine as soon as possible whether such plans can be terminated and, if not, what the ongoing costs will be and how they will affect the overall plan of reorganization.

If a costly Pension Plan can be terminated, then management should determine whether that can be accomplished prior to filing the bankruptcy petition and whether that protects the Company's best interests. However, this determination may take considerable time if the Company belongs to a large controlled group or sponsors multiple Pension Plans. Management must consider the long lag time required to complete a pre-petition termination, the complicated financial circumstances of the Company and all its controlled group members, which will govern whether the controlled group members can

help finance a standard termination and whether (and when) the Pension Plan can qualify for a distress termination, and the potential costs of terminating the plan or continuing the plan during and after the bankruptcy period. Certain costs of terminating a Pension Plan in a distress termination or an involuntary termination cannot be discharged in bankruptcy if the termination occurs during the pendency of the bankruptcy. After management considers all the options, it may find that continuing a frozen plan even after emerging from bankruptcy protection may be the most cost-effective strategy.

Management should also consider how the termination will affect the complicated negotiations among management, the various creditors' committees, any Unions, and other interested parties such as the PBGC, the IRS, and the Department of Labor. To emerge from bankruptcy protection and resume full control of the Company, management needs the creditors' committees to approve the reorganization plan. The status of the Company's retirement plans, however, can govern the relative strength of the creditors and the likelihood certain creditors will recover anything in the bankruptcy. For example, if the Company plans to terminate a Pension Plan in a distress termination during the bankruptcy, the plan and the PBGC will receive claims entitled to administrative claim status that could make them very powerful creditors because their claims will take priority over most other pre-petition claims and the amount

of those claims could dwarf the size of other claims. A retirement plan's funding and its status as a terminated or ongoing plan can also help make a Union a more powerful creditor depending upon the size of its claims through the retirement plan, the priority of those claims, and whether or not those claims can be discharged in the bankruptcy.

The Bankruptcy Code and ERISA, the courts, the IRS, PBGC, and the Department of Labor will also protect the interests of employees and their funds held in the retirement plans. However, to provide the maximum amount of protection for those funds from the Company's other creditors, management needs to ensure that the Company's retirement plans are maintained in compliance with the law, that the Company's human resources and benefits staff and consultants review and monitor the plans to find any past errors, and that any errors are corrected as soon as possible. Sometimes a full correction approved by the IRS or the Department of Labor takes time to complete, so management needs to act quickly to approve any compliance reviews and to start any correction applications.

If management performs its advance planning and acts quickly to take the best course of action with regard to its retirement plans, the management team can greatly improve the chances of obtaining approval of its own reorganization plan and successfully emerging from bankruptcy with the optimal situation, whether that includes ongoing retirement plans or not. ■