



Cornell University
ILR School

Cornell University ILR School
DigitalCommons@ILR

Federal Publications

Key Workplace Documents

6-19-2003

Employment Benefits in Bankruptcy

Robin Jeweler

Congressional Research Service

Follow this and additional works at: http://digitalcommons.ilr.cornell.edu/key_workplace



Part of the [Bankruptcy Law Commons](#)

Thank you for downloading an article from DigitalCommons@ILR.

[Support this valuable resource today!](#)

This Article is brought to you for free and open access by the Key Workplace Documents at DigitalCommons@ILR. It has been accepted for inclusion in Federal Publications by an authorized administrator of DigitalCommons@ILR. For more information, please contact hlmdigital@cornell.edu.

Employment Benefits in Bankruptcy

Keywords

Employment, benefit, bankruptcy, retiree, insurance, federal, state, law, wages, employee, pension, employer, collective bargaining, debtor

Disciplines

Bankruptcy Law | Law

CRS Report for Congress

Received through the CRS Web

Employment Benefits in Bankruptcy

Updated June 19, 2003

Robin Jeweler
Legislative Attorney
American Law Division

Employment Benefits in Bankruptcy

Summary

This report provides an overview of the status of employee wages and benefits, including retiree benefits, when an employer files in bankruptcy. Private pensions, regulated by the Employee Retirement Income Security Act, are generally protected. Health and life insurance benefits, which are not required by federal law, are more vulnerable to an employer's bankruptcy-driven modification or termination. This report examines special provisions in the U.S. Bankruptcy Code which govern the priority of employee wage and benefit claims, including severance payments; procedures for a chapter 11 debtor to modify benefits under a collective bargaining agreement; and, procedures for a chapter 11 debtor to modify retiree life and health insurance benefits. It also examines the role of employees on creditor committees and procedures in bankruptcy for lawsuits that may be directed at an employer/debtor.

Contents

Active employees of an employer in a chapter 11 reorganization	1
Active employees of an employer in liquidation	4
Retiree benefits	7
Employee litigation-based claims against an employer	9

Employment Benefits in Bankruptcy

Many employees, especially retirees, fear loss of all employment benefits upon learning that their employer has filed in bankruptcy. Fortunately, this is not necessarily the case, although some benefits may be subject to modification or termination. It is important to know that employee benefits, including retiree benefits, have no universal legal referent; they may be covered by a wide variety of federal and state laws. More important though is the fact that specific employee welfare benefit plans are governed by contract terms which vary from plan to plan. And, each bankruptcy – and the consequences for each debtor’s creditors, including its employees – is highly case specific. This report addresses the status of wages and basic benefits for active and retired employees which have to date been the subject of greatest concern when an employer files in bankruptcy.

The relatively recent bankruptcies of Enron and other companies, such as Polaroid, Global Crossing, and WorldCom, have raised new concerns about corporate responsibility for harm employees experience as a result of illegal stock manipulation and other forms of corporate malfeasance. For example, employees’ defined contribution pension funds, when comprised of their employer’s stock, can be devastated by employer mismanagement. Addressed below are the procedures a bankruptcy court may utilize to consider a civil claim for damages that has not been reduced to judgment prior to the bankruptcy filing.

A business employer will generally file under one of two of the operative chapters of the U.S. Bankruptcy Code, 11 U.S.C. § 101 *et seq.* It may seek to cease operation and liquidate under chapter 7, or to continue in business and reorganize under chapter 11.

Active employees of an employer in a chapter 11 reorganization.

Typically, a chapter 11 debtor will get an order from the bankruptcy court permitting it to continue business and to compensate its employees just as it had prior to filing. Postpetition operating expenses are considered to be high priority administrative expenses, *i.e.*, “the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.”¹ Thus, in some instances, employees of a chapter 11 debtor will realize no change in the terms and conditions of their employment.

In traditional employment-at-will situations, a debtor/employer may lay off employees or attempt to renegotiate the terms of employment, just as the employee is free to accept a different compensation structure or terminate the employment relationship. These contingencies may occur in connection with the debtor/employer’s bankruptcy. But there are special requirements for a chapter 11 debtor seeking to renegotiate collective bargaining agreements with union employees.

¹ 11 U.S.C. § 503(b).

Rejection of Collective Bargaining Agreements. In 1984, the U.S. Supreme Court held that collective bargaining agreements could be rejected, *i.e.*, terminated, by a debtor.² In response to the Court's interpretation, Congress enacted a statute which prescribes the procedures that a debtor in chapter 11 must take before it may alter the terms of or terminate a collective bargaining agreement.³

After a petition is filed, if the debtor wishes to alter or terminate the collective bargaining agreement, it must supply the authorized representative of the employees complete and reliable information to demonstrate the need, in order to facilitate a reorganization, for the modifications to the employees' benefits and protections. The employees and debtor must engage in good faith negotiations with respect to proposals for alteration or termination of such agreements.

If the debtor files an application to reject a collective bargaining agreement, the court is directed to schedule a hearing for not later than fourteen days after the filing. All interested parties may attend and participate in the hearing and the court should rule on the application within thirty days after the beginning of the hearing.

The court may approve the application for rejection only if it finds (i) that the debtor, prior to the hearing, provided the authorized representative of the employees with the necessary information; (ii) the authorized representative has refused to accept the proposal without good cause; and, (iii) the balance of the equities clearly favors rejection.

In addition the court may, after a hearing, authorize interim changes in the terms, conditions, wages, benefits or work rules provided by a collective bargaining agreement, when it is still in effect, if it is essential to the continuation of the debtor's business or is necessary to avoid irreparable damage to the estate. The implementation of interim changes does not, however, moot the procedures and requirements for an application for rejection.

Employee Representation on Creditor Committees. Viewed broadly, a chapter 11 reorganization contemplates a negotiated settlement of claims by the debtor with its creditors under the supervision of the court and within the strictures of the Code. Creditors actively participate in the development of a reorganization plan, and ultimately vote to accept or reject it. Employees may have a limited voice, or a more active role in reorganization negotiations.

Rules of bankruptcy practice expressly grant a labor union, an employees' association, or a representative of employees a right to address the court "to be heard

² National Labor Relations Board v. Bildisco & Bildisco, 465 U.S. 513 (1984), holding that collective bargaining agreements are "executory contracts" under 11 U.S.C. § 365 and may be rejected by a debtor unilaterally if the debtor can show that the agreement burdens the estate and that the equities balance in favor of rejection.

³ 11 U.S.C. § 1113.

on the economic soundness of a plan affecting employees' interests.”⁴ The right is limited, however, because the employee representative does not generally have standing to appeal any of the bankruptcy court's rulings.

A more active role in the reorganization planning is reserved to creditor committees. Shortly after the bankruptcy petition is filed, the U.S. trustee will appoint an official committee of creditors holding unsecured claims.⁵ In complex cases, the court may create additional committees if necessary to ensure adequate representation of creditors. The unsecured creditors' committee generally is comprised of persons willing to serve who hold the seven largest claims of the types represented by the committee. Among the committee's powers and duties is the authority:

- to consult with the trustee or debtor concerning the administration of the case;
- to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuing it;
- to participate in the formulation of a plan, to advise those represented by the committee of any committee determinations and/or any plan formulated; and
- to generally represent the interests of creditors who are represented.⁶

Every bankruptcy is intensely fact-specific with specific creditor claims dictating the composition of the creditor committee(s). When employees are unsecured creditors, they may be represented on creditor committees.⁷ If and when appropriate, the court may allow the creation of official or unofficial committees composed solely of employee representatives. For example, in the Enron bankruptcy, the court appointed a committee “for the purpose of investigating the issues relating to: (1) the continuation of health or other benefits for former employees of the Debtors; (2) the investigation of claims uniquely held by employees, as such, against the Debtors; (3) the treatment of employees' claims under any plan(s) of reorganization or liquidation; (4) possible Warn Act violations by the Debtors in discharging employees; (5) possible violation by the Debtors of state labor laws and certain provisions of ERISA; and (6) dissemination of non-confidential information

⁴ Fed. Rules of Bankr. Procedure, Rule 2018.

⁵ 11 U.S.C. § 1102.

⁶ 11 U.S.C. § 1103.

⁷ *See, e.g., In re Altair Airlines, Inc.*, 727 F.2d 88 (3rd Cir. 1984)(Pilots' association, which was the exclusive bargaining agent for pilots holding claims for unpaid wages which amounted to the second largest unsecured claim against the debtor, was entitled to appointment to the unsecured creditors' committee.); *In re Salant Corp.*, 53 B.R. 158 (Bankr.S.D.N.Y. 1985)(When the creditor committee was made up of seventeen members, including one representative of managerial employees, the court was willing to grant a union's motion to add an additional three members to represent non-managerial employees.)

relating to items (1) through (5) hereof to employees[.]”⁸ Unofficial committees may be comprised of self-selected members who may be free of the fiduciary responsibilities required of an official committee.

Active employees of an employer in liquidation. If an employer must shut down, it is likely to file under chapter 7. In this chapter, the court appoints a trustee who oversees the debtor’s liquidation. The debtor’s assets are reduced to cash and distributed among creditors. Although chapter 7 traditionally governs liquidation, a debtor may also liquidate its business under chapter 11. Health and life insurance benefits are not pre-funded. Therefore, when a business closes, these benefits will, presumably, be terminated. Pension assets, for the reasons discussed below, are generally held in trust for the employee and are not available to the debtor’s creditors.

A common scenario in bankruptcy involves an employer who may have fallen in arrears in the payment of wages or contributions to employee benefit plans that require continuous funding. Employees who have a contractual claim to payment are considered “unsecured” creditors.

The Code establishes priorities for the payment of unsecured claims.⁹ Nonpriority unsecured claims will be paid only after payment of priority claims. Third priority is designated for unsecured claims for wages, salaries, or commissions, but only to the extent of \$4650 for each individual, including vacation, severance and sick leave pay earned by an individual or corporation within 90 days before the date of filing or the date of the cessation of the debtor’s business, whichever occurs first; or, for sales commissions earned by an individual or by a corporation with only one employee acting as an independent contractor in the sale of goods or services for the debtor.

Fourth priority is similar to the third but governs unsecured claims for contributions to an employee benefit plan arising from services rendered within 180 days before the filing or cessation of the debtor’s business, but only to the extent of the number of employees covered by each such plan multiplied by \$4650 less (1) the aggregate amount paid to such employees under the third priority and (2) the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan. Hence, the third and fourth employee priorities together have an aggregated cap of \$4650.

Severance Benefits. The bankruptcy priority for prepetition employee wages and benefits, including severance pay, is an important benchmark. In a liquidation scenario, it means that each employee with a claim in this category will be near the head of the line for distribution of the priority amount. Nonpriority unsecured claims will be distributed pro rata among unsecured creditors, including employees.

⁸ In re Enron, *Amended Appointment of Employment-Related Issues Committee*, (Bankr.S.D.N.Y. 2002), at 2002 Extra LEXIS 537.

⁹ 11 U.S.C. § 507.

The priority is significant in a reorganization as well. The priority amount must be paid through the reorganization plan in order for it to be confirmed by the court. As noted above, the priority is conferred on claims accruing prior to the bankruptcy filing. Severance earned postpetition, however, may qualify for an administrative expense priority.¹⁰ Claims for severance, particularly those asserting priority as postpetition administrative expenses, will be evaluated according to several factors and decided under the law of the federal circuit. The court will consider the terms of the agreement establishing severance, including whether it is payable in a lump sum or is based on length of service, and when it was agreed to. A determination of when the benefit accrues – pre- or postpetition – is not always readily apparent and rules governing it may also vary among the circuits.

Although the priority amount for prepetition employee severance benefits is capped at \$4650, recently at least one court has taken advantage of the flexibility inherent in bankruptcy process to enlarge the amount allocated to employee severance pay. Invoking the court's equitable authority,¹¹ the U.S. Bankruptcy Court for the Southern District of New York permitted an increased allowance for prepetition employee severance payments in both the Enron and WorldCom bankruptcies. The Enron decision implemented a settlement of litigation brought by former employees of Enron.¹² The court also allowed creditor committees to bring avoidance actions to recover prepetition bonus payments to help fund the severance claims. Parties agreeing to the settlement received a maximum allowance of \$13,500 per employee.

In the WorldCom bankruptcy, the debtor requested – and the court granted – permission to pay amounts due for prepetition severance pay due to terminated employees over the amount of \$4650.¹³ The debtor justified its request by asserting that adverse publicity from the terminated employees could negatively impact WorldCom's relationship with its current employees. The payments were necessary to restore the confidence of current employees, whose cooperation and loyalty were essential to the reorganization effort.

¹⁰ See *In re AcoustiSeal, Inc.*, 290 B.R. 354 (Bankr.W.D.Mo. 2003)(employees that debtor had terminated postpetition would be allowed administrative priority for the pro rata share of severance pay actually earned postpetition; and severance pay claims asserted by nonexecutive employees were in part prepetition claims entitled to priority to the extent that they were earned within 90 days of filing, and in part postpetition claims entitled to priority as administrative expenses to the extent they accrued postpetition.)

¹¹ 11 U.S.C. § 105.

¹² *In re Enron Corp.*, Case Nos. 01-16034, *Order of Final Approval, under 11 U.S.C. §§ 105(a), 363(b), 1103(c)(5) and 1109(b) and Fed. R. Bankr. P. 9019, Approving Settlement of Severance Claims of Similarly-Situated Claimants and Authorizing the Official Employment-Related Issues Committee to Commence Certain Avoidance Actions on Behalf of Estates*, Aug. 28, 2002 at [<http://www.elaw4enron.com/default.asp>].

¹³ *In re WorldCom, Inc.*, Case Nos. 02-13533, *Order Authorizing the Payment of Severance Benefits and Related Obligations to Terminated Employees and Rejection of Certain Severance Agreements*, Oct. 1, 2002 at [<http://www.elaw4enron.com/Worldcomdefault.asp>].

Pension benefits. Federal law does *not* require an employer to provide health insurance or pensions to employees. Although the tax laws are designed to *encourage* employers to provide these benefits, they may be altered or terminated within or outside of bankruptcy.

The creation and administration of private sector defined benefit pension plans are governed exclusively by the Employee Retirement Income Security Act (ERISA).¹⁴ In 1974, Congress enacted ERISA to protect the interests of private sector participants and beneficiaries in a wide variety of employee welfare benefit and pension plans. A prime underlying policy of the Act, articulated by the Supreme Court, is the Congressional guarantee that “if a worker has been promised a defined pension benefit upon retirement – and if he has fulfilled whatever conditions are required to obtain a vested benefit – he will actually receive it.”¹⁵ Because of ERISA’s comprehensive regulatory scheme, pension benefits are the *least* likely of employee benefits to be affected by bankruptcy.

ERISA-qualified pensions are funded as they accrue liability; funds are held in trust for beneficiaries. Hence, when a corporate debtor files in bankruptcy, employee pension trust funds are *not* part of the bankruptcy estate available to satisfy creditor claims.

There are a wide variety of tax-qualified employee pension programs. Among the most common are defined contribution and defined benefit plans. In the former, which includes 401(k) plans, the employee, and perhaps the employer, makes contributions to the retirement account on behalf of the employee. The fund, though managed by an employer in accordance with requirements of ERISA and the U.S. Tax Code, is property of the employee. In the event of the employer’s bankruptcy, defined contribution trust funds are *not* assets available to the debtor’s creditors. According to the Pension Benefit Guaranty Corporation (PBGC), there is a significant trend away from tradition defined benefit plans, discussed below, to new “hybrid” pension plans, such as cash balance plans, which are a form of defined benefit plan insured by the PBGC.¹⁶

Defined benefit pension plans may be terminated voluntarily by an employer or involuntarily by the PBGC. An employer may terminate a plan voluntarily in one of

¹⁴ 29 U.S.C. § 1001 *et seq.* Pension benefit plans generally fall into one of two broad categories, namely, defined contribution plans or defined benefit plans. The former is a plan in which contributions are fixed, but not benefits, *e.g.*, a fixed amount or percentage of compensation is invested in the plan and comprises the basis for accruing plan benefits. The latter, a defined benefit plan, is a pension plan that specifies the benefits or method of determining the benefits, but not the contribution. The sponsor of the defined benefit plan bears the risk of investment performance and must compensate for any discrepancies between the amounts invested and the amounts promised to be paid as benefits. ERISA regulates private sector defined benefit and defined contribution plans.

¹⁵ *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 214 (1986), quoting *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 720 (1984).

¹⁶ PBGC, *A Predictable, Secure Pension For Life: Defined Benefit Plans* 6 at [www.pbgc.gov/publications/defined_benefit_pens.htm].

two ways. It may proceed with a standard termination only if it has sufficient assets to pay all benefit commitments. A standard termination does not, therefore, implicate PBGC insurance responsibilities.

If an employer wishes to terminate a plan whose assets are insufficient to pay all benefits, the employer must demonstrate that it is in financial distress as defined by ERISA. The concern connected with a distress termination is the adequacy of the plan's funding. That is, is there enough money to support payment of the pension commitment? This is where the PBGC's pension insurance program, which is funded by employer paid premiums, is implicated.¹⁷ If an under-funded corporate pension plan is terminated, the PBGC insurance program guarantees payment to covered employees. The PBGC then seeks recovery of the deficiency from the employer, asserting a lien therefor, if necessary. The PBGC guaranty program minimizes the impact of corporate bankruptcy on the debtor's retirees. However, when an under-funded pension plan is terminated, the PBGC imposes a statutory ceiling on guaranteed payments.

Neither a standard nor a distress termination by the employer is permitted if termination would violate the terms of an existing collective-bargaining agreement. The PBGC may, however, terminate a plan involuntarily, notwithstanding the existence of a collective-bargaining agreement. Likewise, termination can be undone and restoration ordered by PBGC. When a plan is restored, full benefits are reinstated, and the employer, rather than the PBGC is again responsible for the plan's unfunded liabilities.

Retiree benefits. *Pensions.* As discussed above, retiree pension benefits are held in trust for the retiree and are regulated by ERISA.

Health and Life Insurance Benefits. Many employers reserve a right to modify or terminate employee welfare benefit plans and do so outside of bankruptcy.¹⁸ Courts reviewing plan alteration or termination generally base their decisions on the specific terms of a plan's documents or associated collective bargaining agreement. In bankruptcy, the status of retiree life and health insurance benefits is largely determined by the nature of the action – chapter 11 reorganization versus liquidation under chapter 7 or chapter 11.

The reorganization of the LTV Corp. proved to be a prime force behind clarification of the Bankruptcy Code's treatment of retirees' health and life insurance benefits *during* reorganization. On the same day it filed in bankruptcy in 1986, LTV Corp. notified more than 66,000 retirees of its intention to terminate health and life insurance coverage under the company's employee benefit plan. Acting swiftly to express its disapproval of LTV's interpretation of the Bankruptcy Code's

¹⁷ Under ERISA pension regulation, participation, vesting, and funding standards are administered by the Internal Revenue Service; fiduciary standards and reporting and disclosure requirements are regulated by the Department of Labor; benefit insurance provisions are regulated by the Pension Benefit Guaranty Corporation.

¹⁸ See U.S. Dept. of Labor, *Can the Retiree Health Benefits Provided By Your Employer Be Cut?*, at [<http://www.dol.gov/dol/pwba/public/pubs/brief1.htm>].

requirements, Congress enacted legislation blocking LTV's cessation of insurance payments on the retirees behalf.¹⁹ Then, in 1988, Congress amended the Code by adding new 11 U.S.C. § 1114 entitled "Payment of insurance benefits to retired employees." The procedures for a debtor's termination of retiree insurance benefits are modeled after those for termination of collective-bargaining agreements in chapter 11.

In summary, § 1114 provides that a debtor in reorganization may *not* terminate health and life insurance payment programs maintained for retirees and their spouses and dependents *without first negotiating proposed modifications* in benefit payments with representatives of the retirees, and second, *seeking and receiving court approval* to make the modifications. If the debtor and the retirees cannot agree upon modifications, and the debtor believes them to be necessary to permit reorganization, the court may permit modifications, subject to statutory guidelines. The debtor must have negotiated with the representative of the retirees in good faith, and the court, after a hearing in which all parties have had an opportunity to be heard, must find that the proposed 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. Thus, in the course of a chapter 11 reorganization in which the debtor continues to operate the business, it *must* continue to pay retiree health and life insurance benefits unless it has negotiated necessary modifications – or termination of payments – with the representatives of the affected group, or has received the bankruptcy court's permission to do so. These payments are accorded high priority "administrative expense" status.

If a corporate debtor's reorganization is unsuccessful, it may liquidate. In a liquidation, the retirees' claims for lost insurance benefits would be unsecured claims. The third and fourth priorities for employee benefits apply only to payments on behalf of present employees, not retirees. The extent to which they would be satisfied in the final distribution would depend upon competing outstanding claims and the funds available to fulfill them.

When Congress passed § 1114 ensuring the continuation of payments of retiree health and life insurance benefits throughout a reorganization if the debtor could afford to pay them, it did not appear to address the status of these claims in liquidation. Nor did it amend § 507 of the Code which creates high priority unsecured claims. Obviously, when a company ceases operation, it cannot continue to incur business-related operating expenses. Retirees with insurance claims would be unsecured creditors of the debtor, and any amount they might recover would depend upon the nature and amount of claims outstanding relative to the funds available to satisfy them.

COBRA Continuation Coverage. Under the provisions of Title X of the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (COBRA),²⁰

¹⁹ P.L. 99-591, § 608, 100 Stat. 3341-74 (1986); P.L. 99-656, 100 Stat. 3668 (1986); P.L. 100-41, 101 Stat. 309 (1987).

²⁰ P.L. 99-272 (April 7, 1986). See U.S. Dept. of Labor, *Health Benefits Under the* (continued...)

employers are required to permit employees or family members to continue their group health insurance coverage at their own expense, but at group rates, if they lose coverage because of designated work or family-related events. Among the “qualifying events” which trigger COBRA’s continuation coverage is an employer’s filing a case under the Bankruptcy Code (on or after July 1, 1986) *with respect to a covered employee who has retired*.²¹ “To lose coverage” for COBRA purposes includes a substantial elimination of coverage that occurs within twelve months before or after the date on which the bankruptcy proceeding begins.²²

In general, a “covered employee” is an individual who is provided coverage by virtue of employment (or previous employment) with the employer. Hence, the definition includes retirees who receive health coverage in addition to their pension. In the case of a retiree of a bankrupt employer, the continuation coverage must be available until the death of the covered employee or the qualified beneficiary. In this situation, a “qualified beneficiary” includes a covered employee who has retired on or before the date on which coverage was eliminated, and any other individual who, on the day before the bankruptcy proceedings, was a beneficiary under the plan, either as the spouse, dependent child, or surviving spouse of the covered employee. For the surviving spouse or dependent children of the covered employee, the period of coverage is limited to 36 months after the death of the covered employee.

Although, COBRA provides retirees’ lifetime coverage, such coverage, to be effected, is contingent upon the employer’s maintaining the plan for current employees. Continuation coverage for all qualified beneficiaries terminates on the date when the employer ceases to provide any group health plan to *any* employee, *i.e.*, when the plan ends.

COBRA may be a useful safety net if an employer in bankruptcy terminates a retiree health plan but continues to offer health benefits to current employees. In that event, retirees would be entitled to continuation coverage under the employer’s ongoing plan. But COBRA works in conjunction with ERISA and the Bankruptcy Code; it *does not* require an employer to fund independent health insurance for retirees or to maintain the plan on behalf of current employees in contravention of other permissible termination provisions of ERISA or the Code.

Employee litigation-based claims against an employer. The recent bankruptcy of Enron and other corporations, such as Polaroid, have raised new concerns about the responsibility an employer may have for fraud, negligence, and/or mismanagement of employee pension funds which are, in large part, comprised of the corporation’s stock.

(...continued)

Consolidated Omnibus Budget Reconciliation Act, COBRA at [<http://www.dol.gov/dol/pwba/public/pubs/COBRA/cobra99.pdf>].

²¹ 29 U.S.C. § 1163.

²² 64 Federal Register 5165 (Feb. 3, 1999).

History teaches that the U.S. Bankruptcy Code is not an efficient vehicle to protect the funding and management of employment benefits.²³ By the time an employer is in bankruptcy, if the system has already failed, it is generally too late to impose new management, auditing, fiduciary, or funding safeguards to restore benefits. Other laws, such as ERISA, the Tax Code, and COBRA, address these employment benefit programs prospectively. Nevertheless, employees who are victims of wrongdoing may wonder if they can assert those claims in the bankruptcy and increase their distributive share of the debtor's assets.

It is frequently said that a debtor in bankruptcy “cannot be sued.” While it is correct that bankruptcy’s automatic stay stops the continuation of a judicial process to collect a money judgment,²⁴ it does not mean that a debtor corporation is immune from claims that have *not yet* been reduced to judgment. If employees want to sue their employer/debtor, they may still have a “claim” in bankruptcy, even if it has not been reduced to judgment.²⁵

When a claim that must be established through a lawsuit is stayed, the bankruptcy court is permitted to estimate “any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case[.]”²⁶ The court may also estimate any right to payment “arising from a right to an equitable remedy for breach of performance.”²⁷ This occurs pursuant to the bankruptcy court’s mandate to allow or disallow claims against the estate. Estimating claims for the purpose of confirming a plan under chapter 11 is expressly cited as a core proceeding within a bankruptcy court’s jurisdiction.²⁸

²³ After the LTV Corp. filed under chapter 11 in 1986, the debtor and the PBGC engaged in a great deal of litigation concerning payment of arrearages as a result of underfunding of the debtor’s pension plans. Although the PBGC was initially unsuccessful in asserting administrative and unsecured priority claims for underfunding arrearages, it ultimately succeeded in ordering restoration of the terminated plans. *See, In re Chateaugay Corp.*, 115 B.R. 760 (Bankr.S.D.N.Y. 1990), *order vacated and withdrawn*, 17 Employee Benefits Cas. 1102 (S.D.N.Y. 1993). *See also*, *PBGC v. LTV Corp.*, 496 U.S. 633 (1990).

²⁴ 11 U.S.C. § 362.

²⁵ A “claim” in bankruptcy is defined broadly at 11 U.S.C. § 101(5) to mean (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured[.]

²⁶ 11 U.S.C. § 502(c)(1). *See, In the Matter of Interco Incorp.*, 137 B.R. 993 (Bankr.E.D. Mo. 1992)(Claims of a multiemployer pension fund against a debtor may be estimated.)

²⁷ *Id.*

²⁸ 28 U.S.C. § 157(b)(2)(B). A bankruptcy court may not, however, liquidate or estimate personal injury tort or wrongful death claims.

Hence, the chapter 11 filing triggers a series of decisions by the court evaluating the stayed litigation. Do the best interests of the parties and the bankruptcy estate require the estimation of outstanding claims or should they be reduced to a sum certain, *i.e.*, fixed by litigation authorized by the court? Agreeing on appropriate methodology to estimate a claim is in itself a complicated issue.

The courts have discretion to consider the most appropriate manner to handle an unliquidated, contingent claim – whether it should be estimated or whether the stay should be lifted. The goal of the bankruptcy process is to fix an amount, *i.e.*, assign a value for a claim in order to expedite reorganization; to determine whether reorganization itself is feasible; and, to assist the parties in fashioning a plan. It is also necessary to create a yardstick to enable the court to apply the “best interests of the creditor” test for a chapter 11 debtor. The court cannot confirm a chapter 11 reorganization plan unless creditors will receive more under the plan than if the debtor were liquidated.²⁹

And, of course, creditors are constrained by practical strategic considerations. Litigation is an expensive proposition and it may not be worthwhile in the face of a looming prospect of the debtor’s having inadequate assets to satisfy the claim. Simply put, does the potential distribution warrant the costs of litigation? Some portion or all of the creditors’ damages may be discharged in the bankruptcy and any recovery will be reduced by distributions among all unsecured creditors.

Employees whose pensions have suffered under the fiduciary mismanagement of corporate debtors face many difficult decisions. Claims against their employers may be based on many legal theories grounded in many different laws. Claims may be directed at different parties within and without of bankruptcy and this may also affect decisions regarding litigation. The bankruptcy process, however, does allow claims that have not been finalized to be considered. And, as in all bankruptcies, the outcome is dependent upon the unique situation of each debtor and its creditors.

²⁹ 11 U.S.C. § 1129(a)(7).